# MAC CLAUSES AND INDEMNIFICATION PROVISIONS IN M&A DEALS: NEGOTIATION AND DRAFTING BEST PRACTICES

**MARCH 1, 2017**

NIXON PEABODY

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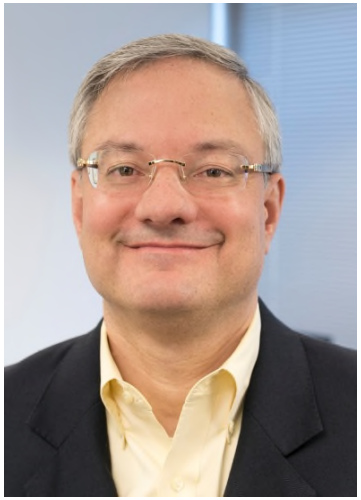

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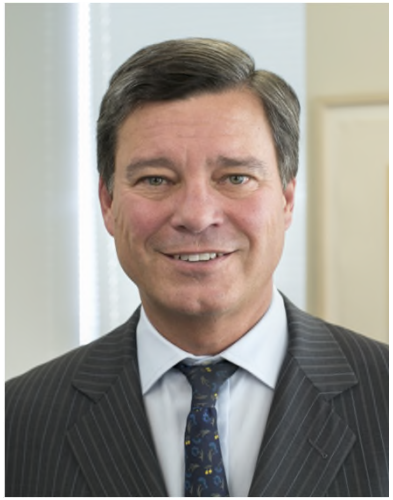

# MAC CLAUSES AND INDEMNIFICATION PROVISIONS IN M&A DEALS

## Agenda

Negotiating and Drafting MAC Clauses

Negotiating and Drafting Indemnification Provisions

Reassessing Common Provisions Favorable to Sellers

# MAC CLAUSES IN M&A DEALS

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NEGOTIATING MAC CLAUSES

# NEGOTIATING MAC CLAUSES
# WHAT IS A MAC?

Means of allocating risks between signing and closing

MACs used in different parts of the acquisition agreement:

Representations, Warranties and Covenants – used to establish a threshold for determining the scope of disclosure or compliance relating to risks associated with changes in the target's business

— A representation may provide that the target has complied with ERISA except as would not have a Material Adverse Effect.

— The agreement may include a separate representation regarding non-occurrence of MAC since a given date

# NEGOTIATING MAC CLAUSES
# WHAT IS A MAC?

Closing Condition - used to delineate the circumstances under which a bidder would be permitted to abandon the transaction without liability:

Frequently referred to as a “MAC out” – appears in the conditions precedent to the bidder’s obligation to close

92% of the publicly filed deals surveyed included a MAC closing condition*

*Nixon Peabody’s 2016 MAC Survey, analyzing 278 publicly filed acquisition agreements, including asset purchase, stock purchase and merger agreements for transactions with values ranging from $100 million to $160 billion that were dated between June 1, 2015 and May 31, 2016 (“2016 NP MAC Survey”).

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# NEGOTIATING MAC CLAUSES
# WHAT IS A MAC? (CONT'D.)

Sample standalone rep provision:

"During the period from the Balance Sheet Date to the date hereof…there has been no Material Adverse Effect and, to the Knowledge of the Company, no fact or condition exists or is contemplated or threatened which might reasonably be expected to cause a Material Adverse Effect."

# NEGOTIATING MAC CLAUSES
# WHAT IS A MAC? (CONT'D)

Sample closing condition provisions:

— "Buyer's obligation to consummate the transactions contemplated by this Agreement is subject to the satisfaction of the following conditions. . .

The representations and warranties of Seller contained in this Agreement were accurate as of the date of this Agreement and are accurate as of the Closing Date, except for any inaccuracy that would not, individually or in the aggregate, reasonably be expected to result in a [MAC]." or

— "There shall not  have occurred a [MAC] in the Company."

# NEGOTIATING MAC CLAUSES
# WHAT IS A MAC? (CONT'D.)

— Simple "MAC" definition: "Material Adverse Change" means any material adverse change in the business, results of operations, assets, liabilities or financial condition of Seller, taken as a whole

— Drafting Issues to Consider

- Inclusion of forward-looking standard in MAC definition?
  - Forward-looking standard was included in MAC definition 54% of the time*
  - Example: "any event, change or effect that could reasonably be expected to be materially adverse to the business…"

*Source: 2016 NP MAC Survey.

# NEGOTIATING MAC CLAUSES
# WHAT IS A MAC? (CONT'D.)

— Drafting Issues to Consider (cont'd)

- Inclusion of "changes on the target's ability to close the transaction" in the MAC definition?
  - Example: "…any change, event or occurrence that would reasonably be expected to prevent or materially delay or impair the ability of the Target to perform its obligations under the Agreement or to consummate the Transactions."
  - Was included in 59% of the 2015-2016 deals we surveyed (and 61% of the top 100 deals we surveyed)
  - Consider whether the carve-outs should also apply to this portion of the MAC definition (See Cooper Tire & Rubber Company v. Apollo (Mauritius) Holdings Pvt. Ltd., (Del. Ch. Oct. 31, 2014)

# NEGOTIATING MAC CLAUSES
# WHAT IS A MAC? (CONT'D.)

— Drafting Issues to Consider (cont'd)

- Inclusion of "changes on the bidder's ability to close the transaction" in the MAC definition?
  - This favorable pro-bidder term was included in 40% of the agreements surveyed in 2015-2016, a significant increase from the 12% reported in 2013*

*Source: 2016 NP MAC Survey.

# NEGOTIATING MAC CLAUSES
# WHAT IS A MAC? (CONT'D.)

- Inclusion of "prospects" in MAC definition?
  - According to the 2016 SRS Study, "prospects" included only 17% of the time, down from 24% in 2010*
  - Less prevalent in public deals where walk away right for MAC – none of the 278 deals surveyed in 2015-2016 included "prospects" in the definition**
- Quantify materiality?
  - According to a 2014 ABA Study, stated dollar amount included in MAC definition in none of the 117 deals surveyed***

* Source: 2016 SRS Acquiom M&A Deal Terms Study, analyzing private target deals between 2012 and the end of 2015 ("2016 SRS Study").

** Source: 2016 NP MAC Survey

***Source: 2014 Private Target Mergers & Acquisitions Deal Points Study ("2014 ABA Study")

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# NEGOTIATING MAC CLAUSES
# WHAT IS A MAC? (CONT'D.)

Inclusions and Carve-outs

- On average, 12.6 carve-outs per agreement*
- Disproportionate affects qualifier included in MAC definition 81% of the time*
- Changes in general economic conditions (89%)*
- Changes affecting industry as a whole (82%)*
- Changes in laws or regulations (88%)*
- Changes in interpretation of laws by courts or governmental entities (59%)*
- Changes in GAAP (82%)*
- Announcement of Agreement (83%)*
- Actions contemplated by the Agreement (81%)*

*Source: 2016 NP MAC Survey.

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# NEGOTIATING MAC CLAUSES
# WHAT IS A MAC? (CONT'D)

Inclusions and Carve-outs (each carve-out has the effect of diluting the definition from the perspective of the Buyer):

- Acts of war or major hostilities (85%)*
- Acts of terrorism (85%)*
- Acts of God (64%)*
- Failure to meet revenue or earnings projections (68%)*
- Changes in securities markets (82%)*
- Change in political conditions (73%)*
- Litigation resulting from any law relating to the agreement or the transactions contemplated (21%)*
- Changes in interest rates or exchange rates (38%)*
- Employee attrition (38%)*
- Reduction of customers or decline in business (39%)*

*Source: 2016 NP MAC Survey.

# APPLICATION OF MAC CLAUSES

During the past several years, MAC clauses were invoked in deals to acquire Genesco, Huntsman, HD Supply, Sallie Mae, Accredited Home Lenders, Cooper Tie and Rubber and, currently, Alere, among others.

In many of these cases, the bidders succeed in backing out of or renegotiating their deals, with litigation often resulting.

# NEGOTIATING MAC CLAUSES
# WHAT DOES CASE LAW TEACH US?

Case Law

— I*n re IBP, Inc. Shareholder Litigation* (Del. Ch. 2001) ("Tyson Foods")
  - Delaware court interpreting New York law
  - Tyson sought to terminate deal based upon sharp earnings decline of IBP
  - Court granted specific performance to IBP
  - In absence of specific language, earnings volatility does not constitute a MAC

— *Frontier Oil Corp. v. Holly Corp.* (Del. Ch. 2005)
  - Buyer sought to terminate for MAC based upon threatened toxic tort litigation
  - Court found that requisite likelihood of "catastrophic" result not established to constitute a MAC
  - Potential litigation costs of $15 million to $20 million relative to a deal size of approximately $340 million

# NEGOTIATING MAC CLAUSES
# WHAT DOES CASE LAW TEACH US?

— *United Rentals, Inc. v. Ram Holdings, Inc.* (Del. Ch. 2007)

- MAC clause excluded the condition of the credit markets in the United States
- However, specific performance not granted – the merger agreement was ambiguous on the subject and evidence established an understanding between the parties that the merger agreement barred the remedy of specific performance
- Cerberus acquisition subsidiary required to pay $100 million termination fee

# NEGOTIATING MAC CLAUSES
# WHAT DOES CASE LAW TEACH US?

— *Hexion Specialty Chemicals, Inc. v. Huntsman Corp.* (Del. Ch. 2008)

- No financing out
- Fairly typical MAC out (with limited carve-outs)
- Reverse break-up fee if buyer breached (no cap, if intentional breach)
- "Heavy" burden rests on party seeking to excuse performance and "poor earnings must be expected to persist significantly into the future" for decline in target's earnings to constitute MAC
- Court found no MAC; Buyer liable for all damages

# NEGOTIATING MAC CLAUSES
# EXAMPLE OF DISPUTE NOT LITIGATED

An example of a MAC-related dispute that was settled by the parties is the October 27, 2011 settlement between Innkeepers USA Trust and Cerberus Capital Management. The price was reduced by $100 million and other Buyer-favorable terms were approved. Note that the MAC clause at issue included "prospects"; did not have any carve-outs; and was governed by New York law. The basis for the MAC claim was a 30% drop in the Dow Jones U.S. Hotel & Lodging REIT Index after signing.

Notwithstanding the Seller-favorable case law, public company Sellers often settle these cases at a lower price for two reasons: (1) the Seller does not want to litigate and argue in court how badly it will be damaged by the MAC termination; and (2) the Seller and its shareholders are often happy to take the lower premium than risk litigation and an adverse decision resulting in no deal at all.

In connection with Abbott Labs' 2016 deal to acquire Alere. Abbot is seeking to invoke a MAC clause due to:

- Alere's late filing of SEC reports
- An SEC subpoena into Alere's revenue recognition practices in Africa
- A DOJ investigation into suspected FCPA issues in Africa, Asia and Latin America
- An NYSE stock delisting notice received by Alere

During this period, Alere also experienced other issues, including:

- Its disclosure in its annual report of material weaknesses in its internal controls
- A notice of revocation of its Medicare enrollment due to submitted claims for 211 dead patients
- A July 2016 voluntary recall of two products

In August 2016, Alere sued Abbott in Delaware Chancery Court to force the deal to closure and, in December, Abbott sued to terminate the deal on the basis that the MAC clause in the merger agreement has been triggered.

The case is pending.

# NEGOTIATING MAC CLAUSES
# WHAT DOES CASE LAW TEACH US?

Key Takeaways

- Party seeking to invoke MAC to avoid closing bears a “heavy burden” to show MAC has occurred
- Parties may reallocate burden of proof in agreement
- MAC ordinarily will be measured in years, not months (i.e., “consequential” change to long-term earnings rather than “short-term hiccup”)
- Reliance on general MAC provision to terminate will be difficult
- If possible, include important events as specifically targeted closing conditions (e.g., no material deterioration in target’s relationship with a key customer or supplier; minimum EBITDA, minimum cash, or maximum leverage ratio at closing) [more difficult, but not impossible, to do in a public deal]
- MAC will be viewed in context of entire agreement, not in isolation

# NEGOTIATING MAC CLAUSES
# DRAFTING CONSIDERATIONS

Case law is fact specific and does not provide uniform benchmarks or definitions. However, materiality standard almost certainly higher than securities law materiality threshold.

Caveat: No Delaware court has found a MAC to have occurred in the context of a merger agreement.

Exclusions/carve-outs are critical and must be carefully crafted

Buyer typically should insist on appropriate forward-looking component

Self-assess: who is the buyer, what is the purpose of the transaction, and what does the buyer know?

Coordinate representations and warranties (and other agreement provisions) with MAC

Language is key! In the world of MACs, one size does not fit all

# INDEMNIFICATION PROVISIONS IN M&A DEALS

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# NEGOTIATING INDEMNIFICATION PROVISIONS

An indemnity clause, if indemnification is the exclusive remedy for breaches of the acquisition agreement, limits or customizes the damages and remedies that would otherwise be available to the parties for a breach of a representation, warranty or covenant.

As a practical matter, the indemnity clause will be most important to the Seller because the Seller has the most exposure on its representations, warranties and covenants and is the party most often required to pay an indemnity claim.

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# NEGOTIATING INDEMNIFICATION PROVISIONS MATERIALITY SCRAPES

Definition of “Materiality Scrape”

— The Materiality qualifications in the representations and warranties are disregarded for the purpose of determining whether a breach of the agreement has occurred, provided that no such breach or breaches, individually or in the aggregate, constitute a MAC.

  - this type of “materiality scrape” is included in the Conditions to Closing Section.

# NEGOTIATING INDEMNIFICATION PROVISIONS MATERIALITY SCRAPES

- A materiality scrape in the Indemnification Section can provide that the materiality qualifications in the representations and warranties are disregarded for all indemnification purposes (determining breaches and calculating losses); or
- That the materiality qualifications in the representations and warranties are disregarded for calculation of losses only
- Here is an example: “For the sole purpose of determining Losses (and not for determining whether any breach of any representation or warranty has occurred), the representations and warranties of Seller shall not be deemed qualified by any references to materiality or Material Adverse Effect.”

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# NEGOTIATING INDEMNIFICATION PROVISIONS MATERIALITY SCRAPES (CONT'D.)

An increase in materiality scrapes was a product of an increasingly buyer-friendly environment, and their use has increased

— In 2015, materiality scrapes were used in about 84% of deals, up from about 69% between 2007 and 2010*

— In 2015, only about 19% of materiality scrapes were used to both determine breach and damages, while about 58% were used only to determine damages*

*2016 SRS Study (private target deals)

# NEGOTIATING INDEMNIFICATION PROVISIONS MATERIALITY SCRAPES (CONT'D.)

Sellers could use the presence of materiality scrapes to negotiate for other provisions, including higher baskets and deductibles

Materiality scrapes provide an additional incentive for sellers to list all items in the disclosure schedules

Buyers will argue the "materiality scrape" is necessary to avoid double materiality when the indemnification obligations are subject to a basket or deductible amount.

If materiality scrapes are used to determine whether a breach has occurred, the Seller's attorney will often seek to exclude certain reps from the materiality scrape so that these reps remain subject to a materiality or MAE qualifier

*2016 SRS Study (private target deals)

# NEGOTIATING INDEMNIFICATION PROVISIONS SURVIVAL PERIODS

## Survival Periods have remained relatively steady

In 2008 through 2015, the average survival period was 18 months*

However, the average additional intellectual property rep survival period in 2015 was 1 year or less (51%), followed by 1-2 years (27%)*

In 2015, the average additional tax rep survival period was the statute of limitations (77%)*

In addition to longer survival periods for breaches of certain reps, a claim for breach of the Seller's covenants survived for a longer period in 40% of the deals surveyed in 2014, down from 77% in 2010**

* 2016 SRS Study (private target deals);
** 2014 ABA Study

# NEGOTIATING INDEMNIFICATION PROVISIONS SURVIVAL PERIODS (CONT'D)

The most common carve-outs from a General Survival Period in 2015 were for:*

- Due Authority (87%)
- Capitalization (83%)
- Taxes (82%)
- Fraud (56%)
- Brokers/Finders Fees (52%)
- Intellectual Property (39%)
- No Conflicts (36%)
- Employee Benefits/ERISA (21%)
- Title to/sufficiency of Assets (17%)
- Environmental (6%)

* 2016 SRS Study (private target deals)

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# NEGOTIATING INDEMNIFICATION PROVISIONS "SANDBAGGING"

"Anti-sandbagging" provision limits the Seller's liability for losses resulting from breaches of representations or warranties if the Buyer had knowledge of the breach before the closing

"Pro-sandbagging" provisions (knowledge savings clauses) expressly provide that the Buyer's indemnification or other remedy is not affected by any knowledge of the Buyer

# NEGOTIATING INDEMNIFICATION PROVISIONS "SANDBAGGING" (CONT'D)

The 2016 SRS Study showed pro-sandbagging clauses in 52% of deals*

— Down from 64% in 2012*

Only 3% of deals in 2015 and 1% in 2014 had anti-sandbagging language*

The compromise position is to remain silent; note that in some jurisdictions, including New York, silence can be interpreted to result in an imputed anti-sandbag

— 45% of deals surveyed were silent in 2015*

*2016 SRS Study (private target deals)

# NEGOTIATING INDEMNIFICATION PROVISIONS BASKETS

Basket amounts have been stable

— In 2015, the average deductible basket for breaches of representations and warranties was approximately .74% of the Purchase Price*

— In 2015, the average first dollar basket for breaches of representations and warranties was approximately .64% of the Purchase Price*

Studies show more first-dollar baskets instead of deductible baskets, but the studies have some conflicting information

— 2016 SRS Study -- 30% deductible baskets, 64% first dollar baskets, 4% combination baskets and 2% no baskets in 2015*

— 2014 ABA Study -- 65% deductible baskets, 26% first dollar baskets, 7% combination baskets and 2% no baskets in 2014

— Baskets typically do not apply to claims based on a breach of the Seller's covenants

- Basket covered covenants in 22% of deals based on 2016 SRS Study
- Basket covered covenants in 38% of deals based on 2014 ABA Study

*2016 SRS Study (private target deals)

# NEGOTIATING INDEMNIFICATION PROVISIONS BASKETS (CONT'D)

Buyers may also request:

— Buyer may argue that the existence of the basket justifies a "materiality scrape" with respect to the indemnity because the Buyer considers breaches which cause damages greater than the basket to be material.

— Seller may seek a higher basket amount if there is a "materiality scrape" with respect to the indemnity.

# NEGOTIATING INDEMNIFICATION PROVISIONS BASKETS (CONT'D)

About 81% of deals in the 2016 SRS Study had one or more basket carve-outs*

— For Seller's breach of covenant or fraud

- In 2015, about 81% of deals included a carve-out for fraud; 43% for intentional breach of rep*

— For specific indemnity provisions

- The most common carve-outs are for the following representations: due authority (80%); capitalization (78%); taxes (73%); due organization (74%); share ownership (74%); brokers/finder fees (53%); no conflicts (30%); and intellectual property (27%)*

*2016 SRS Study (private target deals)

# NEGOTIATING INDEMNIFICATION PROVISIONS
# CAPS AS A PERCENTAGE OF TRANSACTION VALUE

Caps on indemnity claims for breaches of representations and warranties have remained relatively steady

— The 2016 SRS Study reflected an average cap of 13.9% in 2015

— The 2014 ABA Study found the average cap was 13.2% in 2014

# NEGOTIATING INDEMNIFICATION PROVISIONS
# CAPS AS A PERCENTAGE OF TRANSACTION VALUE (CONT'D.)

If cap is less than 100% of purchase price, Buyer may push to include cap carve-outs:

— For Seller's breach of covenant or fraud

- In 2015, about 89% of deals included a carve-out for fraud; 48% for intentional breach of rep*

— For specific indemnity provisions

- The most common carve-outs are for the following representations: due authority (86%); capitalization (81%); share ownership (76%); taxes (73%); and broker/finder fees (53%)*

* Source: 2016 SRS Study

# NEGOTIATING INDEMNIFICATION PROVISIONS ESCROW

Importance of Escrow or Set-off Rights

- Buyer's indemnification claims are ***unsecured claims***
  - This has heightened relevance if Seller files for bankruptcy post closing
- Escrow
  - Portion of purchase price may be placed in escrow
  - Term of escrow account
- Set-off Rights
  - Allow buyer to deduct indemnification amounts against future transaction payments or earn-out payments
  - Procedures for identifying setoff payments are critical
    - Time period of payments v. time of allowable indemnification claims

# NEGOTIATING INDEMNIFICATION PROVISIONS ESCROW (CONT'D)

Escrow periods have remained steady

— In 2013-2015, the median escrow period was 18 months*

Escrow amounts have also remained steadily high

— For 2015, the SRS Study showed an average escrow of 11.1%, similar to the average from 2009 through 2012*

— In the 2014 ABA Study, the average escrow amount was 10-15% of the purchase price in 2014

* 2016 SRS Study;  2012 SRS Study; and 2011 SRS Study

# REASSESSING COMMON PROVISIONS IN M&A DEALS

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# REASSESSING COMMON PROVISIONS CONSEQUENTIAL DAMAGES

Boilerplate provisions commonly exclude more than consequential damages

— Often exclude: Consequential, Incidental, Indirect, Special, Punitive Damages, Loss of Revenue/Income/Profits

# REASSESSING COMMON PROVISIONS CONSEQUENTIAL DAMAGES (CONT'D.)

Consequential damages:

— Compensate the Buyer for real losses resulting from Seller's breach of a representation or warranty

Incidental damages:

— Include expenses incurred by non-breaching party to avoid other losses caused by the breach

# REASSESSING COMMON PROVISIONS CONSEQUENTIAL DAMAGES (CONT'D.)

Incidental damages likely include out-of-pocket expenses incurred by buyers to remedy problems resulting from seller's breach

Thus, buyers should seek to exclude incidental damages from waiver provisions, although they are commonly included in boilerplate limitations of indemnity provisions

# REASSESSING COMMON PROVISIONS CONSEQUENTIAL DAMAGES (CONT'D.)

Types of damages/losses covered by the indemnity

- Consequential Damages
  - 2014 ABA Study – Expressly excluded (49%), silent (44%), expressly included (7%)*
  - 2016 SRS Report – Expressly excluded (32%), silent (61%), expressly included (7%)**
  - Determining what are "consequential damages" and what are direct or general damages remains difficult to apply in practice. (See Biotronik A.G. v. Conor MedSystems Ireland, Ltd. (NY Ct. of Appeals, March 27, 2014).

*2014 ABA Study

**2016 SRS Study

# REASSESSING COMMON PROVISIONS CONSEQUENTIAL DAMAGES (CONT'D.)

Types of damages/losses covered by the indemnity

- Punitive Damages
  - 2014 ABA Study – Expressly excluded (78%), Silent (21%)*
  - 2016 SRS Study – Expressly excluded (69%), Silent (27%), expressly included (4%)**
- Incidental Damages
  - 2014 ABA Study – Silent (74%), expressly excluded (22%), expressly included (4%)*
  - 2016 SRS Study – Silent (82%), expressly excluded (16%), expressly included (2%)**

*2014 ABA Study

**2016 SRS Study

# REASSESSING COMMON PROVISIONS CONSEQUENTIAL DAMAGES (CONT'D.)

Types of damages/losses covered by the indemnity

- Diminution in value
  - 2014 ABA Study –Silent (72%), expressly excluded (17%), expressly included (11%)*
  - 2016 SRS Study – Silent (70%), expressly excluded (12%), expressly included (18%)**

*2014 ABA Study

**2016 SRS Study

# REASSESSING COMMON PROVISIONS
# SURVIVAL CLAUSES

*GRT, Inc. v. Marathon GTF Tech. Ltd*.
(Del. Ch. July 11, 2011):

Survival Clause: the Design Reps would "survive for 12 months after the Closing Date, and will thereafter terminate together with any associated right of indemnification…." Indemnification was also the sole remedy for breach under the securities purchase agreement.

Plaintiff argued: the survival clause simply described the period during which a breach could occur, rather than the time period during which a claim had to be filed.

# REASSESSING COMMON PROVISIONS SURVIVAL CLAUSES (CONT'D)

**Delaware Chancery Court in GRT held:**

The Design Reps and the associated remedies would terminate one year after closing. In other words, the Survival Clause in this agreement, when viewed in the context of the entire agreement, would operate as a contractual statute of limitations. Unlike the case law in some other jurisdictions (notably New York and California), there is no public policy in Delaware that would construe narrowly a contract clause which seeks to shorten the statute of limitations.

The GRT court concluded that practitioners generally intend a survival clause to create a contractual statute of limitations.

# REASSESSING COMMON PROVISIONS SURVIVAL CLAUSES (CONT'D)

**What if the agreement had provided that the Design reps would "survive indefinitely" or "without time limit" ?**

The GRT court suggested that such a provision would be treated as running with the otherwise applicable statute of limitations.

Prior to 2014, there was a public policy in Delaware against lengthening the applicable statute of limitations by contract. Such a provision was generally viewed as being unenforceable in Delaware as a violation of public policy. (See *Shaw v. Aetna Life Insurance Co*., 395 A.2d 384, 386 (Del. Super. Ct. 1978).

# REASSESSING COMMON PROVISIONS SURVIVAL CLAUSES (CONT'D)

**What is the applicable Survival Period in Delaware?**

The applicable statute of limitations for a contract claim under an acquisition agreement appears to be three years from the accrual of the cause of action. (See 10 Del. Code Section 8106; *Certainteed Corp. v. Celotex Corp.*, 2005 Del. Ch. Lexis 11, 16 (January 24, 2005) (discussing the three year statute of limitations in the context of an asset purchase agreement).

Section 8106 of Title 10 of the Delaware Code was amended (effective August 1, 2014), to enable the parties to a written contract involving at least $100,000 to provide that any action based on such contract may be brought within a period specified up to 20 years from the accrual of the cause of action.

# REASSESSING COMMON PROVISIONS
# SURVIVAL CLAUSES (CONT'D)

**What is the applicable Survival Period in Delaware?**

— If the contract specified an indefinite period, then the action must nevertheless be brought prior to the expiration of 20 years from the accrual of the cause of action. (See Bear Stearns Mortg. Funding Trust 2006- SL1 v. EMC Mortg. LLC, 2015 Del. Ch. LEXIS 9)

— If the contract specified that a claim based on the breach of a representation or warranty would survive until 60 days after the expiration of the applicable statute of limitations, such claim must generally be brought within 3 years plus 60 days after the date of closing. (See Hydrogen Master Rights, Ltd. v. Weston, 2017 U.S. Dist. LEXIS 2694 (D. Del. Jan. 9, 2017).

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# REASSESSING COMMON PROVISIONS SURVIVAL CLAUSES (CONT'D)

**Application of Delaware Code, Title 10, Section 8106(c)**

- No specific language is required to be included in the acquisition agreement to have this longer survival period apply to the acquisition agreement (but it is advisable to provide for Delaware jurisdiction since a statute of limitations can sometimes be treated as procedural, so the statute of the forum would apply, rather than the law which governs the contract)
- The statutory changes apply retroactively to contracts entered into prior to August 1, 2014, unless a retroactive application would cause injustice. (See Bear Stearns Mortg. Funding Trust 2006-SL1, cited above)

# REASSESSING COMMON PROVISIONS SURVIVAL CLAUSES (CONT'D)

## Application of Delaware Code, Title 10, Section 8106(c)(Cont'd)

Sample clause from a recent acquisition agreement where the "Fundamental Representations" and covenants were intended by the parties to survive indefinitely:

> "Subject to the limitations set forth in Section 11.1 [Seller's indemnity] and Section 11.2 [Buyer's Indemnity], pursuant to Section 8106, Title 10 of the Delaware Code the parties hereto agree that a Proceeding may be brought by any of the parties to enforce the terms of this Agreement (and in the case of a breach, inaccuracy or nonfulfillment of any representation, warranty, covenant or agreement contained in this Agreement, a claim for indemnification under Article XI) at any time during the twenty (20) year period following the Closing Date, it being the intention of the parties that, except as otherwise provided in Section 11.1 and Section 11.2, the parties shall have the maximum amount of time permitted under the Laws of the State of Delaware to bring a claim or action related to this Agreement."

# YAHOO CYBERSECURITY BREACH

**Did the Yahoo! Cybersecurity breach constitute a "Business Material Adverse Effect" under the parties Stock Purchase Agreement?**

- In 2014 (2 years before the Stock Purchase Agreement was signed, but the breach was not disclosed until after it was signed) at least 500 million accounts were compromised.
- Yahoo! claims it was a state-sponsored attack
- Its stock fell 1.75% by the end of the trading day when the cyber attack was announced in 2016 and 5.35% during the next month.
- Analysts estimated that the value of Yahoo! was reduced by more than $1 billion as a result of the hack, but the long-term effects of the data breach are difficult to measure.

# YAHOO CYBERSECURITY BREACH (CONT'D)

- **What did the MAC clause say?**

"Business Material Adverse Effect" means any circumstance, event, development, effect, change or occurrence that, individually or in the aggregate…has had, or would or would reasonably be expected to have, a material adverse effect on the business, assets, properties, results of operation or financial condition of the Business, taken as a whole; provided, however, that none of the following shall constitute or be taken into account in determining whether a Business Material Adverse Effect has occurred or would reasonably be expected to occur for the purposes of this clause: … (iv) any change in the price or trading volume of Seller's securities, in and of itself; (v) any failure by Seller to meet published analyst estimates or expectations of Seller's revenues, earnings or other financial performance or results of operations for any period, in and of itself; (vi) any failure by Seller to meet its internal or published projections, budgets, plans or forecasts of its revenues, earnings or other financial performance or results of operations, in and of itself; (vii) any outbreak or escalation of hostilities or war or any act of terrorism, or any acts of God or natural disasters or other *force majeure* events; … provided, however, that the facts, circumstances, events, developments, changes, occurrences or effects set forth in clause[s] … (vii) above shall be taken into account in determining whether a Business Material Adverse Effect has occurred to the extent (but only to such extent) such circumstances, events, developments, changes or occurrences have a disproportionate adverse impact on the Business, relative to the other participants in the industries or markets in which the Business operates; provided, further, that the exceptions in clauses (iv) through (vi) above shall not prevent or otherwise affect a determination that the underlying cause of any failure or change referred to therein has had or contributed to a Business Material Adverse Effect.

# YAHOO CYBERSECURITY BREACH (CONT'D)

**If not a MAC, why was Verizon able to negotiate a $350 million (7.2%) reduction in the purchase price?**

- There were knowledge-qualified reps relating to no security breaches or theft or unauthorized access to Personal Data in the Seller's business, but the reps were also qualified by Business Adverse Effect.
- Verizon had negotiated for the right to terminate the Stock Purchase Agreement and pay a $144.8 million termination fee.

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# YAHOO CYBERSECURITY BREACH (CONT'D)

- Yahoo's business has been declining and it may not have wanted to face the prospect of selling itself again.
- Going to court is expensive, time-consuming and uncertain.
- According to the Wall Street Journal, Verizon and Yahoo agreed to a 50/50 split of any liabilities relating to lawsuits from consumers or partners relating to the hacks, and the selling entity will retain liability for the pending SEC investigation and shareholder suits relating to the deal itself.