

MAE is MIA No Longer: Delaware Court Upholds Use of “Material Adverse Event” Clause for the First Time

by Layne T Smith and Paul Justensen

In *Akorn, Inc. v. Fresenius Kabi AG*, the Delaware Chancery Court held that Fresenius, a German pharmaceutical company, was justified in invoking a “material adverse event” (MAE) clause to terminate its \$4.8 billion merger agreement with American generics manufacturer Akorn, Inc. Although MAE clauses are common in large transactions, *Akorn* marks the first time that the Chancery Court has upheld a buyer’s use of such a clause to back out of a merger agreement. Nevertheless, the Court’s reasoning suggests that the bar for successfully invoking an MAE clause remains high.

MAE clauses, also known as “material adverse change” (MAC) clauses, permit a would-be buyer to terminate a merger agreement if the target company experiences materially harmful changes between signing and closing. These clauses often are loosely defined and leave an interpretative task for a court down the road. In previous cases, the Chancery Court has consistently rebuffed buyers seeking to terminate merger agreements under MAE clauses.

In *Akorn*, Vice Chancellor Travis Laster held that Fresenius was justified in terminating the merger agreement under the MAE clause for several reasons. First, after the parties signed the merger agreement, “Akorn’s business performance fell off a cliff.” Measured year-over-year, Akorn’s revenue dropped by approximately 30% in each of the quarters after signing and its operating income fell by 84%, 89%, 292%, and 134% during those quarters. Quarterly earnings per share experienced declines ranging from 96% to 300%. These results were well below Akorn’s historical performance and that of its competitors over the same period; they also fell short of even the most pessimistic of Fresenius’ pre-merger forecasts. The Court distinguished this “dramatic, unexpected, and company-specific downturn in Akorn’s business” from previous MAE cases in which buyers merely had “second thoughts after cyclical trends or industrywide effects negatively impacted their own businesses.”

Second, Fresenius discovered that *Akorn* had “serious and pervasive data integrity problems” related to FDA-regulated product development and quality control processes.

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The issues were so severe that the Court described *Akorn* as “a company in persistent, serious violation of FDA requirements with a disastrous culture of noncompliance.” The Court estimated that it would cost approximately \$900 million to fix these problems—nearly 21% of the deal value. As a result, the Court held that the data integrity issues “rendered Akorn’s representations about its regulatory compliance sufficiently inaccurate” to result in a material adverse effect.

Crucial to the Court’s finding were Fresenius’s careful efforts to comply with its obligations under the merger agreement. Despite Akorn’s immediate downturn, Fresenius took the steps necessary to obtain antitrust approval, including pushing back the “outside date” of the deal. It did not invoke the MAE clause until after *Akorn* had posted several quarters of significantly lower financial results and significant compliance issues were exposed. Had Fresenius materially breached the agreement, it would not have been entitled to invoke the MAE clause.

The Court’s opinion shows that a buyer’s burden to prove an MAE has occurred is not insurmountable. Given Akorn’s massive financial downturn and substantial regulatory compliance issues, the *Akorn* decision is understandable. Still, the Court emphasized that a buyer “faces a heavy burden when it attempts to invoke a material adverse effect clause in order to avoid its obligation to close” and that, in most cases, a decline by the target must have the hallmarks of durational significance—“short-term hiccup[s] in earnings should not suffice.” In cases with less dramatic facts, buyers will likely continue to face an uphill climb when attempting to rely on MAE clauses.