

并购交易的重大不利改变条款

Material Adverse Change (MAC) Clauses in M&A Transactions

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“重大不利改变”条款是经常用于公司并购交易的一项合同安排，指目标公司的业务、运作、资产、财务状况、运营成果或预期产生的重大不利影响的情况。其目的是为了在目标公司的条件发生重大不利变化时，能够为买方提供一种解除交易的机会。在目前情况下，重大不利改变对于并购成败具有举足轻重的作用。美国特拉华州法院于2008年10月就重大不利改变作出了一个经典判决。该案件中，Hexion公司意图兼并Huntsman公司。其收购以Huntsman在兼并协议签订之日到交割日期之间未发生重大不利改变为前提。Huntsman2008年第一季度的财报显示其收入低于预期。Hexion主张，由于Huntsman未能实现其季度财务预期为一重大不利改变，Hexion取得融资完成交易的义务被免除。法院认定Huntsman没有发生重大不利改变，而Hexion有意违反了其一系列义务（包括关于融资的义务），判令Hexion实际履行兼并协议。通过对这一案例的分析，我们认为，对于重大不利改变举证责任而言，至关重要的是要在交易文件中对举证责任作出明文约定；对于重大不利影响的判断标准而言，有两点需要尤其注意，一是约定财务预测不作为判断重大不利情况的参考标准，二是约定确定重大不利改变应以“年”作为量化单位；对于“重大不利”的判比基准，也有两方面经验值得借鉴，一是考虑在协议中明确约定判定重大不利改变的基准和计算单位，二是具体约定重大不利改变的除外情况，比如需要考虑如何定义“特殊”情况——如何选择行业比较对象？以行业平均作为量化比较标准？虽然这些问题没有明确的答案，但在实践中为我们提供了思考的方向。

这一案件最终由目标公司胜出。学习该判决总结的规则及重大不利改变条款就购并双方的影响，这对于中国的出售方和目标公司都将是宝贵的一课。

For more than a decade, China has been a popular destination of foreign mergers and acquisitions (“M&A”). While Chinese sellers are excited for the opportunities to capitalize on their business or to partner with foreign companies, it is not uncommon that such sellers dread the thick and detailed transaction documents that contain substantially foreign concepts. This article is intended to help explain one such typical concept in M&A deals pertaining material adverse change (“MAC”) or material adverse effect (“MAE”) provisions, helping to identify advantages and disadvantages

provided to transacting parties, as well as comment on the climate for negotiations with respect to MAC, or MAE. The Introduction explains MAC, or MAE, and the role that the relevant clause plays in an agreement. The main text provides a case study of the important and precedent-setting ruling in *Hexion v. Huntsman* from the Delaware Court of Chancery (US) in October, 2008, regarding the use of MAC clauses in M&A transaction documents. Annex I provides an abridged text of the MAC provision in *Hexion v. Huntsman*.

Introduction

MAC or MAE provisions in an agreement generally consist of two elements of an acquisition agreement. In the first, the MAC or MAE definition describes the circumstances that would constitute a material adverse change or effect on the target. This definition is used in the representations and warranties of the target or sellers, i.e., “The company’s contracts are in full force and effect, except as would have a Material Adverse Effect.”

The definition is also used to delineate the circumstances that, upon their occurrence, permit a buyer to withdraw from the transaction without penalty. This latter use is known in common parlance as the “MAC out” and appears in the buyer’s conditions precedent to close, i.e., “there shall not have occurred a Material Adverse Change in the company.” The other side is the listing of specific events, the “MAC exceptions,” that would prohibit a buyer from backing out of a deal. The elements of MAC clauses generally are negotiated heavily, with sellers attempting to narrow the MAC definitional elements and include as many exceptions as possible, and buyers doing the reverse.

MAC After Huntsman

In the wake of the *Hexion v. Huntsman* ruling in October, 2008, there are important lessons to take away from the court’s ruling and rationale regarding MAC provisions. Unlike China, a civil law country, whose law is stipulated in codes, the United States has a case law system, often referred to as a “common law” system. Prior decisions made by competent courts are binding on subsequent cases. Therefore discussing the specifics of a particular ruling made by a US court not only has illustrative effect, but is also helpful in securing a strong negotiating position should disputes arise. In addition to MAC, the *Huntsman* case dealt with the concept of “reasonable best efforts” in the context of the buyer obtaining financing for the acquisition, a subject which goes hand-in-hand with MAC, as such obligation is conditioned upon there being no MAC, and is particularly important when credit markets are volatile and the valuation and performance of target companies are uncertain. One effect of the credit crisis is being seen readily in the increased attempts by buyers to walk away from signed M&A deals by stating that a MAC had occurred with respect to the target. This section is aimed to serve as a quick reference guide for considerations of the aforementioned topics.

Background

In October 2008, the Delaware Court of Chancery rejected the

efforts of Hexion Specialty Chemicals Inc. and its affiliate (“Hexion”) to avoid consummating a \$10.6 billion leveraged cash acquisition by merger of Huntsman Corp. (“Huntsman”) and granted Huntsman the remedy of specific performance, ordering Hexion to comply with the terms of the merger agreement (the “Agreement”).

The Agreement contained a standard condition that Hexion’s obligations were conditioned on Huntsman not experiencing a MAE from the date of the Agreement through the closing date. It also specifically provided that if Hexion had “knowingly and intentionally” breached its covenants, its liability to Huntsman would not be limited to the \$325 million dollar termination fee that it could pay to terminate the transaction if it otherwise complied with the Agreement.

During the Spring of 2008, Huntsman reported disappointing financial results for the first fiscal quarter. Hexion argued that the failure of Huntsman to meet its projected quarterly targets constituted an MAE for purposes of the Agreement, thereby excusing Hexion from completing the transaction.

In his decision, Vice Chancellor Lamb found that Huntsman had not suffered an MAE, and that Hexion had “knowingly and intentionally” breached a number of its covenants under the Agreement, including the covenants regarding the financing. Consequently, the Court granted Huntsman’s request for specific performance, and ordered Hexion to perform all of its covenants and obligations under the agreement (with the exception of the ultimate obligation to close because the Agreement expressly provided that the remedy of specific performance was not available with respect to that obligation).

The Court’s consideration of the major arguments of the parties are discussed below, along with the corresponding takeaway points for future transactions.

The MAE Clause

In a decision consistent with other cases in which the Delaware courts have examined MAE or MAC clauses, the Court rejected Hexion’s argument that Huntsman had experienced an MAE. Vice Chancellor Lamb remarked that it was no coincidence that Delaware courts have never found a MAE to have occurred within the context of a merger agreement. In the absence of clear language to the contrary, the Court found that the burden of proof rests on the party invoking the MAE clause and seeking to excuse its performance under the contract.

- Takeaway Point #1: MAE Burden of Proof (“BOP”) is heavy on the buyer.

o Buyer has a “heavy burden” to prove MAE. No Delaware court had ever found for a buyer on a MAE claim.

o BOP is on buyer because it is party seeking to excuse performance under contract. It does not matter whether MAE is a representation, warranty, or condition to closing.

o In a footnote, the judge noted that the burden of a MAE can be shifted by contract, that MAE is a creature of contract and its interpretation can be altered by the parties.

o Lesson Learned: Consider specifically allocating BOP in the merger agreement.

The Court noted that, in examining an MAE clause, the important question is “whether there has been an adverse change in a target’s business that is consequential to the company’s long term earnings over a commercially reasonable period” (i.e., years rather than months). As the Delaware Chancery Court had previously noted in another case, “a short-term hiccup in earnings should not suffice; rather an adverse change should be material when viewed from the longer-term perspective of a reasonable acquirer.” In analyzing the decline in earnings, the Court stated “for such a decline to constitute a MAE, poor earning results must be expected to persist significantly into the future.”

• Takeaway Point #2: Adverse change duration

o Buyer must show that there has been an adverse change consequential to the long-term earnings of the target company—measured in years, not months. A short-term set-back in earnings is

not an MAE.

o Lesson Learned: MAE is a “backstop” protecting the buyer from “unknown events” that threatens target in a “durationally-significant manner.”

Hexion based its claim that an MAE had occurred (and, therefore, that it was excused from consummating the merger or paying the \$325 million termination fee) on three factors: (i) disappointing results in earnings since signing the Agreement relative to management’s projections, (ii) an increase in net debt contrary to expectations, and (iii) underperformance of two of Huntsman’s divisions. The Court rejected all three arguments; in reaching its conclusions, the Court found:

(a) Huntsman’s “failure to hit its forecasts cannot be a predicate to the determination of an MAE in Huntsman’s business,” given that the Agreement specifically excluded projections, forecasts and estimates from Huntsman’s representations and warranties, and allocated to Hexion the risk that Huntsman’s performance would not live up to management’s expectations at the time. Hexion had, therefore, failed to demonstrate the existence of an MAE in order to negate its obligation to close;

(b) Because Hexion’s original financial models which considered Huntsman’s projected reduction in net debt to be not more than “an added attraction,” accordingly, Hexion could not now claim that even a 5% increase in net debt as against expectations should excuse its obligation to perform; and

(c) the Agreement required a MAE to be determined based on an examination of Huntsman as a whole, and not an examination of selected divisions “only tangentially related to the issue.” The court was also satisfied that the underperformance was “short-term” in nature, and that Hexion was aware of the cyclical nature of one of the division’s businesses.

• Takeaway Point #3: Appropriate benchmark for measuring “materially adverse”

o Performance since Agreement v. expected performance (e.g. 2008 EBITDA is 32% less than June 2007 forecast of 2008 EBITDA)



Compared performance since the execution of the Agreement against industry indexes

Backward and forward looking comparison using a variety of metrics (EBITDA, EBITDA margin, EPS, stock price, value, debt)

- o Relevance of “disproportionate” peer comparison

Only if there has been an MAE

Relevant only to carve-outs

- o Performance since Agreement v. historical performance (e.g. 2008 EBITDA only 7% less than 2007; 2007 only 3% below 2006)

Agreement disclaims representations and warranties regarding projections

- Requiring target to substantially meet its forecast targets as a condition precedent would void disclaimer

- Not a fraudulent inducement case; contract claim and contract allocated risk to Hexion of missing projection

Target projections to show no reasonable expectation of MAE as compared to past performance

- o The correct metric—EBITDA v. EPS

Earnings per share (“EPS”) is a function of capital structure—effects of leverage

Acquirer for cash is replacing the capital structure of target

Results of operations is what matters (EBITDA)

- o Lessons Learned:

Consider specifying the benchmark and metric(s) to use to determine MAE.

Non-reliance language on projections has a broad application. Year-to-year comparison of results to ascertain a MAC is preferable.

Make carve-outs specific. E.g., what does disproportionate mean? Is below the mean sufficient? Does disproportionate effect have to be statistically significant? What peer groups used to measure disproportionate? Because Judge Lamb found that the exclusions to the MAC need not be considered, how these exclusions are read, particularly the term “disproportionality,” is still an open question.

“Only to the extent” language should be significant protection to seller: For “changes” to be relevant, buyer should have to identify and quantify the portion of the change that disproportionately affected seller relative to other persons in the industry. Specify that part of the change that also affects others should not be counted toward an MAE.

Conclusion

Although the Delaware Chancery Court decided in favor of the seller, Huntsman, it is important for Chinese sellers and target

companies to understand the rationale behind such decision and the basic rules how a MAC clause operates to the advantage and disadvantage of one party. We hope the foregoing discussions will facilitate Chinese companies to be better suited in negotiating a favorable agreement with their foreign counterparts.

Annex I

The following is the MAC clause from the Hexion v. Huntsman case. The original text contains much more sub-sections and details which reflects a heavily negotiated position. The abridged part below represents how a more standard MAC provision appear:

“A “Company Material Adverse Effect” means any occurrence, condition, change, event or effect that is materially adverse to the financial condition, business, or results of operations of the Company and its Subsidiaries, taken as a whole; provided, however, that in no event shall any of the following constitute a Company Material Adverse Effect:

(A) any occurrence, condition, change, event or effect resulting from or relating to changes in general economic or financial market conditions, except in the event, and only to the extent, that such occurrence, condition, change, event or effect has had a disproportionate effect on the Company and its Subsidiaries, taken as a whole, as compared to other Persons engaged in the chemical industry;

(B) any occurrence, condition, change, event or effect that affects the chemical industry generally (including changes in commodity prices, general market prices and regulatory changes affecting the chemical industry generally) except in the event, and only to the extent, that such occurrence, condition, change, event or effect has had a disproportionate effect on the Company and its Subsidiaries, taken as a whole, as compared to other Persons engaged in the chemical industry; or

(C) the outbreak or escalation of hostilities involving the United States, the declaration by the United States of war or the occurrence of any natural disasters and acts of terrorism, except in the event, and only to the extent, of any damage or destruction to or loss of the Company's or its Subsidiaries' physical properties.

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