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Material Adverse Effect Clauses and the Delaware Supreme Court

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Editor's note: Richard Slack is a partner and Joshua Glasser is an associate at Weil, Gotshal & Manges LLP. This post is based on their Weil memorandum and is part of the Delaware law series; links to other posts in the series are available here. Related research from the Program on Corporate Governance includes Allocating Risk Through Contract: Evidence from M&A and Policy Implications (discussed on the Forum here) and M&A Contracts: Purposes, Types, Regulation, and Patterns of Practice, both by John C. Coates, IV.

[On December 7,] the Delaware Supreme Court issued a three-page order in *Akorn, Inc. v. Fresenius Kabi AG*, No. 535, 2018 (Del. Dec. 7, 2018), affirming the Court of Chancery's 246-page opinion finding that Fresenius Kabi AG validly terminated its merger with Akorn, Inc., based on the existence of a material adverse effect (MAE). The affirmance confirms Fresenius's ability to walk away from its announced $4.3 billion merger with Akorn based on the first court-approved MAE in Delaware history.

Specifically, the Court held that the factual record:

- "adequately supports the Court of Chancery's determination, based on its application of precedent such as *In re IBP, Inc. Shareholders Litigation* and *Hexion Specialty Chemicals, Inc. v. Huntsman Corp*" that Akorn had suffered a general MAE under the Merger Agreement;
- "adequately supports" the trial court's determination that Fresenius validly exercised its termination rights because the divergence between Akorn's representations concerning its compliance with the applicable regulatory requirements and the actual state of affairs could reasonably be expected to result in an MAE (i.e., based on failure of the "Bring-Down Condition");
- "supports the Court of Chancery's finding that Fresenius did not breach" its covenant to use "reasonable best efforts" to close the Merger (i.e., the "Reasonable Best Efforts Covenant"), preserving Fresenius's ability to exercise its MAE-related rights;
- "supports" the trial court's finding that Fresenius's "temporary breach" of its obligation to take "all actions necessary" to achieve antitrust approval (i.e., the "Hell-or-High-Water Covenant") "was not material," additionally preserving Fresenius's ability to exercise its MAE-related rights.

Though the Delaware Supreme Court's en banc order mentions that the Court of Chancery's conclusion was supported based on the trial court's "application of precedent" such as *IBP* and *Hexion*, this language appears to be less than a whole-hearted endorsement of each

and every aspect of the Court of Chancery's reasoning—especially because those precedents are trial court opinions, and the Supreme Court has not otherwise spoken definitively on MAE issues. The Court's use of the phrase "adequately supports" for the two MAE-related holdings—as opposed to "supports," as with the other two—may signal the Supreme Court's hesitance to fully endorse each aspect of the trial court's reasoning.

Because the Supreme Court already found grounds to uphold Fresenius's actions, it refrained from issuing a ruling on Akorn's appeal of the Court of Chancery's holding that Fresenius also validly terminated the Merger Agreement based on Akorn's failure to operate in the ordinary course of business in all material respects (the "Ordinary Course Covenant").

Future litigants are likely to argue over the strength of the Supreme Court's validation of the Court of Chancery's application of law to the highly fact-intensive MAE inquiry. But, for the time being at least, Vice Chancellor Laster's opinion remains the most recent MAE analysis and important for dealmakers and litigators to study. We previously provided in-depth analysis on this opinion, which can be found by clicking here, as well as here.