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The Long Arm of the MAC

A recent Delaware decision extends the reach of MAC jurisprudence beyond exact phrasing and outside the acquisition context.

Dealmakers have long recognized the implications of a Material Adverse Effect (MAE/MAC) standard in a merger agreement. As the Delaware court noted in the *Hexion* case, a buyer asserting an MAC condition "faces a heavy burden when it attempts to invoke a material adverse effect clause in order to avoid its [contractual] obligation."

In a recent Delaware case involving chocolate chip cookies, Chancellor Bouchard extended the reach of the MAC jurisprudence in assessing the termination of a license agreement between Mrs. Fields and Interbake.

First, the court applied the high judicial bar to finding an MAC even though the license agreement did not use the 'magic' words or defined term "Material Adverse Effect/Change". Here, the agreement referred to a "change…that is…materially adverse to…the business," which the court conclusively treated as the equivalent of a traditional MAC standard.

Second, the court held that the MAC case law, largely developed in the acquisition context, was equally applicable to a license agreement, and therefore applied the well known *IBP* three-prong MAC test — knowledge, magnitude and duration — in assessing whether the termination standard had been met. The court did concede that the durational aspect of the MAC test applied in the license context required the duration of the adverse event to be measured against the finite term of the license as compared to the perpetuity nature of an acquisition.

The court ventured even further in extending an MAC-like test to reviewing another termination right that did not even use "material adverse" language. Noting the use of undefined terms in a termination right based on the licensor materially damaging the brand in a manner that "renders the performance of this Agreement by Licensee commercially unviable", Chancellor Bouchard held that the *IBP* test and rationale were equally applicable here. The court reasoned that the "gravity of a provision" permitting a party to walk away from a contract suggested that the magnitude and duration of the loss should be of MAC-like significance before that party could invoke the condition.

This decision dispels an assumption that the rigorous MAC test always will be confined to closing conditions using exact "material adverse effect" phrasing or those appearing in acquisition agreements, especially where the contract terminology sounds like an MAC. What remains unclear is what combination of phrasing, context and/or consequence is required before the court will treat a condition as the equivalent of an MAC and therefore apply the "heavy burden" on the invoking party.

If you have any questions about the matters addressed in this *M&A Update*, please contact the following Kirkland authors or your regular Kirkland contact.

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