

The Journal

What is a “MAC”? Let the Buyer Beware

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To deal professionals, a “MAC” is not a large hamburger sold by McDonald’s. It is a crucial clause found in mergers & acquisitions or venture financing agreements that determines whether a buyer (or investor) is required to buy (or invest in) a company if a calamity befalls that company between the time of signing the purchase agreement and the closing. Like so many other legal terms with seemingly simple words like “Material Adverse Change,” defining this fundamental deal point is not so easy and is an often contentious point of negotiation among deal attorneys.

A typical “MAC” clause might include a definition of “Material Adverse Effect” similar to the following:

“‘Material Adverse Effect’ shall mean any event, circumstance, change, occurrence or effect that, individually or in the aggregate, has a material adverse effect upon the business or the assets, liabilities, prospects, condition (financial or otherwise) or operating results of the Company.”

and a closing condition similar to the following:

“No Material Adverse Effect. There shall not have occurred any event, circumstance or change which has resulted in or is reasonably likely to result in a ‘Material Adverse Effect.’” ▶

Based upon a plain English reading of this typical “MAC” clause, if there is a swine flu outbreak when a buyer is about to close on buying a ham factory, and every news story on TV is talking about customers avoiding ham (at least in the short term), the buyer might view this as a “Material Adverse Effect” upon the ham factory. However, cases interpreting the meaning of a broadly-drafted “MAC” clause tend to strongly disfavor finding that a “MAC” has taken place, taking the approach of “Caveat Emptor” or “Let the Buyer Beware.”

As an example, in the seminal 2001 “MAC” case, *IBP v. Tyson Foods*¹, a 64% earnings shortfall in one fiscal quarter compared to the same quarter of the prior fiscal year was not considered sufficient to constitute a “MAC” essentially because it was not a permanent impairment on the value of the target company. Quoting the *IBP/Tyson Foods* court:

“[E]ven where a Material Adverse Effect condition is as broadly written as the one in [the *IBP/Tyson Foods* merger agreement], that provision is best read as a backstop protecting the acquiror from the occurrence of unknown events that substantially threaten the overall earnings potential of the target in a durationally-significant manner. A short-term hiccup in earnings should not suffice; rather the Material Adverse Effect should be material when viewed from the longer-term perspective of a reasonable acquiror.”²

In the 2005 *Holly v. Frontier Oil*³ case, two public companies entered into a merger agreement, but before closing, environmental activist Erin Brockovich sued a Frontier Oil subsidiary in a high-profile toxic tort lawsuit. Holly became concerned and attempted to invoke the “MAC” clause in the merger agreement to get out of the deal. Again, the court took a narrow view of what constitutes a “MAC,” noting that “[a]s a general matter, the consequences of threatened litigation are speculative and hard to quantify and, thus, courts are hesitant to find threatened litigation material”⁴ and “Holly has not met its burden of proving by a preponderance of the evidence that the [*Erin Brockovich*] Litigation, because of the risk of adverse results, because of the costs of defense, or because of both considerations taken together, does have, would have, or would reasonably be expected to have a [Material Adverse Effect].”⁵

On top of the general difficulty of a buyer invoking a “MAC” clause, a seller-friendly deal market in much of the 2000s resulted in a number of pro-seller carve outs from the standard definition of “Material Adverse Effect.” These carve outs generally included one or more of the following:

- Announcement of the transaction (usually in public company deals);
- Changes in law;
- Changes in Accounting Principles;
- War/Terrorism; and
- Failure to meet projections.

Sellers would attempt to negotiate exclusions for one or more of the foregoing events so that if any one of those carved-out events occurred, that event would not constitute a “MAC” under any circumstances, and the buyer would not have a right to walk away from the transaction without liability. ▶

As the deal market tightened during the past few years, there has been a trend towards more buyer-protective “MAC” clauses containing more specific and tightly-worded (and in some cases quantifiable) definitions of a “MAC.” For example, in a recent transaction we negotiated on behalf of a buyer, the buyer was willing to take the risk of adverse events taking place between signing and closing, but only to the extent such adverse events would be expected to result in less than \$100,000 in losses. Hence, the following language was included in the “MAC”:

“[A “Material Adverse Change” shall include] any actual or threatened change in the assets, liabilities (whether actual or contingent), business, operations, financial condition, properties or prospects of the [Target] which is, or is expected to, either individually or in the aggregate with other such actual or threatened changes, (i) result in a financial loss to the [Target] in excess of [\$100,000] had such event or change not occurred, (ii) be likely to reduce the amount a reasonable, sophisticated purchaser would be willing to pay for ownership of the [Target], (iii) affect the short-term or long-term value of the [Target], (iv) result in the creation of any type of contingent liability or obligation in excess of \$100,000, or (v) otherwise be materially adverse to the [Target].”⁶

As any deal lawyer or investment banker will tell you, the aforementioned clause is certainly a diamond in the rough for a buyer. Unless a seller’s lawyer has been told by their client to “get the deal done now!”, it can be quite difficult for a buyer to negotiate such a favorable provision. Nonetheless, if the IBP/Tyson Foods merger agreement had included a quantifiable “MAC” stating that an earnings shortfall in the upcoming quarter of greater than 25% from the same quarter of the prior fiscal year would be a “MAC,” the results in that case may have turned out differently. Nevertheless, those sellers who have performed well in the current economic climate continue to have the advantage and likely will be able to negotiate favorable “MAC” clauses that increase the certainty of closing. Those sellers who sacrifice favorable deal closing certainty for a more favorable purchase price may find themselves facing a “MAC” clause that is more risky for the seller.

But one thing remains certain. “MAC” clauses will continue to be a strong source of contention between buyers and sellers that seek to allocate the risk of whether “Caveat Emptor” prevails or a last-minute “situation” instead becomes a “deal killer.” ■

¹*In Re: IBP, Inc. Shareholders Litigation*, 789 A.2d. 14 (Del. Ch. 2001).

²*Id.* at 68.

³*Frontier Oil Corp. v. Holly Corp.*, C.A. No. 20502 (Del. Ch. Apr. 29, 2005).

⁴*Id.* at *147.

⁵*Id.* at *143. The Frontier Oil court also noted that “[i]t would be neither original nor perceptive to observe that defining a “Material Adverse Effect” as a ‘material adverse effect’ is not especially helpful,” a humorous observation, given that nearly all “MAC” clauses build its definition around this phrase. *Id.* at *126.

⁶Excerpt from purchase agreement negotiated on behalf of buyer by Seyfarth Shaw LLP.

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