KIRKLAND & ELLIS

KIRKLAND **M&A UPDATE**

October 16, 2018

Materiality and Efforts Qualifiers — Some Distinctions, Some Without Differences

The Akorn *decision is a useful reminder that there sometimes is a gap between practitioners' expectations about theoretical formulations and real-world outcomes when those expectations are judicially tested.*

Much deserved attention has been paid to the first finding of a "material adverse change" (MAC) by a Delaware court in the recent *Akorn* decision. Of perhaps equal practical importance to dealmakers is the court's guidance on a question that has long occupied draftspersons — whether or not there is, and the extent of, any legal difference between the many shades of qualifiers used in deal agreements on two key terms: materiality modifiers and efforts covenants. Building on earlier Delaware decisions, the court reached a clear split decision on this question.

In the case of efforts covenants, the court noted that qualifiers like "best efforts", "reasonable best efforts", "commercially reasonable efforts" and shades in between are used to define "how hard the parties have to try" to satisfy a commitment in the agreement such as obtaining regulatory approvals. VC Laster cited an ABA publication that purports to set a hierarchy among these clauses, with each prescribing a slightly different level of required efforts. However, he pointed to a string of recent cases, including the decision in *Williams v. ETE*, which view these standards — even when they appear in the same agreement — as largely interchangeable despite clearly seeming to suggest the parties intended a difference. In the *Williams* case, the court found that the "commercially reasonable efforts" and "reasonable best efforts" standards both "impose[d] obligations to take all reasonable steps to solve problems and consummate the transaction". In another case (*Alliance Data*), the Delaware court said that even a flat "best efforts", typically considered the most demanding standard, "is implicitly qualified by a reasonableness test". A recent New York decision (*Holland Loader*) suggests that New York law will similarly imply a reasonableness standard regardless of which modifier is used.

By contrast, the *Akorn* decision confirms a sharp, and perhaps larger than expected, distinction between the two most common materiality qualifiers used to modify representations, covenants and closing conditions — "material adverse change/effect" and "in all material respects". In the case of a MAC, VC Laster closely followed Delaware precedent (including *Hexion* and *IBP*) in holding that a buyer asserting a MAC "faces a heavy burden" and the relevant effect must "substantially threaten the overall earnings potential of the target in a durationally-significant manner". But in interpreting the similar-sounding "in all material respects" standard, the court articulated a much lower burden, stating that this qualifier merely "seeks to exclude small, *de minimis*, and nitpicky issues" and to limit the operation of the representation, covenant or condition to "issues that are significant in the context of the parties' contract".

The *Akorn* decision is a useful reminder that there sometimes is a gap between practitioners' expectations about theoretical formulations and real-world outcomes when those expectations are judicially tested. While we do not necessarily expect the deal community suddenly to abandon negotiations around efforts formulations or to depart significantly from market practice for materiality qualifiers, parties can use an informed understanding of the case law to more effectively deploy negotiating leverage and goodwill where it matters most.

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.

Daniel E. Wolf
Kirkland & Ellis LLP
601 Lexington Avenue
New York, NY 10022
www.kirkland.com/dwolf
+1 212-446-4884

Eric L. Schiele
Kirkland & Ellis LLP
601 Lexington Avenue
New York, NY 10022
www.kirkland.com/eschiele
+1 212-446-4791