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Case Western Reserve Law Review

Volume 74 | Issue 3 Article 7

2024

Does a Buyer Really Have the “Luxury” of Invoking an MAE Clause? A (Hypothetical) MAE Analysis of the LVMH-Tiffany Merger After *Akorn*

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Case Western Reserve Law Review · Volume 74 · Issue 3 · 2024

— Note —

Does a Buyer Really Have the "Luxury" of Invoking an MAE Clause? A (Hypothetical) MAE Analysis of the LVMH-Tiffany Merger After *Akorn*

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Introduction

The luxury industry[1] is no stranger to the merger and acquisition world. To compete in the world's constantly evolving and digitized

1. The "luxury industry" encompasses a broad range of product markets, including haute couture clothing and jewelry, as well as vehicles, yachts,

economy, luxury fashion houses are moving away from their roots as small, family-owned businesses to join forces with billion-dollar conglomerates.[2] Within the last twenty years, luxury mergers and acquisitions have more than doubled, and in 2020 alone, 277 mergers closed in the luxury industry, a five-year high.[3] The buzz surrounding fashion mergers only increased the following year, as LVMH Moët Hennessy—the world's leading luxury goods conglomerate[4]—finally completed its highly publicized merger with American high jeweler Tiffany & Co. after a hard-fought legal battle in the Delaware Court of Chancery.[5] Shortly after the parties first signed their merger agreement, the world began to experience the detrimental health and economic impacts of the COVID-19 pandemic. Tiffany was not immune to these effects, as the pandemic forced store closures and travel bans caused the jeweler's worldwide sales to plummet.[6] This decline ultimately led LVMH to withdraw from the deal, invoking the agreement's "material adverse effect" (MAE)[7] clause in court.[8]

An MAE is a legally powerful provision that allows a buyer to walk away from its deal without liability, if the target company suffers a

estates, hotels, and wines. Will Kenton, *What Is a Luxury Item (AKA Luxury Good)? Definition and Examples*, Investopedia (Feb. 13, 2021), https://www.investopedia.com/terms/l/luxury-item.asp [https://perma.cc/8PAH-5PLZ]. This Note will use the term "luxury industry" to encompass these various sectors.

2. Anna Cabigiosu, Digitalization in the Luxury Fashion Industry: Strategic Branding for Millennial Consumers 25–26 (Paurav Shukla & Jaywant Singh eds., 2020).

3. *Id.* at 25; Tugba Sabanoglu, *M&A in the Luxury Goods Sector—Statistics & Facts*, Statista (July 3, 2023), https://www.statista.com/topics/8464/manda-in-the-luxury-goods-sector/ [https://perma.cc/C6QP-LMFZ].

4. Luca Solca, *How LVMH Dominates the Luxury Business*, Bus. of Fashion (July 27, 2022), https://www.businessoffashion.com/opinions/luxury/how-lvmh-dominates-the-luxury-business/ [https://perma.cc/2D5N-ZPGY].

5. *Id.*

6. Rachel Wynn, *Hard Luxury: Material Adverse Effect in the LVMH and Tiffany Merger*, Minn. L. Rev.: De Novo Blog (May 10, 2022), https://minnesotalawreview.org/2022/05/10/hard-luxury-material-adverse-effect-in-the-lvmh-and-tiffany-merger/ [https://perma.cc/3YQV-WPGG].

7. "Material adverse effect" (MAE) and "material adverse change" (MAC) are often used interchangeably, by scholars and courts alike. This Note uses "MAE" to encompass both, as their meanings are similar. For a more in-depth discussion on the similarities and differences between these terms, see Kenneth A. Adams, *A Legal-Usage Analysis of "Material Adverse Change" Provisions*, 10 Fordham J. Corp. & Fin. L. 9, 17–20 (2004).

8. Wynn, *supra* note 6.

"materially adverse effect."[9] For decades, the Delaware court placed an extraordinarily high burden on buyers attempting this "MAE out," consistently rendering seller-friendly judgments.[10] Then, a change came in 2018, with the court's shocking decision in *Akorn, Inc. v. Fresenius Kabi AG*,[11] finding for the first time that a buyer successfully proved the occurrence of an MAE. In LVMH's case, the Delaware court had to decide whether Tiffany's sales decline due to the pandemic qualified as an MAE, in light of *Akorn.* Unfortunately for commercial buyers, the court never had the opportunity to rule on this issue, as the parties dropped the suit and closed the deal, at a lower purchase price.[12]

This Note contributes to the existing literature on MAE clauses, by applying the post-*Akorn* MAE framework to the LVMH-Tiffany dispute, had the parties not settled. Part I of this Note will explore MAE clauses, generally, to provide a background on the purposes of these clauses and how parties can contract around them through "carve-outs." Part II then details the Delaware court's seller-friendly MAE approach, focusing on two foundational decisions from the early 2000s, *In re IBP*[13] and *Hexion v. Huntsman.*[14] Part III fast-forwards to the court's 2018 decision in *Akorn*, detailing the factual background and reasoning that led the court for the first time to find the occurrence of an MAE. Despite the court's seemingly drastic departure from its previous precedent, I argue that *Akorn* is an outlier case, failing to significantly change the seller-friendly MAE standard. Part IV of this Note will then apply this foundational MAE case law to the LVMH-Tiffany dispute, to predict how this litigation would have ended had the parties not settled and renegotiated the deal. Through analyzing the American jeweler's financial history and the duration of its financial troubles, as well as the underlying causes of Tiffany's financial decline, I find that LVMH's MAE claim would have ultimately failed, even in

9. Robert T. Miller, *Material Adverse Effect Clauses and the COVID-19 Pandemic* 5 (U. Iowa Legal Stud. Rsch. Paper, Working Paper No. 2020-21, 2020), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3603055 [https://perma.cc/2RY9-QS6D].

10. Samuel Shapiro, *Rethinking MAC Clauses in the Time of* Akorn*,* Boston Scientific*, and COVID-19*, 10 Mich. Bus. & Entrepreneurial L. Rev. 241, 243 (2021); Naveen Thomas, *Mythical Adverse Effect*, 73 Emory L.J. (forthcoming 2024) (manuscript at 9), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4388755 [https://perma.cc/7ALT-QVXH].

11. No. 2018-0300, 2018 WL 4719347, at *1 (Del. Ch. Oct. 1, 2018), *aff'd,* 198 A.3d 724 (Del. 2018).

12. Vincent Scala, *Changes to Material Adverse Effect Clauses Following Major Events: Evidence From COVID-19*, 95 St. John's L. Rev. 549, 550 (2021).

13. *In re* IBP, Inc. S'holders Litig., 789 A.2d 14 (Del. Ch. 2001).

14. Hexion Specialty Chem., Inc. v. Huntsman Corp., 965 A.2d 715 (Del. Ch. 2008).

a post-*Akorn* world. This Note will conclude by explaining that, although the Delaware court still retains a seller-friendly MAE standard, commercial buyers can continue to use the threat of MAE litigation to their advantage, as a vehicle for renegotiating the deal. Drawing a parallel to divorce cases where out-of-court settlements are the norm, both parties to MAE litigation have more of an incentive to drop the suit and renegotiate the deal on their own terms. Rather than enduring expensive and prolonged litigation with uncertain outcomes due to the unstable MAE jurisprudence in Delaware, both parties benefit from this alternative: the seller gets to close the deal and reap the profits, and in return, the buyer often secures a significantly lower purchase price than originally contracted for.

I. Exploring MAE Clauses

A. MAE Clauses in General

The majority of modern agreements and financial commitments contain an MAE clause.[15] While these provisions can vary considerably, they most commonly appear as a condition to closing.[16] The use of these clauses is a way for the parties to allocate risks to the target's business that may arise between the deal's signing (when the parties enter the agreement) and its closing (when the buyer pays the target and gains ownership of it).[17]

MAE clauses are firstly a way for parties to establish a threshold for the various warranties and representations made during negotiations that relate to the risks associated with the target's business.[18] A target company may represent that its business has complied with all regulatory compliance laws, "*except as would not have a Material Adverse Effect*." As a result of this qualification, any breach of the regulatory compliance laws by either party that the parties deem immaterial to the contract would not preclude closing of the deal.[19]

Importantly, MAE clauses also provide a catch-all legal mechanism that outlines the circumstances in which a party (usually the buyer, rather than the target) is permitted to walk away from the deal,

15. Shapiro*, supra* note 10, at 242.

16. David Cheng, *Interpretation of Material Adverse Change Clauses in an Adverse Economy*, 2009 Colum. Bus. L. Rev. 564, 568 (citing Yair Y. Galil, *MAC Clauses in a Materially Adversely Changed Economy*, 2002 Colum. Bus. L. Rev. 846, 848.

17. Robert T. Miller, *Pandemic Risk and the Interpretation of Exceptions in MAE Clauses*, 46 J. Corp. L. 681, 683 (2021).

18. Shapiro, *supra* note 10, at 244.

19. *Id.*

without the risk of contractual liability.[20] This mechanism, often known as the "MAE out"[21] clause, typically states that as a condition to closing, "there shall *not* have occurred a Material Adverse Change in the [target] Company." Such a material adverse change may be to the target's financial conditions, properties, or business operations.[22] By including an MAE clause, the target and buyer agree that the deal's completion is conditional on the absence of such a material change. Then, under traditional contract law principles, the occurrence of an MAE discharges the buyer's obligation under the merger agreement, leaving the target in a difficult position.[23]

When considering the length of time between the deal's signing and closing, this general catch-all provision takes on a powerful role. In a merger agreement, the parties to the contract do not perform their obligations immediately. Instead, there is an executory period between the signing and closing that can vary in time based on the complexity of the agreement, lasting a few months to even several years.[24] This executory period is a time of both high anticipation and uncertainty—anything can happen to the target, possibly even an event significant enough to trigger the contract's MAE clause and cancel the deal.[25]

The MAE clause's ability to dictate the completion of a merger and acquisition deal has transformed this clause from an oft-ignored boilerplate provision to one that parties heavily negotiate.[26] In these negotiations, the target would typically prefer not to have an MAE clause in the contract at all, thereby eliminating any potential for the

20. Miller, *supra* note 9, at 5; Shapiro, *supra* note 10, at 244.

21. Thomas, *supra* note 10, at 9.

22. *Id.* at 20 n.155.

23. Robert T. Miller, *Canceling the Deal: Two Models of Material Adverse Change Clauses in Business Combination Agreements*, 31 CARDOZO L. REV. 99, 109–10 (2009).

24. Grace Maral Burnett & Eleanor Tyler, *ANALYSIS: As Reviews Stretch, M&A Deals Keep Shorter Deadlines*, BLOOMBERG L. (Oct. 21, 2021, 3:21 PM), https://news.bloomberglaw.com/bloomberg-law-analysis/analysis-as-reviews-stretch-m-a-deals-keep-shorter-deadlines [https://perma.cc/YS2Z-BJBH] (finding that the average executory period for eighty-one public merger deals valued at over $1 billion was 278 days, with some contracts allowing for an executory period of over one year in length).

25. Andrew A. Schwartz, *A "Standard Clause Analysis" of the Frustration Doctrine and the Material Adverse Change Clause*, 57 UCLA L. REV. 789, 818 (2010) (stating that the "executory period—is frequently a time of high anxiety for acquirers, as they know that the world and the business climate is dynamic and unpredictable").

26. Michelle Shenker Garrett, *Efficiency and Certainty in Uncertain Times: The Material Adverse Change Clause Revisited*, 43 COLUM. J. L. & SOC. PROBS. 333, 333–34 (2010).

buyer to back out of the agreement.[27] However, most targets cannot realistically avoid such clauses, given that in today's corporate world, over 95 percent of merger agreements include some form of an MAE clause.[28] Instead, the target must come to terms with the clause's inclusion and negotiate for a narrow reading, limiting the number and types of events that can trigger the "MAE out."[29] On the other side, the buyer asks for a much broader clause that encompasses as many triggering events as possible, thereby shifting the risk to the target and giving itself the flexibility to remain in the deal, walk away, or renegotiate it.[30] Generally, the buyer will win; due to the impracticability of identifying and then agreeing to a narrow set of unknown future events that would give rise to an MAE, it is easier for the parties to agree to a standard, broadly drafted MAE clause.[31] With such a broad clause, the parties essentially leave it to the court to conduct a fact-based inquiry into what constitutes an MAE under their contract, if the issue were to arise.[32]

B. MAE Carve-Outs and the Disproportionate Effect Exception

In addition to negotiating for the existence and breadth of the MAE clause, opposing parties must also agree on what "carve-outs" should be included in the agreement. Through negotiation, the parties expressly create exceptions for, or "carve out," certain future circumstances that may otherwise give rise to an MAE but cannot form the grounds for a party to terminate the deal under the contract's MAE clause.[33] By including the carve-out, the parties agree that such an event is outside the target's control, so the buyer should accept it as an inherent risk of making the merger agreement.[34]

In legal theory and practice, carve-outs are essentially the converse of the contract's actual MAE provision. Instead of outlining possible ways for a buyer to have an "out" from the merger, carve-outs are a

27. Cheng, *supra* note 16, at 571.

28. Erik Lopez, *Material Adverse Effect Clauses*, The M&A Law. Blog, https://themalawyer.com/material-adverse-effect-clauses/ [https://perma.cc/3U4N-LUWB].

29. *See* Shapiro, *supra* note 10, at 245.

30. *Id.*

31. Cheng, *supra* note 16, at 571.

32. Bradley C. Sagraves & Bobak Talebian, *Material Adverse Change Clauses in Tennessee:* Genesco v. Finish Line, 9 Transactions: Tenn. J. Bus. L. 343, 348 (2008).

33. Ketan Mukhija, *Analyzing the 'MAC' Clause in a Volatile Economic Environment*, 1 Gujarat Nat'l L. U. L. Rev. 43, 52 (2009).

34. *Id.* at 52–53.

way to ensure that the deal ultimately closes, even after the changed circumstances. And, because carve-outs focus on reasonably expected events only,[35] it is easier for parties to explicitly agree to them in advance; this is different from the MAE clause, where identifying all unknown events is impractical, and a viable alternative is simply agreeing to broader contractual language.[36]

The presence of carve-outs in a merger agreement largely favors the selling target, rather than the buyer. This preference plays out in the negotiation process, as the target will argue for a broad and expansive carve-out section, with as many exempt events as possible to ensure that the deal closes.[37] The buyer on the other hand will try to minimize the number of carve-outs, to preserve its contractual right to walk away from the deal if any changed circumstances amount to an MAE.[38] Increasingly, targets are getting their way, as modern merger agreements contain more and more carve-outs, that are increasing in number, length, and specificity.[39]

One of the most common types of exceptions found in MAE clauses is changes to general economic conditions, appearing in over 85 percent of deals.[40] The inclusion of this exception precludes a seller from asserting that a target's financial downturn is enough to trigger the seller's way out of the deal through the MAE clause, if that downturn is widely experienced around the world. Other common carve-outs include

35. As I explain later, common carve-outs usually encompass systemic or industry-wide events that, generally, the buyer or seller may reasonably expect to occur. For example, a company can reasonably expect that, over the years of its operation, there may be changes to applicable industry laws. Mitchell Fournie, *Managing Risk in M&A: Material Adverse Change and Material Adverse Effect Clauses*, M&A Risk Advisor (Jan. 5, 2023), https://www.mandariskadvisor.ca/article/blog/managing-risk-in-m-a-material-adverse-change-and-material-adverse-effect-clauses [https://perma.cc/G5Z5-2LT6].

36. *See supra* note 30 and accompanying text.

37. Shapiro, *supra* note 10, at 245–46.

38. *Id.*

39. *See* Andrew M. Herman & Bernardo L. Piereck, *Revisiting the MAC Clause in Transaction: What Can Counsel Learn from the Credit Crisis?*, Bus. L. Today, Aug. 2, 2010, at 3 (noting that "[s]ellers have traditionally been successful at negotiating very specific carve-outs to the general MAC definition"); *see also* Guhan Subramanian & Caley Petrucci, *Deals in the Time of Pandemic*, 121 Colum. L. Rev. 1405, 1450 (2021). These authors found that MAE carve-out language has increased dramatically in length, from approximately 220 words in 2005, on average, to more than 600 words by 2020. This increase is accompanied by a corresponding increase in the number of carved-out events, from six in 2005 to more than ten by 2020. *Id.*

40. Shapiro, *supra* note 10, at 245–46.

changes in the industry in which the seller operates, the effects of changes in applicable laws or government regulations, acts of terrorism, changes in geopolitical conditions (such as acts of war), and natural weather disasters.[41] Events such as acts of God, pandemics, disease outbreaks, or other similar events were not standard MAE carve-outs until recent years. In fact, before 2005, pandemic carve-outs were nonexistent, and act of God exceptions were in a mere 13 percent of MAE clauses.[42] The COVID-19 virus and its economic impacts changed this dramatically, increasing the prevalence of these carve-outs to 60 percent and 90 percent, respectively.[43] This shift signifies that sellers are increasingly insisting that any MAE affecting the target due to the pandemic is a "buy-side risk"[44]—that is, if a buyer cannot accept the potential negative effects of COVID-19 or other similar phenomena on the seller's business, then there really should be no deal between the parties at all.

Even with the target-friendly trend for carve-outs, buyers can still protect themselves through the addition of a "disproportionate effect" exception, following the contract's MAE carve-outs.[45] This exception can modify some or all of the carve-outs, to allow a buyer to terminate the merger based on a carved-out event, provided that the target company suffered a disproportionately adverse effect compared to other companies in the same industry.[46] Stated simply, if the target is more significantly affected by an explicitly carved-out event than its competitors, the carve-out does not stand in the way of a court finding that this event is an MAE, thus, allowing the buyer to walk away from the deal. In this way, the buyer can "claw back" at least some of the protection that a broad set of carve-outs provides the target company.[47]

II. Tracing back the Seller-Friendly Standard

A. *Before* IBP

Despite the powerful legal effect that an MAE clause can have on a deal, what constituted a material adverse effect remained legally undefined throughout the twentieth century. Although MAE clause

41. Cheng, *supra* note 16, at 573.

42. Subramanian & Petrucci, *supra* note 39, at 1453–54.

43. *Id.*

44. *Id.* at 1455.

45. Brian JM Quinn, *Mergers, MACs, and COVID-19*, 55 U. Rich. L. Rev. 565, 576–77 (2021).

46. *Id.*

47. *Id.* at 576.

litigation did exist in courts throughout the nation, it was of such limited extent that it provided little meaningful precedent for courts' interpretation of MAE clauses in merger agreements.[48] Because trial courts had little to no judicial guidance from higher courts on which to ground their decisions, the presiding trial judge effectively called the shots.[49] As a result, courts were split: there were instances of judges rendering buyer-friendly judgments,[50] while other courts leaned far more seller friendly, declining to find the occurrence of an MAE.[51]

This inconsistent case law coupled with a lack of an authoritative definition elsewhere caused commercial parties to be unsure when and how the buyer could exercise its termination rights under the contract's MAE clause.[52] The only way to know for sure was to invoke the clause in court and hope for a favorable judgment.[53] In seeking an answer, the parties endured expensive and prolonged ligation.[54]

B. IBP *and* Hexion*—Setting the Seller-Friendly Standard*

In its seminal 2001 decision that "define[d] MA[E] clause[] [jurisprudence] for the next two decades,"[55] the Delaware Court of Chancery finally provided both courts and commercial parties with a set standard for determining the existence of an MAE.[56] The case arose

48. Sherri L. Toub, Note, *"Buyer's Regret" No Longer: Drafting Effective MAC Clauses in a Post-*IBP *Environment*, 24 Cardozo L. Rev. 849, 871 (2003) (explaining that prior to *IBP*, "there existed no historically significant decision focused almost entirely on the interpretation of MAC clauses in merger agreements").

49. Y. Carson Zhou, *Material Adverse Effects as Buyer-Friendly Standard*, 91 N.Y.U. L. Rev. Online 171, 173–75 (2016).

50. *See, e.g.*, Raskin v. Birmingham Steel Corp., No. 11365, 1990 WL 193326 (Del. Ch. Dec. 4, 1990) (suggesting that target's short-term earnings declining by more than 50 percent may have been a material adverse effect, though the parties ultimately settled out of court); Allegheny Energy, Inc. v. DQE, Inc., 74 F. Supp. 2d 482, 518 (W.D. Pa. 1999) (finding for the buyer based on material changes occurring in the industry), *aff'd*, 216 F.3d 1075 (3d Cir. 2000).

51. *See, e.g.*, Pine State Creamery Co. v. Land-O-Sun Dairies, Inc., 201 F.3d 437 (4th Cir. 1999) (declining to find that a party's operating losses of more than $400,000 during a two-month period amounted to a material adverse effect, stating that this is not a question suitable for summary judgment).

52. Scala, *supra* note 12, at 556.

53. Zhou, *supra* note 49, at 173.

54. Scala, *supra* note 12, at 556.

55. Shapiro, *supra* note 10, at 250.

56. *In re* IBP, Inc. S'holders Litig., 789 A.2d 14, 68 (Del. Ch. 2001). While this case was decided under New York law, the Delaware court adopted the judicial ruling into its own state law in 2005. *See* Frontier Oil Corp.

from the U.S. meat industry, when Smithfield (the nation's largest pork producer) and Tyson (the largest poultry producer) each independently began discussions to acquire IBP, which at the time was the nation's largest beef producer.[57] Both companies saw the potential in this acquisition: the chance to dominate the meat market not only in the United States, but also the entire world.[58] As a result, a bidding war between Tyson and Smithfield ensued, with Tyson ultimately winning.[59] During this bidding process, Tyson gained information that suggested shortcomings in IBP's business operations, including inaccurate financial projections, SEC investigations, management troubles, and even accounting fraud within an IBP subsidiary.[60] Tyson's determination to acquire IBP allowed the company to ignore these "red flags," increase its bid to win the auction, and finally sign the Tyson-IBP Merger Agreement in January of 2001.[61] Between signing and closing of this agreement, a severe winter caused things to take a turn for the worse—not just for IBP, but for Tyson, too.[62] Both companies began to struggle financially as the cold winter "adversely affected livestock supplies and vitality," leading to two poor quarters and a chilling of the parties' relationship.[63] Tyson soon began to experience some "buyer's regret," having second thoughts about upholding its end of the agreement.[64] By March of that same year, Tyson sent a letter to IBP, terminating the merger agreement and claiming that both companies' poor financial showing in 2001 was strong evidence that an MAE occurred. Because of the agreement's ambiguous MAE clause, the parties were forced to turn to the courts for an answer, and a massive lawsuit ensued in the Delaware Chancery Court.[65]

v. Holly Corp., No. 20502, 2005 WL 1039027, at *33–34 (Del. Ch. Apr. 29, 2005).

57. *In re IBP*, 789 A.2d at 21–22.

58. *Id.* at 22 (explaining that Tyson hoped to acquire IBP "to create the world's preeminent meat products company—a company that would dominate the meat cases of supermarkets in the United States and eventually throughout the globe").

59. *Id.* at 21–22.

60. *Id.* at 22.

61. *Id.* at 38–40.

62. *Id.* at 22.

63. *Id.*

64. *Id.*

65. *Id.* at 23 ("This expedited litigation ensued, which involved massive amounts of discovery and two weeks of trial.").

Unpersuaded by Tyson's argument, the court held that an MAE did not occur and ordered specific performance by both parties to complete the merger.[66] The court rejected Tyson's first argument that IBP's poor quarter in 2001 was itself an MAE, dismissing these numbers as a short-term consequence of an unfortunately cold, but short-lived, winter season.[67] The court announced that acquirors seeking to purchase a company as part of their long-term strategy may consider MAEs only when changes in business operations or results of such changes are "*consequential* to the company's earnings power over a *commercially reasonable period* . . . measured in years rather than months."[68] In other words, when a buyer is purchasing the target company as part of its long-term strategy, the target's failure to meet projected earnings over a short period of time, such as one fiscal quarter, is irrelevant to an MAE analysis. From this seller-friendly perspective, the court restricted MAE clauses to a "backstop," protecting the buyer only from "unknown events that substantially threaten the overall earnings potential of the target in a durationally-significant manner."[69]

That IBP had a subpar quarter simply did not rise to the high level of materiality needed to find an MAE, neither in duration nor degree. Instead, this was simply a "blip" in the overall financial scheme of the companies.[70] Moreover, this "blip" was something that Tyson should have expected given its previous access to IBP's historical financial data during the bidding war. This financial data showed that, although IBP was a profitable company overall, it was still subject to large swings in annual net earnings. Insofar as Tyson knew of IBP's uncertain and cyclical business when it signed, the company could not turn around and use this as an excuse to terminate the deal.[71] These considerations led the court to conclude that IBP had not suffered an MAE.

The seller-friendly MAE standard began to form with the Court of Chancery's *IBP* decision and its "substantially threaten[ing]" key language, making it nearly impossible for buyers to successfully litigate their MAE claims. It was clear that "a 'substantial burden [was placed] on a remorseful buyer attempting to prove a MA[E].'"[72] Less clear to the courts and commercial parties was what the application of the new

66. *Id.* at 82–84.

67. *Id.* at 67, 70–71.

68. *Id.* at 67 (emphasis added).

69. *Id.* at 68.

70. *Id.* at 67.

71. *Id.* at 71.

72. Shapiro, *supra* note 10, at 253 (quoting Steven M. Davidoff, Gods at War: Shotgun Takeovers, Government by Deal, and the Private Equity Implosion 64 (2009)).

"durational significance" and "substantially threaten[ing]" standard looked like in different contexts, including when the contract contained MAE carve-outs.

Further guidance came from the Delaware court six years later, with its decision in *Hexion Specialty Chemicals, Inc v. Huntsman Corp.* Hexion, a large chemical product manufacturer, entered into a merger agreement with Huntsman, another top manufacturer in the industry.[73] Although the contract was signed and ready, issues with the parties' necessary regulatory and antitrust approvals delayed the merger's closing for over a year.[74] During this lengthy executory period, Hexion looked for ways to terminate the agreement, as the company worried about Huntsman's potential insolvency after poor earnings reports in the first quarter of 2008.[75] Hoping to walk away from the deal without paying Huntsman the contract's set "$325 million deal breakup fee,"[76] Hexion pursued MAE litigation.[77]

Relying on its prior decision in *IBP*, the Delaware Chancery Court found for Huntsman, holding that the seller did not suffer any material adverse effect to trigger the contractual clause.[78] Before making this determination, the court first decided that the party invoking the MAE clause is also the party that bears the burden of proof.[79] This preliminary allocation of the burden was significant because whichever party this falls onto faces a "heavy burden"—expressly affirming *IBP*'s high bar for MAEs.[80] The court's next step was to clarify the framework laid out in *IBP*, beginning with the appropriate benchmark to use in MAE analyses. While the *IBP* court utilized both earnings per share and earnings before interest and taxes (EBIT),[81] the *Hexion* court decided that neither of these is the proper metric in the context of all-cash

73. 965 A.2d 715, 721–22 (Del. Ch. 2008).

74. After a short period of negotiations, the parties drafted a merger agreement with a narrow MAE clause, containing various general and industry-specific carve-outs. *Id.* at 734–35.

75. *Id.* at 721.

76. Megan Davies, *Huntsman Banks Provide Funding for Breakup Fee*, Reuters (Dec. 19, 2008, 4:25 PM), https://www.reuters.com/article/huntsman/huntsman-banks-provide-funding-for-breakup-fee-idUSN1946535520081219 [https://perma.cc/5UNW-UGXB].

77. *Hexion*, 965 A.2d at 721–22.

78. *Id.* at 738.

79. *Id.* at 739–40.

80. *Id.* at 738 ("A buyer faces a heavy burden when it attempts to invoke a material adverse effect clause in order to avoid its obligation to close.").

81. *In re* IBP, Inc. S'holders Litig., 789 A.2d 14, 66–67 (Del. Ch. 2001).

mergers.[82] Instead, the court chose to use earnings before interest, taxes, depreciation, and amortization (EBITDA) as a benchmark for its quantitative analysis.[83] Justifying its decision, the court explained that unlike earnings per share, which only represents the capital structure of the company, EBITDA better reflects the "*results* of operation," which is "[w]hat matters" in MAE analyses.[84] Further, EBITDA is the metric that the parties themselves rely on most during their merger negotiations.[85]

The court then turned to the language announced in *IBP*. Although this set a new temporal standard for what constitutes an MAE, courts still lacked guidance on how to apply it when the contract also contained MAE carve-outs. This issue was particularly relevant to the *Hexion* court, as the parties specifically bargained for various carve-outs related to the chemical industry.[86] Based on these carve-outs, Hexion argued that the court must compare the target's performance since the time of signing of the agreement to the overall chemical industry and determine whether changes in this industry disproportionately affected Huntsman's performance. If the court found a disproportionate effect, then Hexion would have won because the target would have suffered an MAE and the carve-out would have been inapplicable.[87] The court rejected this argument, finding that an analysis of the applicability of any MAE carve-outs is needed *only if* the court finds that an MAE occurred.[88] So, the court must first determine the materiality of the target's financial underperformance, circling the court back to the original standard. Applying the *IBP* test by comparing Huntsman's performance in the same quarter from the prior year, the court held that Hexion had not met its burden of proof. While it was true that the target suffered a "difficult year," with a 3.6 percent decline in the company's EBITDA from 2006 to 2007 and a projected decline of 7 percent the following year, the court failed to find any long-term impact.[89] Reiterating *IBP*, the court stated that "poor

82. *Hexion*, 965 A.2d at 740. A cash merger is one in which the buyer pays the target entirely in cash, rather than in stock or equity. *See generally* Pavel G. Savor & Qi Lu, *Do Stock Mergers Create Value for Acquirers?*, 64 J. Fin. 1061 (2009).

83. *Hexion*, 965 A.2d at 740.

84. *Id.* (emphasis added).

85. *Id.*

86. *Id.* at 737.

87. *Id.*

88. *Id.* at 738.

89. *Id.* at 740, 742–43, 742 n.74 ("Huntsman's Q3 2006 EBITDA was down 26% from Q2 2006, and Q4 2006 was down 21% from Q3. In 2005, a

earnings results must be expected to persist significantly into the future" to constitute an MAE.[90] Through analyzing past financial data, it became apparent to the court that Huntsman often experienced highs and lows in its earnings, with a trend towards less lucrative third and fourth quarters, followed by increases in earnings the following year. That Huntsman was again experiencing this seasonal fluctuation was nothing new, even something that Hexion should have been aware of at signing.[91] This simply was not enough meet the buyer's high MAE burden.

When considered together, *IBP* and *Hexion* create a seller-friendly standard for MAE analysis, an approach that favors closing the deal rather than allowing the buyer to walk away. *IBP* laid the groundwork for how the Delaware court should conduct MAE analysis through three key elements. Under the tripartite *IBP* test, MAE clauses offer protection only from "(i) unknown events (ii) which substantially threaten the target's overall earnings potential (iii) in a durationally significant way," measured over a commercially reasonable period.[92] *Hexion* expanded on this ruling, explicitly placing the high burden of proof on the buyer, and clarifying that any analysis of quantitative metrics (such as EBITDA) requires the court to compare the seller's current performance under the metric to its performance during the same quarter of the previous year. Above all, what the *IBP* and *Hexion* decisions reinforce is the Delaware court's exceedingly, even "impossibly," high standard for MAE litigation.[93]

III. *AKORN*—AN UNEXPECTED CHANGE?

After *Hexion*, the Delaware Chancery Court continued to apply its seller-friendly approach, declining ever to find that a buyer could

similar pattern appeared as well, with Q3 2005 down 12% from Q2, and Q4 2005 down 43% from Q3. Thus, Hexion should have been well aware at signing that the second half of 2007 was likely to be less lucrative for Huntsman than the first.") (citation omitted).

90. *Id.* at 738.

91. *Id.* at 740–43.

92. Katelyn E. Bryant, Comment, *Bringing Down the Deal: Reevaluating the Delaware MAE Standard After* Akorn v. Fresenius, 51 SETON HALL L. REV. 815, 824 (2020).

93. Schwartz, *supra* note 25, at 828. From a contract-law perspective, this high standard does not come as a shock. At the core of contract law is the principle of "*pacta sunt servanda*: [the] contract must be observed." *Id.* at 800 (quotations omitted).

validly terminate its merger agreement pursuant to an MAE clause.[94] Over a decade later, the court in *Akorn v. Fresenius* breathed life back into the MAE clause, ruling for the first time that a buyer successfully invoked such a clause.[95] This Part will first condense the immense factual record of the case, then describe the Delaware court's analysis of both quantitative and qualitative factors, leading to the first-of-its-kind holding. I will then analyze the judicial impact of this holding, to argue that any effect on Delaware's MAE jurisprudence is likely minimal due to the case's exceptional nature.

A. Factual Overview of Akorn

In April 2017, Fresenius Kabi AG, a major German pharmaceutical company, signed a merger agreement to acquire Akorn, an American pharmaceutical company, in a deal worth $4.75 billion.[96] The parties negotiated for and drafted an industry-standard merger agreement, with Akorn making extensive representations to Fresenius, including compliance with applicable FDA regulatory requirements and a commitment to use all commercially reasonable efforts to continue operations in the ordinary course of business between signing and closing of the deal.[97] In turn, the agreement provided Fresenius with the right to terminate if (1) any of Akorn's representations were not "true and correct," so long as this failure could not reasonably constitute an MAE as defined by their contract (also known as the "bring-down condition"); (2) Akorn failed in a material respect to comply with its contractual obligations; or (3) Akorn suffered an MAE.[98] Their contract contained a general MAE clause, with a customary definition of what constituted a material adverse effect: "any effect, change, event or occurrence that, individually or in the aggregate . . . has a material adverse effect on the business, results of operations or financial conditions of the Company and its Subsidiaries, taken as a whole."[99] The definition then included various carve-out exceptions, including changes generally affecting the pharmaceutical industry or the larger economy.[100]

94. *Hexion*, 965 A.2d at 738 ("Delaware courts have never found a material adverse effect to have occurred in the context of a merger agreement. This is not a coincidence.").

95. No. 2018-0300, 2018 WL 4719347, at *62 (Del. Ch. Oct. 1, 2018), *aff'd,* 198 A.3d 724 (Del. 2018).

96. *Id.* at *1, *19.

97. *Id.* at *1.

98. *Id.* at *1, *44.

99. *Id.* at *50.

100. *Id.* at *51.

After the parties signed the agreement, Akorn's financial performance soon began to "f[a]ll off a cliff."[101] Fresenius was "shocked" to discover that Akorn had experienced a 29 percent year-over-year decline in revenue, an 84 percent decline in operating income, and a staggering 96 percent decline in earnings per share.[102] Akorn attributed this decline to new competitors in the market and the unexpected loss of a key contract, but nonetheless reassured Fresenius that these obstacles were only "temporary."[103] As the year continued, so did Akorn's decline in performance, with the company experiencing subsequent quarters of poor financial results and significant delays in product launches. By the fourth quarter, Akorn reported a decline of 34 percent in revenue, and losses of $0.52 per share, amounting to a decline of 300 percent.[104] The company's reported EBITDA also fell by 86 percent from the previous year.[105] Adding yet another blow to the deal, Fresenius then received two whistleblower letters alleging that Akorn violated regulatory compliance laws, in its product-development and quality-control processes. Fresenius brought these concerns to Akorn's attention, but the American pharmaceutical company declined to investigate further.[106] Invoking its own rights under the merger agreement to reasonable access to Akorn's information, Fresenius conducted its own independent investigation into the allegations. Uncovering "serious and pervasive data integrity problems"[107] as well as false representations to the FDA, Fresenius gave Akorn one more chance: the company was willing to extend the agreement's Outside Date, to provide Akorn with ample time to investigate and resolve the issues.[108] When Akorn declined this offer, Fresenius decided enough was enough. On April 22, 2018, Fresenius notified Akorn that it was terminating the merger agreement, asserting that an MAE occurred.[109] Not surprisingly, Akorn's next step was to immediately file suit in Delaware court for specific performance of the merger agreement.[110]

101. *Id.* at *60.

102. *Id.* at *1, *21.

103. *Id.* at *1–2, *21.

104. *Id.* at *35, *54.

105. *Id.* at *35, *55.

106. *Id.* at *26–28.

107. *Id.* at *2.

108. *Id.*

109. *Id.*

110. *Id.* at *3.

B. The Court's Legal Analysis and Holding

In an incredibly fact-intensive, 246-page opinion, Vice Chancellor Laster ultimately ruled that an MAE occurred, allowing a buyer to walk away from the merger agreement for the first time in Delaware jurisprudence.[111] The court considered the issue of whether Akorn suffered an MAE as the "most straightforward," turning to both *IBP* and *Hexion* to guide its analysis.[112] Vice Chancellor Laster clarified that he was following *IBP*'s materiality and temporal standard, stating that any "unknown" effect found must "substantially threaten the overall earnings potential of the target in a durationally-significant matter."[113] From *Hexion*, he also adopted the use of EBITDA as the appropriate metric for an MAE analysis. Because of this, the court set about evaluating Akorn's performance compared to its performance in the same quarter of a previous year.[114]

Applying these precedents together, Vice Chancellor Laster conducted a thorough analysis of both quantitative and qualitative factors. The Vice Chancellor first found that quantitative factors showing Akorn's declines were both "unexpected" and materially significant enough to find a "[g]eneral" MAE.[115] He highlighted that Akorn's EBITDA dropping by 86 percent in 2017 compared to the same quarter of 2016 was a "dismal" and "dramatic" change, amounting to a material decline since the signing of the merger. The court also noted that Akorn's decline was a "departure from its [own] historical trend," as the previous five years only brought growth to the company.[116] It was also significant to the court that Akorn's performance in the quarter prior to the signing of the merger did not show any declines.[117] Based on this, the court found no cyclical trends or seasonal fluctuations to which the decline could be attributed, unlike in *Hexion*.[118] Presumably, the court was hinting that Fresenius was blindsided: the German company did not anticipate Akorn's financial decline at the time of signing, nor could it have, given the positive financial information it

111. *Id.* at *47.

112. *Id.*

113. *Id.* at *60–62.

114. *Id.* at *53–54 ("The *Hexion* decision teaches that when evaluating the magnitude of a decline, a company's performance generally should be evaluated against its results during the same quarter of the prior year, which minimizes the effect of seasonal fluctuations.").

115. *Id.* at *62.

116. *Id.* at *55, *59.

117. *Id.* at *55.

118. *Id.* at *3, *53–55.

had.[119] As a result, the decline also was also an "unknown" event, or at least one that was not contemplated by either party during negotiations.[120]

Vice Chancellor Laster then determined that the decline was also "durationally significant" under the traditional *IBP* language, as it had already persisted for a full year with no signs of stopping.[121] Akorn claimed that the two main issues underlying its decline were the loss of a key contract and increased competition in the marketplace, specifically from "unexpected new market entrants" competing for Akorn's top three products.[122] To the court, these factors created a long-lasting and inescapable problem for Akorn's business.[123] This competition was not going anywhere—in fact, at the time of litigation, it was further increasing, as Akorn faced an additional rival that management had not previously foreseen. As for the lost contract, Akorn presented no evidence to show that it could recapture or even replace it.[124] Additional quantitative support for the court's conclusion came from the evaluations of analysts, whose projections of Akorn's EBITDA at time of termination were over 60 percent lower than their estimates at the time of signing—amounting to more than a fivefold decline, compared to its industry peers.[125]

When considered together, these factors pointed to a finding that Akorn's financial decline had persisted, and would continue to persist, for at least a "commercially reasonable period."[126]

As for qualitative factors, the court concluded that Akorn's problems with regulatory compliance also strongly supported Fresenius's assertion of the occurrence of another type of MAE: a "[r]egulatory" MAE.[127] Being in the pharmaceutical industry, Akorn's compliance with the FDA regulations and standards was essential, both to its own business and Fresenius's.[128] As a result, FDA compliance became an underpinning of their agreement through its "bring-down condition,"

119. *Id.* at *1, *60–61.

120. *Id.* at *60–61.

121. *Id.* at *55.

122. *Id.* at *21.

123. *Id.* at *55.

124. *Id.* ("There is every reason to think that the additional competition will persist and no reason to believe that Akorn will recapture its lost contract.").

125. *Id.* at *56.

126. *Id.* at *53 (quoting Hexion Specialty Chems., Inc. v. Huntsman Corp., 965 A.2d 715, 738 (Del. Ch. 2008)).

127. *Id.* at *63–71.

128. *Id.* at *66.

which allowed Fresenius to walk away if Akorn's compliance representations were not true at closing.[129] After reviewing evidence of Akorn's data-integrity issues (including falsified data submissions to the FDA, destroyed evidence, and computer-data breaches), the court saw that Akorn was not the FDA-compliant company that it represented itself to be at time of signing.[130]

Returning to a quantitative analysis, the court then considered the financial impact these data-integrity problems had on Akorn. At trial, Akorn estimated it would cost the company $44 million to remedy these issues over a span of three years, while Fresenius's estimations were as high as $1.9 billion.[131] After considering independent expert reports, the court rejected both parties' estimates and instead found a credible valuation at a midpoint of $900 million, amounting to 21 percent of Akorn's stand-alone equity value in the merger.[132] The issue then became whether this decrease in value was sufficiently material under *IBP*. Since the parties and the industry did not provide standards for making this determination, Vice Chancellor Laster had to rely on his own "intuition and experience."[133] Admitting that his experience is that of a judge rather than a businessman, he nonetheless concluded that a reasonable acquiror would consider an expense amounting to 20 percent of a target's value as sufficiently material to the deal, justifying the court's finding of a second MAE.[134]

C. Akorn*'s Minimal Impact on MAE Jurisprudence*

As a result of *Akorn*, questions naturally arise as to the decision's impact on MAE jurisprudence in Delaware. Does *Akorn* signify a movement away from the seller-friendly *IBP* tradition? Will the Court of Chancery now lessen its MAE standard, to allow for more permissive rulings in future cases? Although some have hinted at such a possibility,[135] and while a definitive response to these questions can only arise

129. *Id.* at *62.

130. *Id.* at *71. Based on this finding, it is possible that in future cases, the Delaware Chancery court could conclude that misrepresentations by a target to a merger agreement may constitute an MAE, even if the buyer has conducted its proper due diligence. However, because of the minimal post-*Akorn* case law and this state's seller-friendly MAE framework, this is only a mere possibility—further case law on this matter is needed to fully address this issue.

131. *Id.* at *42, *71–72.

132. *Id.* at *73–74.

133. *Id.* at *74.

134. *Id.*

135. *See, e.g.*, Shapiro, *supra* note 10, at 277 (explaining that *Akorn* "give[s] future courts the precedent they need to begin applying a more coherent

from further development of MAE case law in the Delaware courts, the few subsequent decisions following *Akorn*[136] and the opinion itself should point towards a tentative answer of "no." Instead, here I suggest that *Akorn* is simply a factual outlier, where the court was presented with facts of such exceptional nature that it had no choice but to find an MAE, even under the traditional seller-friendly framework. As a result, *IBP* is still the standard in Delaware.

While *Akorn*'s finding of an MAE was unprecedented, the framework in which Vice Chancellor Laster grounded his decision was not. Although he contended that both *IBP* and *Hexion* did not establish an "overarching standard" for MAE analyses,[137] these two cases were the only judicial precedent on which the court grounded its MAE decision. Indeed, a simple review of the decision shows that Vice Chancellor Laster mentioned *IBP* and *Hexion* sixty-four and thirty-six times, respectively.[138] More importantly, he continuously relied on *IBP*'s three-element test to guide the MAE analysis, declining to formulate and announce a new, lower materiality threshold.[139]

The exceptional nature of the facts of *Akorn* may also mean that it does not lower the high MAE burden placed onto buyers. Vice Chancellor Laster himself hinted at *Akorn*'s distinctiveness in the opinion, stating that compared to prior MAE cases, "[t]his case is markedly *different*."[140] When looking only at the facts of the *Akorn* decision, a reader is first hit by its volume. In total, the *Akorn* memorandum opinion comes in at a whopping 246 pages, rendering it

(and correct) judicial philosophy" to MAE cases); Tom Hals, *Delaware Judge Says Fresenius Can Walk Away from $4.8 Billion Akorn Deal*, Reuters (Oct. 1, 2018, 12:03 PM), https://www.reuters.com/article/idUSKCN1MB2PX/ [https://perma.cc/C8A7-EZ87] ("'This is a landmark case,' said Larry Hamermesh, a professor at Delaware Law School in Wilmington, Delaware."); *Delaware Chancery Court Finally Finds an MAE*, Jones Day: Insights (Oct. 2018) https://www.jonesday.com/en/insights/2018/10/delaware-chancery-court-finally-finds-an-mae [https://perma.cc/SW29-HP4W] ("A buyer can successfully show a MAE if it can demonstrate that the target suffered a company-specific, material change in performance that is durationally significant.").

136. *See infra* text accompanying notes 157–161.

137. *Akorn*, 2018 WL 4719347, at *61–62.

138. *See generally id.* at *1–101. In his MAE analysis, the Vice Chancellor additionally cited *Frontier Oil v. Holly Corp.*, which followed *IBP* and formally adopted the *IBP* standard into Delaware law. No. 20502, 2005 WL 1039027, at *34 (Del. Ch. Apr. 29, 2005).

139. *Akorn*, 2018 WL 4719347, at *52–62.

140. *Id.* at *3 (emphasis added) ("This case is markedly different. Fresenius responded to a dramatic, unexpected, and company-specific downturn in Akorn's business that began in the quarter after signing.").

one of the longest written opinions in the court's history.[141] Of these 246 pages, Vice Chancellor Laster dedicated over 100 pages simply to a statement of facts, condensing the necessary information from more than 1,892 exhibits, fifty-four deposition transcripts, and sixteen live witness testimonies over a five-day trial.[142] Compared to *IBP*'s twenty-seven pages, and *Hexion*'s fourteen pages of facts,[143] *Akorn*'s 100-plus pages are a significant upsurge, highlighting the inherent complexity and uniqueness of the facts at issue in this case.[144]

Readers are then struck by the severity of the facts. From Akorn's utter financial deterioration to the company-wide compliance violations, it comes as no surprise that some have considered this to be a unique set of "*egregious* facts," ones that are atypical of merger dealings in the pharmaceutical industry, and otherwise.[145] In finding a regulatory MAE, the court placed considerable emphasis on Akorn's data-integrity problems, as recounted by experts in the pharmaceutical field.[146] Although the pharmaceutical industry has faced prevalent data-integrity deficiencies since the 2010s,[147] an expert testified at trial that

141. Edward B. Micheletti & Arthur R. Bookout, *Analyzing* Akorn*: Delaware's First M&A Termination Under Material Adverse Effect*, Skadden (Oct. 19, 2018), https://www.skadden.com/insights/publications/2018/10/analyzing-akorn [https://perma.cc/D3H6-JSSN].

142. *Akorn*, 2018 WL 4719347, at *4.

143. *See In re* IBP, Inc. S'holders Litig., 789 A.2d 14, 23–51 (Del. Ch. 2001); Hexion Specialty Chems., Inc. v. Huntsman Corp., 965 A.2d 715, 723–36 (Del. Ch. 2008).

144. Gerald Lebovits, Alifya V. Curtin & Lisa Solomon, *Ethical Judicial Opinion Writing*, 21 Geo. J. Legal Ethics 237, 252 (2008) (explaining that an opinion's length is in part determined by the complexity of the facts at issue, with a lengthier opinion indicating a more complicated set of facts that the judge must account for).

145. *See, e.g.*, Adam O. Emmerich & Trevor S. Norwitz, *The MAC Is Back: Material Adverse Change Provisions After* Akorn*, in* The International Comparative Legal Guide to: Mergers & Acquisitions 4, 4 (13th ed. 2019); Albert Manwaring, *Extraordinary Circumstances MAE Allow a Buyer to Break a Bad Deal,* Morris James (Nov. 25, 2018), https://www.morrisjames.com/newsroom-articles-1018.html [https://perma.cc/T3V3-4XLT]; Barbara Becker, Jeffrey Chapman & Stephen Glover, *A Watershed Development for "Material Adverse Effect" Clauses*, Harv. L. Sch. F. on Corp. Governance (Oct. 22, 2018), https://corpgov.law.harvard.edu/2018/10/22/a-watershed-development-for-material-adverse-effect-clauses/ [https://perma.cc/8E9D-XMSN].

146. *Akorn*, 2018 WL 4719347, at *66.

147. Barbara Unger, *An Analysis of 2018 FDA Warning Letters Citing Data Integrity Failures*, Pharm. Online (June 12, 2019), https://www.pharmaceuticalonline.com/doc/an-analysis-of-fda-warning-letters-citing-data-integrity-failures-0001 [https://perma.cc/6Q3M-J7VG].

Akorn's regulatory-compliance issues were among the top three worst examples out of over 120 assessed companies.[148] Another expert testified that in his work, he had yet to encounter another company that had as pervasive and severe data-integrity issues as Akorn.[149] To make matters worse, once the company learned of these issues, Akorn simply turned a blind eye, choosing not to address or cure them. To the court, this amounted to an action plainly outside the ordinary course of business for an FDA-regulated company.[150] In the end, these compliance failures were so fundamental and unexpected for the industry that it caused the experts to question the safety and validity of all of Akorn's previously released pharmaceutical products.[151]

As for the financial facts supporting the court's finding of a general MAE, the declines that the American pharmaceutical company experienced are incomparable to prior MAE precedent in the Delaware court. Durationally, Akorn's financial decline persisted for over a year and was projected to continue for the following three, a lengthy decline surpassing that of the targets in both *IBP* and *Hexion*.[152] Akorn's decline also falls neatly into *IBP*'s "commercially reasonable period" of years, rather than months. As for the magnitude of the declines, at its worst in 2017, Akorn's EBITDA was 86 percent below the previous years, and at its best the company was experiencing a 51 percent decline.[153] Both of these figures greatly exceed *Hexion*'s actual EBITDA drop by 3 percent and forecasted drop of 7 percent for the next year.[154] Since the *IBP* court did not use this metric in its MAE analysis, there is no direct EBITDA comparison to Akorn. Instead, the *IBP* court looked at earnings from operations, comparing a 64 percent decrease in

148. *Akorn*, 2018 WL 4719347, at *66.

149. *Id.* at *69.

150. *Id.* at *27–28.

151. *Id.* at *66 (explaining that an expert "believed that the 'FDA would get extremely upset' about Akorn's lack of data integrity 'because this literally calls into question every released product [Akorn has] done for however many years it's been this way'").

152. *Id.* at *53–56. IBP's decline persisted for one winter season, amounting to two quarters, and the dispute at issue in *Hexion* arose from the target's financial decline over only one quarter, with no long-term impacts. *In re* IBP, Inc. S'holders Litig., 789 A.2d 14 (Del. Ch. 2001); Hexion Specialty Chems., Inc. v. Huntsman Corp., 965 A.2d 715 (Del. Ch. 2008); *see also supra* text accompanying notes 63 & 75. Thus, Akorn's decline persisted for double, and quadruple, the amount of time seen in the Delaware court's prior MAE case law.

153. *Akorn*, 2018 WL 4719347, at *55.

154. *Hexion*, 965 A.2d at 742.

the producer's earnings for the first quarter of 2001 to a "blip."[155] With Akorn's year-over-year decline in operating income amounting to 134 percent in the first quarter of 2018, the pharmaceutical company's decline on this metric is over double in magnitude.[156]

The fact that the Delaware Chancery Court has failed to find another MAE occurrence since *Akorn* is also indicative of the decision's exceptional nature. So far, the court has had the opportunity to expand Delaware's post-*Akorn* MAE case law on at least four separate occasions.[157] While utilizing language from *Akorn*, the court has repeatedly declined to find the occurrence of an MAE.[158] For example, a little over a year after *Akorn* was decided, the Chancery Court decided another MAE merger suit in *Channel Medsystems, Inc. v. Boston Scientific Corp.*[159] This time, a merger deal between two medical technology companies fell through after the discovery of a senior executive's extensive scheme to defraud the target company of $2.6 million.[160] Despite extensively and positively quoting from *Akorn*, and despite both cases involving allegations of fraud in the target company, the court declined to find an MAE occurrence.[161]

IV. LVMH and Tiffany & Co.: A (Hypothetical) Case Study

A. The "Luxurious" Facts

In 2019, numerous partnerships and mergers were announced,[162] yet none caught the world's attention quite like the announcement that

155. *In re IBP*, 789 A.2d at 67, 69.

156. *Akorn*, 2018 WL 4719347, at *40.

157. *See* Snow Phipps Grp., LLC v. Kcake Acquisition, Inc., No. 2020-0282, 2021 WL 1714202 (Del. Ch. Apr. 30, 2021); Level 4 Yoga, LLC v. CorePower Yoga, LLC, No. 2020-0249, 2022 WL 601862 (Del. Ch. Mar. 1, 2022); Channel Medsystems, Inc. v. Bos. Sci. Corp., No. 2018-0673, 2019 WL 6896462 (Del. Ch. Dec. 18, 2019); Bardy Diagnostics, Inc. v. Hill-Rom, Inc., No. 2021-0175, 2021 WL 2886188 (Del. Ch. July 9, 2021).

158. *Snow Phipps Grp.*, 2021 WL 1714202, at *35; *Level 4 Yoga*, 2022 WL 601862, at *2; *Channel Medsystems*, 2019 WL 6896462, at *35; *Bardy Diagnostics*, 2021 WL 2886188, at *42.

159. No. 2018-0673, 2019 WL 6896462 (Del. Ch. Dec. 18, 2019).

160. *Id.* at *1.

161. *Id.* at *17, *24–25, *34–35.

162. About 35,800 merger and acquisition deals were announced in 2019. *See* Jens Kengelbach et al., *The 2019 M&A Report: Downturns Are a Better Time for Deal Hunting*, Bos. Consulting Grp. (Sept. 25, 2019), https://www.bcg.com/publications/2019/mergers-and-acquisitions-report

Paris-based LVMH, the leading luxury goods conglomerate, planned to acquire American jeweler Tiffany & Co. The acquisition itself did not come as a total shock to the luxury industry, as the European conglomerate has acquired large brand names such as Dior, Louis Vuitton, and Marc Jacobs since its inception in 1987, which itself was generated from a merger of two luxury houses.[163] That LVMH was attempting to close its gap in the U.S. market, specifically in the jewelry industry, also made Tiffany & Co. the perfect target.[164] Instead, what was noteworthy was the deal's price; at a reported transaction value of $135 per Tiffany & Co. share, amounting to over $16 billion, this merger was set to become the largest deal in the history of the luxury industry.[165]

After weeks of bidding and negotiations, the two luxury houses finalized their all-cash merger agreement in late November.[166] The deal was set to close by August 24th of the following year, subject to approval from Tiffany's shareholders and European regulatory bodies.[167] Like most other merger agreements, LVMH and Tiffany's contract included a standard MAE clause:

> "Material Adverse Effect" means any Effect that, individually or in the aggregate with all other Effects, (a) has had or would be reasonably expected to have a material adverse effect on the business, condition (financial or otherwise), properties, assets, liabilities (contingent or otherwise), business operations or results of operations of the Company and its Subsidiaries, taken as a whole or (b) would or would reasonably be expected to prevent, materially delay or materially impair the ability of the Company

-shows-downturns-are-a-better-time-for-deal-hunting [https://perma.cc/F38L-WJUF].

163. Martí Nogué Corominas & Roger Masclans Armengol, Qualitative and Quantitative Analysis of LVMH 4, 6, 27–30 (Jordi Martí Pidelaserra, ed., 2013); Cabigiosu, *supra* note 2, at 26.

164. Martina Olbertova, *Opinion: A Deal Between LVMH and Tiffany Represents a Win-Win for Both Parties*, Luxury Soc'y (Oct. 31, 2019), https://www.luxurysociety.com/en/articles/2019/10/opinion-deal-between-lvmh-and-tiffany-represents-win-win-strategy-both-parties [https://perma.cc/7QQB-QN7B] ("LVMH has a gap in the United States luxury market right now.").

165. Lauren Hirsch & Elizabeth Paton, *Tiffany's $16 Billion Sale Falls Apart in Face of Pandemic and Tariffs*, N.Y. Times (Sept. 9, 2020), https://www.nytimes.com/2020/09/09/business/lvmh-tiffany-deal-lawsuit.html [https://perma.cc/58CZ-W2EP].

166. *Tiffany & Co. v. LVMH: The Timeline Behind Luxury's Biggest Deal to Date*, The Fashion Law (Jan. 7, 2021), https://www.thefashionlaw.com/a-running-timeline-of-the-16-2-billion-tiffany-co-v-lvmh-battle/ [https://perma.cc/7QGA-FYST].

167. *Id.*

to consummate the Merger or to perform any of its obligations under this Agreement by the Outside Date.[168]

Following this general definition, LVMH and Tiffany agreed to limit the scope of their MAE clause through various carve-outs, including general economic or political conditions, applicable changes in law, and natural disasters. Their merger agreement also contained a standard "disproportionate adverse effect" exception to balance out these carve-outs.[169]

Less than ten months after signing, and amid the ongoing COVID-19 pandemic, the partnership that LVMH's executives hoped would "thrive for centuries to come" began to crumble.[170] As a result of the pandemic's economic impact on the jeweler's sales in February 2020, Tiffany forecasted in March that the company would take a significant results hit for the remainder of the year.[171] This prediction turned into reality, as the jeweler's net sales around the world dropped. Cancelled weddings, closed shopping malls, travel restrictions, and the loss of over half of its operating days in China all contributed to Tiffany's sales decreasing by 45 percent in the first quarter of 2020.[172] LVMH's delay in filing requests for necessary antitrust and regulatory approvals coupled with letters from the French Minister of Foreign Affairs asking to halt the deal until early 2021 only increased tensions in the partnership.[173] Then, amid this tension, Tiffany finally had a small silver lining: the company reported stronger-than-expected results for the second quarter, with retail sales and e-commerce business steadily increasing from May to June 2020.[174] Despite the return to profitability,

168. Tiffany & Co., LVMH Moët Hennessy-Louis Vuitton SE, Breakfast Holdings Acquisition Corp., and Breakfast Acquisition Corp., Agreement and Plan of Merger 7–8 (Nov. 24, 2019) [hereinafter Tiffany & Co. Plan of Merger], https://www.sec.gov/Archives/edgar/data/98246/000119312519299997/d840067dex21.htm [https://perma.cc/CL8C-E9KF].

169. *Id.* at 8.

170. Hirsch & Paton, *supra* note 165.

171. *Coronavirus Takes Shine off Tiffany's Sales Before LVMH Takeover*, REUTERS (Mar. 20, 2020, 3:58 PM), https://www.reuters.com/article/us-tiffany-results/coronavirus-takes-shine-off-tiffanys-sales-before-lvmh-takeover-idUSKBN2171TA?il=0 [https://perma.cc/9J5J-TK94].

172. *Tiffany Reports First Quarter Results*, BUS. WIRE (June 9, 2020, 6:30 AM), https://www.businesswire.com/news/home/20200609005290/en/Tiffany-Reports-First-Quarter-Results [https://perma.cc/WN8R-LR5M]; Wynn, *supra* note 6.

173. *Tiffany & Co. v. LVMH: The Timeline Behind Luxury's Biggest Deal to Date*, *supra* note 166.

174. *Tiffany Reports Significant Improvement in Sales Trajectory and Profitability*, BUS. WIRE (Aug. 27, 2020, 7:30 AM), https://www.businesswire.com

Tiffany still experienced a 29 percent decline in sales in the second quarter of 2020 compared to the previous year.[175]

After a whirlwind couple of months of public fighting between the two companies, their saga came to a head on September 9, 2020, when LVMH announced that the deal was off. This prompted Tiffany to bring suit in the Delaware Court of Chancery, seeking specific performance of the merger on the grounds that LVMH's breach of contract has resulted in the jeweler suffering "ongoing irreparable harm."[176] LVMH invoked what it planned to be its free way out: the agreement's MAE clause. The French luxury house argued that the COVID-19 pandemic and its economic impacts on Tiffany qualified as an MAE under contract's general definition. Tiffany did not agree, seeing LVMH's decision to back out as simply "buyer's remorse."[177] Relying on the agreement's numerous carve-outs, Tiffany further argued that the pandemic simply was not an actionable MAE under the "narrowly defined" MAE clause the parties specifically agreed to.[178] Before the Chancery Court had the opportunity to rule on this MAE issue, the companies decided to drop the suit, and re-entered negotiations.

*B. "What If"? A Possible Result Under the Post-*Akorn *Framework*

Ultimately, LVMH and Tiffany settled their legal dispute outside of court, and the deal went through at a $425 million lower purchase price.[179] Although we may never know how the Delaware Court of Chancery would have ruled on the parties' claim, here I argue that in light of both *Akorn* and *IBP*, LVMH presented a weak MAE case.

1. An Analysis of the Materiality and Durational Significance of Tiffany's Financial Decline

The first step in any MAE analysis under both *IBP* and *Akorn* is to determine whether the target's financial decline is sufficiently material and unknown to both parties. As the buyer, the heavy burden of proving materiality fell onto LVMH. Because the luxury houses'

/news/home/20200827005390/en/Tiffany-Reports-Significant-Improvement-in-Sales-Trajectory-and-Profitability [https://perma.cc/98EN-QGJ4].

175. Scala, *supra* note 12, at 549.

176. Verified Complaint, ¶ 25, Tiffany & Co. v. LVMH Moët Hennessy-Louis Vuitton SE, No. 2020-0768 (Del. Ch. Sept. 9, 2020).

177. *Id.* ¶ 13.

178. *Id.* ¶ 50.

179. Sarah White & Silvia Aloisi, *LVMH and Tiffany End Luxury Battle, Cut Price on $16 Billion Takeover*, Reuters (Oct. 29, 2020, 5:32 AM), https://www.reuters.com/article/idUSKBN27E13K/ [https://perma.cc/D8HT-G7VZ]. This amounts to approximately a 2.6 percent drop from the original purchase price.

contract did not specify what constitutes an MAE in their contract, a court would have to apply the *IBP* standard to assess materiality. And, because the contract did specify that the transaction was an all-cash merger, under *Hexion*, the court would also have to utilize EBITDA as the reference metric, evaluating Tiffany's EBITDA performance against its results during the same quarter of the previous year. Upon reviewing the jeweler's performance for the first quarter of 2020, Tiffany indeed experienced a significant decline, with the jeweler reporting an EBITDA of –$15.3 million, down 107.20 percent from 2019.[180] This percentage decline far surpasses that found in *Akorn*, as the pharmaceutical company's EBITDA fell by only 86 percent.[181] Although this alone may persuade a court to find that the decline is sufficiently material to constitute an MAE, a court may still be skeptical of ruling against Tiffany due to the jeweler's past financial trends. Unlike in *Akorn*, where the court found that the company experienced continuous growth in the five years prior to the event causing Akorn's decline, Tiffany's EBITDA greatly fluctuated between 2014 to 2019. Rather than showing a consistent upward trend, each quarter of significant EBITDA growth for Tiffany was followed by three consecutive quarters of declines. The percent decreases generally ranged from 25 to 54 percent, though one quarter did show a decline of over 165 percent.[182] As this pattern of highs and lows in Tiffany's EBITDA persisted for five years prior to the pandemic, it parallels the seasonal fluctuations that the target in *Hexion* experienced. The *Hexion* court viewed these fluctuations as reasonably expected by the buyer, had it looked at the target's financial records.[183] Based on this reasoning, LVMH could also have reasonably

180. In Quarter 1 of 2019, Tiffany reported an EBITDA of $212.40 million. By the same quarter of 2020, the jeweler's EBITDA declined to –$15.3 million. *See Tiffany and Co's EBITDA Margin by Quarter*, CSIMarket, https://csimarket.com/stocks/singleProfitabilityRatios.php?code=TIF&ebit [https://perma.cc/FJ73-4A5X]. Based on my calculations, this represents a 107.20 percent decrease, which I calculated as follows: $[(-15.3 - 212.40) \div 212.40] \times 100$. *See* Will Kenton, *How to Calculate the Percentage Change*, Investopedia (Jan. 23, 2024), https://www.investopedia.com/terms/p/percentage-change.asp [https://perma.cc/HY8S-RQ7Q] (explaining the formula for a percentage decrease).

181. *See* Akorn, Inc. v. Fresenius Kabi AG, No. 2018-0300, 2018 WL 4719347, at *55 (Del. Ch. Oct. 1, 2018), *aff'd*, 198 A.3d 724 (Del. 2018).

182. *Tiffany & Co (TIF) Earnings Before Interest, Taxes, Depreciation and Amortization (EBITDA),* DiscoverCI, https://www.discoverci.com/companies/TIF/earnings-before-interest-taxes-depreciation-and-amortization-ebitda [https://perma.cc/DF8X-2KLR] (graphing Tiffany's quarter EBITDA values from 2014 to 2015). For an explanation and depiction of how I calculated these percentage declines from EBITDA values, see *supra* note 180.

183. *See* Hexion Specialty Chems., Inc. v. Huntsman Corp., 965 A.2d 715, 721, 740–41 (Del. Ch. 2008).

expected that a decline would occur, especially since Tiffany's decline occurred in a quarter that was immediately preceded by a quarter of growth.[184]

Even if a court finds that Tiffany's financial decline is sufficiently material, LVMH's MAE claim would ultimately fail at the final step of an MAE analysis, as a court would be unable to conclude that this decline amounts to a "durationally significant" effect; it is more likely a "short-term hiccup."[185] As opposed to experiencing a financial decline that spanned consecutive quarters or at least a commercially reasonable period of years, the American jeweler suffered a drop in sales for a mere three months, amounting to only one fiscal quarter.[186] In *Akorn*, the company's financial decline persisted for over four times this length, not abating for more than a year.[187] Akorn's prolonged financial underperformance caused its EBITDA to also take a projected hit for the following three years;[188] here, Tiffany's sales began to increase by the following quarter, with no projected adverse impacts on its EBITDA. Indeed, by the fourth quarter of 2020, the jeweler reported an EBITDA of $328.10 million, surpassing Tiffany's prepandemic performance.[189]

For durational significance, an additional consideration for the Chancery Court in *Akorn* was that Akorn provided evidence of new market entrants and losses of key contracts, which were viewed as both long-lasting and incurable reasons for the company's past and future declines.[190] Tiffany's short financial decline can only be attributed to the COVID-19 pandemic and, indeed, this is all LVMH asserted in its countersuit to support its MAE argument.[191] Although the world is still

184. White & Aloisi, *supra* note 179.

185. *In re* IBP, Inc. S'holders Litig., 789 A.2d 14, 68 (Del. Ch. 2001) ("A short-term hiccup in earnings should not suffice.").

186. *Tiffany and Co's EBITDA Margin by Quarter*, *supra* note 180. In *Akorn*, the Vice Chancellor referenced a case from another state that found an MAE after the target experienced a financial decline for two consecutive quarters. *See Akorn*, 2018 WL 4719347 at *53 ("Chancellor Allen posited that a decline in earnings of 50% over two consecutive quarters would likely be an MAE.") (citing Raskin v. Birmingham Steel Corp., No. 11365, 1990 WL 193326, at *5 (Del. Ch. Dec. 4, 1990)).

187. *See Akorn*, 2018 WL 4719347, at *54.

188. *See id.* at *56.

189. *Tiffany and Co's EBITDA Margin by Quarter*, *supra* note 180.

190. *See* text accompanying notes 120–126.

191. Press Release, LVMH, LVMH Files Countersuit Against Tiffany. The Conditions to Close the Acquisition Are Not Met (Sept. 29, 2020), https://www.lvmh.com/news-documents/press-releases/lvmh-files-countersuit

feeling the economic and social effects of the pandemic, recent studies show that economic recovery is near—at least within the luxury industry.[192] During the height of the pandemic, fashion houses such as LVMH, Prada, and Tiffany itself worked to mitigate the financial effects of the pandemic through embracing e-commerce as a safe alternative to in-store shopping.[193] Proving fruitful, Tiffany's e-commerce business increased by 122 percent in the second quarter of 2020, with online purchases making up 15 percent of total sales.[194] Further, the entire luxury market is projected "to grow by 4.5% annually," to a revenue of up to $369 billion in 2024, at least partly due to these increased online sales.[195] Taking a broader view, this economic recovery through e-commerce shows that the underlying COVID-19 issues causing Tiffany's decline can be fixed by the house itself, unlike the exogenous roots of Akorn's decline.

2. Application of the Contract's Carve-Outs

Though unlikely, if LVMH could meet the high burden of proving both materiality and durational significance of the effect, the analysis would not end there. *Hexion* teaches that the next step after a finding of materiality is for the court to determine whether the parties agreed-

-against-tiffany-the-conditions-to-close-the-acquisition-are-not-met/ [https://perma.cc/K7LJ-VGCZ].

192. *See* Council of Econ. Advisors, Economic Report of the President 97, 100–01 (2022), https://www.whitehouse.gov/wp-content/uploads/2022/04/ERP-2022.pdf [https://perma.cc/RF27-3WTF]; Fflur Roberts, *Coronavirus Pandemic Continues to Challenge the Luxury Goods Industry*, EuroMonitor Int'l (Oct. 3, 2022), https://www.euromonitor.com/article/coronavirus-pandemic-continues-to-challenge-the-luxury-goods-industry [https://perma.cc/4RFC-3J4N] ("Global sales of luxury goods are set to grow by just under 6% in 2022 to reach USD1.2 trillion . . . . The outlook also remains positive, with sales set to exceed the pre-pandemic level by 2023.").

193. Daphne Duong, *How Will Luxury Brands Survive the COVID-19 Crisis?*, Edited (Dec. 14, 2020), https://edited.com/blog/how-will-luxury-brands-survive-the-covid-19-crisis/ [https://web.archive.org/web/20221203084316/https://edited.com/blog/how-will-luxury-brands-survive-the-covid-19-crisis/] (explaining that many luxury houses moved away from brick-and-mortar storefronts during the pandemic and turned to online retail to keep themselves afloat).

194. Lenore Fedow, *Tiffany's Q2 Sales Sink. E-Commerce Shines*, Nat'l Jeweler (Aug. 27, 2020), https://nationaljeweler.com/articles/4705-tiffany-s-q2-sales-sink-e-commerce-shines [https://perma.cc/M5N4-BSSH].

195. Jessica Fraley, *5 Luxury Brand Trends for a Post-Pandemic World*, ESW (Mar. 30, 2023), https://esw.com/blog/5-luxury-brand-trends-for-a-post-pandemic-world/ [https://perma.cc/L2HP-HJH7]; *Luxury Goods—Worldwide*, Statista, https://www.statista.com/outlook/cmo/luxury-goods/worldwide [https://perma.cc/7878-E3JX].

upon carve-outs apply. To complete this analysis, a court would have to stray from the familiar MAE framework and turn to a post-*Akorn* decision from the Chancery Court. As the world began to endure the economic and social impacts of the COVID-19 virus, corporate parties began to contemplate whether the pandemic could constitute an MAE in the eyes of the Chancery Court. In *AB Stables VIII LLC v. Maps Hotels and Resorts One LLC*,[196] the Delaware court answered this question in the affirmative. Although a thorough recitation of the specific facts is unnecessary, this case also stemmed from the luxury industry, focusing on a $5.8 billion merger between AB Stable VIII LLC, the seller of fifteen luxury hotels, and Maps Hotel and Resorts, the buyer. The standard merger agreement was signed in September 2019 and was set to close mid-April 2020.[197] By March 2020, the COVID-19 pandemic had started, and the world was responding accordingly. The hospitality industry was especially affected, as countries around the world implemented travel bans and stay-at-home orders, which significantly decreased the demand for these businesses.[198] As a result, AB Stable was forced to take unprecedented measures, including closing two of its hotels entirely and reducing the operations of its remaining properties. Because the buyer had not consented to these business changes, Maps refused to close, alleging that the target suffered an MAE as a result of the pandemic.[199] For the sole purpose of analysis, the Chancery Court agreed, making an *assumption* that any financial effects suffered by the target due to the pandemic were sufficiently material under Delaware law. Rather than actually coming to a final conclusion on the issue, the court effectively said that it will presume materiality for the sake of its analysis.[200] Having made that assumption, the court then turned to the question of whether this effect could fall under the contract's MAE carve-out for "natural disasters or calamities," since the contract lacked a specific carve-out for the COVID-19 pandemic.[201] After looking at the plain meaning of both calamity and natural disaster, the court concluded that the COVID-19

196. No. 2020-0310, 2020 WL 7024929 (Del. Ch. Nov. 30, 2020), *aff'd*, 268 A.3d 198 (Del. 2021).

197. *Id.* at *1.

198. Dogan Gursoy & Christina Geng-Qing Chi, *Effects of COVID-19 Pandemic on Hospitality Industry: Review of the Current Situations and a Research Agenda*, 29 J. Hosp. Mktg. & Mgmt. 527, 527 (2020) ("Restrictions placed on travel and stay-at-home orders issued by the authorities led to sharp decline in hotel occupancies and revenues.").

199. *AB Stables VIII*, 2020 WL 7024929, at *1–2.

200. *Id.* at *55.

201. *Id.*

virus fell under both. Characterizing the pandemic as a "terrible event that emerged naturally . . . , grew exponentially, and resulted in serious economic damage and many deaths," this corresponded with the court's understanding of a natural disaster as "a sudden and terrible event in nature," causing great damage.[202] The court noted that the "generally seller-friendly nature of the MAE [d]efinition" also supports this broad interpretation (an interesting proposition, considering that this is a post-*Akorn* decision).[203]

Turning back to the merger agreement between LVMH and Tiffany, it too did not contain a specific COVID-19 carve-out.[204] The parties, however, did agree to a carve-out for "any hurricane, tornado, flood, earthquake, *or other natural disaster*."[205] Following the same logic used by the court in *AB Stables*, the effect of COVID-19 on Tiffany's business would likely fall under this MAE exception.

Like most other merger agreements, the luxury houses also agreed to include a "disproportionate effect exception" to their carve-outs.[206] To trigger the application of this exception, and thereby diminish any effect of the natural disasters carve-out, LVMH would have to prove that the effects of COVID-19 disproportionately affected Tiffany's business, compared to others in the industry. This, LVMH simply cannot do. With less disposable income available,[207] the demand for luxury goods began to decrease during the pandemic, resulting in sales for the entire luxury sector falling by 23 percent in 2020, the largest decline since the financial crisis of 2009.[208] When compared to its luxury peers, Tiffany suffered similar sales declines and even outperformed

202. *Id.* at *57–59.

203. *Id.* at *63.

204. Tiffany & Co. Plan of Merger, *supra* note 168. As explained in Part I.B., it is uncommon for contracts written before the COVID-19 virus to include a carve-out for pandemics, so Tiffany and LVMH's omission is not surprising.

205. *Id.* (emphasis added).

206. *Id.* For a discussion on these types of exceptions to MAE carve-outs, see *supra* notes 45–47 and accompanying text.

207. Richard Lord, *Which Brand Did COVID-19 Affect Most—Louis Vuitton, Dior, Gucci or Hermès? Luxury Houses' Results Show a Turnaround in the Second Half of 2020*, Style (Dec. 29, 2020), https://www.scmp.com/magazines/style/luxury/article/3115602/which-brand-did-covid-19-affect-most-louis-vuitton-dior [https://perma.cc/B792-J5GJ].

208. *Global Luxury Sales Set to Outpace Pre-COVID Levels This Year, Bain Says,* Reuters (Nov. 11, 2021, 5:54 AM), https://www.reuters.com/business/retail-consumer/global-luxury-sales-set-outpace-pre-covid-levels-this-year-bain-says-2021-11-11/ [https://perma.cc/SS52-5ZTB].

some.[209] LVMH's own sales in the first quarter of 2020 fell by 38 percent compared to the previous year, representing a decline only 7 percent higher than the decline that it based its MAE argument on.[210] The unusual circumstance of the buyer also experiencing a similar financial decline as the target lends further proof that Tiffany was not disproportionately affected by the pandemic, allowing the carve-out to apply.[211] And since the carve-outs apply, Tiffany ultimately did not suffer a legal MAE.

C. MAE Clauses as a Bargaining Chip in Deal Renegotiations

Moving away from the hypothetical, the actual out-of-court agreement to close the deal between LVMH and Tiffany highlights the real-world application of MAE clauses: parties can use these clauses as tools for renegotiating their merger agreements by pursuing litigation and ultimately agreeing on a lower purchase price out-of-court.[212] Consequently, litigation is likely not the desired outcome of a buyer's invocation of the contract's MAE clause. Rather, litigation is a possible means for the buyer to behave opportunistically and score the best deal for itself, through renegotiation of a deal it no longer finds appealing.

LVMH and Tiffany's renegotiation to close the deal at a discount shows that such opportunistic behavior occurs at least within the luxury industry. Beyond this, research exists to show that other industries

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209. Comparable peers to Tiffany in the luxury sector include LVMH itself, as well as Richemont (which owns French luxury jewelers Cartier and Van Cleef & Arpels), as well as Kering (which owns luxury fashion and jewelry brands such as Gucci, Balenciaga, and Yves Saint Laurent). *See Our Maisons*, Richemont, https://www.richemont.com/our-maisons/ [https://perma.cc/3NE9-K97D]; *Discover Kering*, Kering, https://www.kering.com/en/group/discover-kering/ [https://perma.cc/JQL3-M87X]. While Tiffany's sales from April 1 through June 30 of 2020 declined by 43 percent, during this same period LVMH's, Richemont's and Kering's sales also declined by 38 percent, 47 percent, and 43.7 percent, respectively. Verified Complaint, ¶ 195, Tiffany & Co. v. LVMH Moët Hennessy-Louis Vuitton SE, No. 2020-0768 (Del. Ch. Sept. 9, 2020).

210. Verified Complaint, ¶ 195, Tiffany & Co. v. LVMH Moët Hennessy-Louis Vuitton SE, No. 2020-0768 (Del. Ch. Sept. 9, 2020).

211. That both parties here suffered financially due to a natural event is reminiscent of *IBP*, where both the target and buyer experienced financial declines due to a severe winter. *See supra* notes 62–63 and accompanying text.

212. Numerous authors have previously argued that parties often use MAE clauses as a tool of renegotiation. *See, e.g.*, Shapiro, *supra* note 10, at 246–47; Eric L. Talley, *On Uncertainty, Ambiguity, and Contractual Conditions,* 34 Del. J. Corp. L. 755, 788 (2009) ("[O]ne of the key reasons for a MAC/MAE provision is to provide a backdrop for possible deal restructuring should market conditions change.").

commonly use MAEs as a renegotiation tool as well.[213] In a study of mergers from a variety of industries, the researchers found that fifty were renegotiated by the parties to some extent. Of these fifty mergers, 80 percent were renegotiated as a direct result of one party (usually the buyer) invoking the contract's MAE clause in court.[214]

Research thus shows that parties tend to drop their MAE lawsuits to renegotiate their merger agreements after drafting. The next question is *why* they are motivated to do so. In the context of family law, scholars have found a similar trend of "private ordering," where divorcing spouses use the risks of divorce court proceedings to influence their bargaining process outside the courtroom.[215] In any divorce case that arrives in a domestic relations courtroom, both parties have high transactional costs stemming mostly from legal fees, as well as feelings of uncertainty, since "outcome[s] in court [are] far from certain, with any number of outcomes possible," including "all-or-nothing consequences."[216] This uncertainty is heightened by the fact that existing legal standards governing divorce disputes lack precision, giving the court broad discretionary power.[217] The ability of the divorcing parties to avoid these associated risks and uncertainties by drafting and creating their own agreement *outside* the courtroom creates a significant incentive for the parties to take this route.[218]

In the MAE context, the same rationale can apply, as commercial MAE litigation comes with its own set of costs and uncertainties that can adversely affect both parties.[219] As large commercial parties are spending upwards of hundreds of millions of dollars on legal fees to adjudicate their disputes fully, there is a clear financial burden that the parties must consider.[220] In addition to these financial costs, MAE suits

213. Shapiro, *supra* note 10, at 247.

214. David J. Denis & Antonio J. Macias, *Material Adverse Change Clauses and Acquisition Dynamics*, 48 J. Fin. & Quantitative Analysis 819, 830 (2013).

215. Robert H. Mnookin & Lewis Kornhauser, *Bargaining in the Shadow of the Law: The Case of Divorce*, 88 Yale L.J. 950, 950–52 (1979).

216. *Id.* at 971, 969, 956.

217. *Id.* at 969.

218. *Id.* at 956.

219. Vice Chancellor Laster himself noted this possibility in *Akorn*, stating that parties to a merger agreement often leave the materiality term undefined, it being "efficient to [do so] because the resulting uncertainty generates productive opportunities for renegotiation." Akorn v. Fresenius Kabi AG, No. 2018-0300, 2018 WL 4719347, at *48 (Del. Ch. Oct. 1, 2018).

220. Laws. for Civ. Just., Civ. Just. Reform Grp., U.S. Chamber Inst. for Legal Reform, Litigation Cost Survey of Major Companies 2

foster some degree of uncertainty, as neither the buyer nor the seller can be extremely self-assured of the outcome of an MAE litigation, even under *IBP*'s seller-friendly standard.[221] As I argued in Part II.C, *Akorn* does not negate the heavy burden that the buyer must meet to win on an MAE claim.[222] The buyer still must prove all three key elements of the *IBP* test, and since *Akorn*, no buyer has managed to do so, with LVMH also being an unlikely candidate.[223] At the same time, the *Akorn* decision does show that successful MAE clauses are not "mere hypotheticals" in the Delaware court; under the right set of facts, the court will exercise its discretion and give effect to this contractual provision.[224] As a result of both this uncertainty in outcomes and the litigation's high costs, when a buyer invokes the contract's MAE clause as leverage to reduce the purchase price, the seller has more of an incentive to enter renegotiations than to litigate, where one possible outcome is the court deciding there is no deal at all.[225] Such an adverse court judgment would leave the seller worse off than before the merger and force it to spend significant transaction costs on finding a new buyer or strategic partner to take over.[226] By that same coin, the buyer also has an incentive to renegotiate for a lower price rather than continue the MAE litigation and risk the potential (or, even likely) outcome of losing in court and having to pay the seller the contract's

(2010), https://www.uscourts.gov/sites/default/files/litigation_cost_survey_of_major_companies_0.pdf [https://perma.cc/CVL8-5LW7] (finding that the average outside litigation cost per respondent was nearly $115 million in 2008, with this cost increasing on average by 9 percent per year). Another scholar has also argued that the process of finding a partner, then negotiating and drafting the original merger agreement also requires significant investment from the parties, further increasing the financial costs for buyers and sellers, alike. *See* Andrew C. Elken, Note, *Rethinking the Material Adverse Change Clause in Merger and Acquisition Agreements: Should the United States Consider the British Model?*, 82 S. CAL. L. REV. 291, 300 (2009).

221. Shapiro, *supra* note 10, at 246 ("Inconsistent judicial interpretations of MACs have left both buyers and sellers uncertain what the result of litigating their claims would be.").

222. *See generally* Part II.C.

223. *See supra* text accompanying notes 157–161. *See also* Part III.A–B.

224. Eric Fidel, Akorn*: Establishing a Material Adverse Effect*, AM. BAR ASSOC. (Jan. 11, 2019), https://businesslawtoday.org/2019/01/akorn-establishing-material-adverse-effect/ [https://perma.cc/H4L2-STUR].

225. *See* Steven Davidoff Solomon, *In Abbot's Bid to Halt Purchase of Alere, the MAC Makes a Comeback*, N.Y. TIMES (Dec. 7, 2016), https://www.nytimes.com/2016/12/07/business/dealbook/abbott-laboratories-alere-mac-clause.html [https://perma.cc/65LS-SBFG].

226. Elken, *supra* note 220, at 300.

original price.[227] On average, when parties agree to renegotiate the merger, the buyer is successful is reducing the purchase price by 15 percent.[228] The choices then boil down to either taking the risk of going to trial on the MAE claim, or dropping the suit and choosing the safer option of renegotiating the merger agreement. For risk and cost-averse parties, this is an easy decision. Although neither party gets what they hoped for, agreeing to a renegotiation of the purchase price is still preferable to a court decision, which "necessarily has a winner and a loser."[229]

It is perhaps possible to extend this rationale even further, beyond both the divorce and MAE setting, to encompass *all* civil cases in the U.S. adversarial system. It is a well-documented fact that very few cases are fully litigated to a final judicial decision in U.S. federal and state courts. Instead, in upwards of 70 to 90 percent of filed civil cases, the parties settle.[230] Given that the same risks found in MAE and divorce litigation are present in all other types of civil trials, this figure makes sense.[231] Rather than having to cope with the negative side effects of a full trial, culminating in the factfinder rendering a judgment that may or may not benefit the plaintiff, both civil parties have higher incentives to bargain for a settlement agreement on their own terms. And, because these parties go into the negotiations with full control and knowledge of their circumstances (financial and otherwise), a settlement agreement is more likely to be mutually beneficial, or at least more favorable than the typical winner-loser trial outcome.[232]

Conclusion

Despite the Delaware Court of Chancery's first-of-its-kind decision in *Akorn*, the court's *IBP* seller-friendly standard isn't going anywhere. Instead of being the precedent-flipping case that some hoped for, *Akorn*

227. *Id.*

228. Shapiro, *supra* note 10, at 247; Denis & Macias, *supra* note 214, at 830.

229. Mnookin & Kornhauser, *supra* note 215, at 958.

An interesting question that is beyond the scope of this Note, but could be the subject of further scholarly inquiry, is whether this private-ordering effect on renegotiation of the merger agreement is *beneficial* for the parties and their respective industries, from a policy perspective.

230. Alexandre de Gramont, Michael D. Igyarto & Tatiana Sainati, *Divergent Paths: Settlement in US Litigation and International Arbitration*, 40 Fordham Int'l L.J. 953, 954 (2017).

231. *Id.* ("Litigation in the state and federal courts of the United States is notoriously expensive, time-consuming, and disruptive, with far-reaching and intrusive discovery.").

232. *See* Mnookin & Kornhauser, *supra* note 215, at 958.

is better characterized as an outlier case, an example of the court applying its well-entrenched standard to a set of facts so extraordinary that the buyer met its heavy materiality burden. Had LVMH and Tiffany continued its MAE claim, the court applying this same standard would have come to the exact opposite conclusion. But what LVMH had to hypothetically lose, it gained in the real-life outcome of the case, as the luxury house used the MAE clause as a bargaining chip to renegotiate the deal in its favor.

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† J.D., 2024, Case Western Reserve University School of Law; B.A., Psychology, 2021, University of Guelph. A massive thank you to Professor Juliet Kostritsky, for providing the inspiration for this Note, as well as her constant guidance and mentorship throughout my time at law school. I also would like to thank every member of Volume 74 of *Law Review* for their keen insights and edits. Thank you also to my parents, grandparents, and little sister, Teodora, for always believing in me, no matter what. *Vă iubesc din tot sufletul.* Finally, thank you to Grant Marshall—I couldn't have done this without your unwavering love, encouraging words, and constant reviews of the many (many) drafts of this Note.