

Delaware Supreme Court: Affirms Chancery Court Decision Finding a “Material Adverse Effect” for the First Time

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On December 7, 2018, the Delaware Supreme Court affirmed the Delaware Chancery Court’s decision in [Akorn v. Fresenius Kabi, 2018 WL 4719347 \(Del. Ch. 2018\) \(Laster, V.C.\)](#), which held that a buyer was justified in terminating a public company merger agreement on the basis that a Material Adverse Effect (“MAE”) had occurred. [Akorn v. Fresenius Kabi, 2018 WL 6427137 \(Del. 2018\) \(Strine, Jr., C.J.\)](#). An MAE, one of the key terms in an acquisition agreement, essentially defines when a buyer does not have to complete an agreed-upon acquisition as a result of an adverse change to a target’s business during the period between signing and closing.

Delaware courts to consider this issue have found that an MAE requires that “unknown events” threaten earnings potential in a “durationally-significant manner.” *IBP v. Tyson Foods*, 789 A.2d 14 (Del. Ch. 2001). In *Akorn*, the buyer terminated the merger agreement on the grounds that (1) significant declines in the target’s performance amounted to an MAE (and therefore, a failure of the standalone MAE condition), and (2) serious FDA compliance failures breached the target’s regulatory compliance representations in a manner that constituted an MAE (and therefore, a failure of the target’s ability to “bring-down” its representations and warranties at closing).^[1]

In a brief decision, the Delaware Supreme Court held that “[t]he factual record adequately supports the Court of Chancery’s determination, based on its application of precedent such as *IBP* . . . that [the target] had suffered a material adverse effect . . . that excused any obligation on [the buyer’s] part to close.” The Delaware Chancery Court further held that “[t]he record adequately supports the Court of Chancery’s declaration that [the buyer] properly terminated the merger . . . because [the target’s] breach of its regulatory representations and warranties gave rise to an MAE and [the buyer] had not itself engaged in a prior, material breach of a covenant that would have prevented [the buyer] from exercising its immediate termination rights under the Merger Agreement.”

^[1] Please [click here](#) to read our discussion of the Delaware Chancery Court’s decision in *Akorn*.

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