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ARTICLES

RISE AND FALL OF ORDINARY COURSE COVENANTS AND MAE CLAUSES: CASE AND TREND ANALYSIS

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RISE AND FALL OF ORDINARY COURSE COVENANTS AND MAE CLAUSES: CASE AND TREND ANALYSIS

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Table of Contents

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INTRODUCTION

In the United States, the ordinary course of business provision has received inadequate attention in the field of corporate mergers and acquisitions. As anyone in the field is probably aware, the ordinary course of business covenant ("OC Covenant") is one of the most common provisions included in almost every merger agreement.[1] Illustrated by the fact that there are remarkably few notable precedents for the OC Covenant,[2] despite its prevalence in merger agreements, notions of implementations and implications of the covenant have not drawn much attention from related professionals and scholars.

In turn, Material Adverse Effect Provisions ("MAE Provisions") have been "The Beatles" of mergers and acquisitions in the United States. Since its increased practical relevance from the subprime mortgage crisis,[3] many notable precedents have since proved and confirmed that the MAE Provisions' sophisticated and complex enforcement standards made this provision extremely difficult to execute in the real world.[4] However, in actual merger negotiations the provision has never stepped down from its celebrity status.[5] Many influential theorists view the MAE Provisions as having

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[1] The OC Covenant is generally treated as one of the basic components of the merger agreement and related cases and academic analysis do not doubt this status. *See, e.g.*, Akorn, Inc. v. Fresenius Kabi AG, No. 2018-0300-JTL, 2018 WL 4719347, at *82–84 (Del. Ch. Oct. 1, 2018), *aff'd*, 198 A.3d 724 (Del. 2018) (providing general guidance on purpose and scope of governance of OC Covenant with reference to a number of collective analysis and secondary sources assuming that OC Covenant is a common part of the merger agreement); *see also* Guhan Subramanian & Caley Petrucci, *Deals in the Time of Pandemic*, 121 COLUM. L. REV. 1405, 1405 (2021) (noting that OC Covenant is a common provision of the merger agreement).

[2] Subramanian & Petrucci, *supra* note 1, at 1426.

[3] *See* Andrew C. Elken, *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, 292 (2009) (discussing MAE disputes that erupted during the subprime mortgage crisis by showing that of thirteen high-profile cases, the four largest disputes ranged from $1.5 billion to $25.3 billion).

[4] *See* ChyronHego Corp. v. Wight, No. 2017-0548-SG, 2018 WL 3642132, at *9 (Del. Ch. July 31, 2018) (comparing MAE with a "Delaware tornado" to emphasize how rarely an MAE was recognized); *see also* Katelyn E. Bryant, *Bringing Down the Deal: Reevaluating the Delaware MAE Standard After* Akorn v. Fresenius, 51 SETON HALL L. REV. 815, 816 (2021) (mentioning that no Delaware case ever held for termination from an MAE until 2017).

[5] *See* John Prinzivalli, *Defining Materiality: Drafting Enforceable MAC Provisions in Business Combination Agreements Following* IBP v. Tyson, 8 No. 2 U.P.R. Bus. L.J. 162, 163 (2017); *see also* Bryant, *supra* note 4, at 816 (both articles mention MAE Provisions receive significant attention in regards to risk allocation of the merger agreement).

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absolute authority in connection with risk allocation during the time from signing agreements to closing the transaction, and with such recognition in past decades, the MAE Provisions holds an untouchable significance by being perceived as an attractive route to call off agreed transactions in a crisis.[6]

This Article proclaims that given recent trends in contract drafting and court decisions in connection with risk allocation during the interim period between signing and closing the merger, the role of the OC Covenant has been strengthened. To support this analysis, this Article will proceed as follows. Part I will introduce the general features and background for the MAE Provisions and the OC Covenant. Part II will introduce relevant risk allocation theories that have been suggested to govern risk allocation in order to present the history of important theories and their developments. Parts III and IV will examine features and developments of the MAE Provisions and the OC Covenant with case examinations and literature analysis. The sections will refer to the 2021 data examination that Professor Guhan Subramanian conducted by examining 1,293 merger agreements in the MergerMetrics Database.[7] The analysis will cover current structural shapes, as well as legal interpretation standards from meaningful precedents. Finally, Part V will propose a new understanding scheme for the risk allocation structure that implements and combines the academic theories, and drafting and litigation trends.

I. MAE AND OC: GUARDIANS OF THE INTERIM PERIOD

A. General Features of MAE Provisions and OC Covenant

For all corporate mergers and acquisitions that parties agree upon, an interim period between the effective date of the merger agreement and the deal closing inevitably occurs.[8] With the increasing complexity of current merger and acquisition trends, including convoluted tax structuring and

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[6] *See* Andrew P. McDonough et al., *The Coronavirus and M&A Transactions: MAE Clauses*, AG DEAL DIARY OF AKIN GUMP STRAUSS HAUER & FELD LLP (Mar. 6, 2020), https://www.akingump.com/en/experience/practices/corporate/ag-deal-diary/the-coronavirus-and-m-a-transactions-mae-clauses.html.

[7] Subramanian & Petrucci, *supra* note 1, at 1444.

[8] Robert T. Miller, *The Economics of Deal Risk: Allocating Risk Through MAC Clauses in Business Combination Agreements*, 50 WM. & MARY L. REV. 2007, 2012 (2009).

Vol. 41, No. 2 (2023) ● ISSN: 2164-7984 (online) ● ISSN 0733-2491 (print)
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regulatory compliances,[9] such an interim period is likely to become longer than the previous mergers and acquisitions with relatively simpler pre-conditions.

With lengthier interim periods, the extent of risk related to such period should also get larger. As revealed by the market turmoil, including the COVID-19 crisis, lengthier interim periods expose parties to more events and occurrences that may lead to merger terminations.[10] Under such conditions, the parties of the merger agreement are exposed to more internal and external changes and effects which may impact valuation and operational conditions of the target. Considering that changes in circumstances during the interim period may lead to termination of the deal and related damage claims,[11] importance of the risk allocation scheme is ever-growing.

As many of the risk factors like changes in general market and regulatory disruptions are not within the parties' control,[12] the drafters in the United States believed that it was better to figure out a contractual method to allocate the risks in connection with the interim period.[13] For the risk allocation, the drafters came up with a contractual feature called the MAE

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[9] Today, with rise of complex merger structures such as SPAC, the interim period will be likely to involve more layers and conditions such as additional capital investments like Private Investment in Public Equity (PIPE). *See* Anne Kirkwood, *The Role of Private Investment in Public Equity (PIPE) in Financing SPACs Business Combinations*, ALLEN & OVERY (June 1, 2021), https://www.allenovery.com/en-gb/global/news-and-insights/publications/the-role-of-private-investment-in-public-equity-pipe-in-financing-spacs-business-combinations.

[10] *See* Robert T. Miller, *Pandemic Risk and the Interpretation of Exceptions in MAE Clauses*, 46 J. CORP. L. 681, 682–84 (2021); *see also* Prinzivalli, *supra* note 5, at 166–67; *see generally* Stephen P. Younger et al., *COVID-19's Impact on Commercial Transactions and Disputes*, N.Y. STATE BAR ASS'N NEWS CENTER (Mar. 23, 2020), https://nysba.org/covid-19s-impact-on-commercial-transactions-and-disputes/.

[11] *See* Miller, *supra* note 10, at 682–84; *see also* Prinzivalli, *supra* note 5, at 166–67; *see generally* Younger et al., *supra* note 10.

[12] *See* Akorn, Inc. v. Fresenius Kabi AG, No. 2018-0300-JTL, 2018 WL 4719347, at *48–50 (Del. Ch. Oct. 1, 2018), *aff'd*, 198 A.3d 724 (Del. 2018) (discussing risk allocation features of MAE Provisions and how the feature allocates risks in accordance with which party has more control); *see generally* Miller, *supra* note 10 (proposing a new system of risk allocation during the interim period as those risks could not be fully prevented by the parties); *see, e.g.*, Snow Phipps Grp., LLC v. KCAKE Acquisition Inc., No. 2020-0282-KSJM, 2021 WL 1714202, at *35–36 (Del. Ch. Apr. 30, 2021) (holding that economic adverse effect from changes in government policies did not constitute an MAE under an exception designed to allocate the risk).

[13] *See* Subramanian & Petrucci, *supra* note 1, at 1411–13; *see also* Prinzivalli, *supra* note 5, at 164–66.

Provisions.[14] Merger agreements offer various features to govern risky situations that may disrupt the merger.[15] Representations and warranties provisions, which are enforced through bring-down conditions, enforce compliance with the representations and warranties.[16] There are also pre-closing covenants which control and govern the actions of the seller and the target until the closing of the merger.[17]

As a condition in the representations and warranties, the MAE Provisions governs risk allocation for matters that occur during the interim period between signing and closing of the merger.[18] Normally, the MAE Provisions is structured in two parts: a definition and a closing condition.[19] Along with other general bring-down conditions in the representations and warranties section, as a pre-condition in the representations and warranties section, the MAE Provisions requires that the target does not suffer any material adverse effect as defined in the Merger Agreements ("MAE").[20] While the events and aspects that constitute MAEs are defined under the MAE definition in the definition section of merger agreements, the specific features and application structures will be elaborated later with more detail.[21]

In addition to the MAE Provisions, the merger agreement commonly includes another feature called the OC Covenant.[22] Even though it also deals with some risk in connection with the interim period, the OC Covenant was structured to prevent something more specific than the general interim risks

[14] *See infra* Section III, Part A.

[15] *See* Ronald J. Gilson & Alan Schwartz, *Understanding MACs: Moral Hazard in Acquisitions*, 21 J.L. ECON. & ORG. 330, 336–38 (2005) (explaining terms in merger agreements that allocate risks in connection with the respective transactions); *see also* Robert T. Miller, *Canceling the Deal: Two Models of Material Adverse Change Clauses in Business Combination Agreements*, 31 CARDOZO L. REV. 99, 164–67 (2009) (explaining risk allocation of merger agreements and use of MAE Provisions).

[16] *See* Gilson & Schwartz, *supra* note 15, at 336–38 (explaining terms in merger agreements that allocate risks in connection with the respective transactions); *see also* Miller, *supra* note 15, at 164–67 (explaining risk allocation of merger agreements and use of MAE Provisions).

[17] *See* Gilson & Schwartz, *supra* note 15, at 336–38.

[18] *See id.*; *see also* Miller, *supra* note 15, at 104–05.

[19] *See generally* Miller, *supra* note 15, at 109–13 (explaining typical and general structure of MAE Provisions).

[20] *See id.*

[21] *See infra* Part III, Section A.

[22] *See* Subramanian & Petrucci, *supra* note 1, at 1417–18; *see also* Akorn, Inc. v. Fresenius Kabi AG, No. 2018-0300-JTL, 2018 WL 4719347, at *82–84 (Del. Ch. Oct. 1, 2018), *aff'd*, 198 A.3d 724 (Del. 2018).

that the MAE Provisions intends to cover.[23] Until the final closing after the interim period, the operational decision making and profit collection authorities of the target being transferred are still under control of the seller.[24] In other words, if there are no restrictive measures to constrain the operational malpractice of the seller, the seller may act in ways that are adverse to interests of the buyer with extreme or even illegal operational decisions,[25] as the seller has an incentive to take actions to collect more short-term profits which could harm long-term valuation of the target. Such moral hazard problems that the OC Covenant tries to prevent is certainly a significant risk in connection with the circumstances around the merger and the interim period. This moral hazard problem that the OC Covenant tries to prevent, however, has been treated as a risk separate from general risks of the interim period that the MAE Provisions intended to prevent.[26]

The OC Covenant has a relatively simple structure in comparison to the MAE Provisions.[27] Without any designated definition section, the OC Covenant is generally placed in the pre-closing covenant section of the merger agreement, which lays out specific pre-conditions for the closing.[28] Subject to formatting variations, the OC Covenant requires the seller to operate the target's business in compliance with the ordinary course that the target has been following prior to the signing.[29] If the seller makes extreme or extraordinary operational changes that are not within the ordinary course,

[23] *See* Subramanian & Petrucci, *supra* note 1, at 1417–18; *see also Akorn, Inc.*, 2018 WL 4719347, at *82–84.

[24] *See* Subramanian & Petrucci, *supra* note 1, at 1417–18; *see also Akorn, Inc.*, 2018 WL 4719347, at *82–84.

[25] *See, e.g.*, *Akorn, Inc.*, 2018 WL 4719347, at *1–4 (OC Covenant was violated in *Akorn* due to the various regulatory breaches of the target including disclosure and data management requirements); *see also, e.g.*, AB Stable VIII LLC v. Maps Hotels & Resorts One LLC, No. 2020-0310-JTL, 2020 WL 7024929, at *76–78 (Del. Ch. Nov. 30, 2020), *aff'd*, 268 A.3d 198 (Del. 2021) (OC Covenant was violated when the target fired over 5,200 employees, reduced operations significantly, and made other material operational changes due to COVID-19).

[26] *See* Subramanian & Petrucci, *supra* note 1, at 1410–11; *see also* Gilson & Schwartz, *supra* note 15, at 336–38.

[27] *See* Subramanian & Petrucci, *supra* note 1, at 1417–18; *see also Akorn, Inc.*, 2018 WL 4719347, at *82–84.

[28] *See* Subramanian & Petrucci, *supra* note 1, at 1417–18; *see also Akorn, Inc.*, 2018 WL 4719347, at *82–84.

[29] *See* Subramanian & Petrucci, *supra* note 1, at 1417–18; *see also Akorn, Inc.*, 2018 WL 4719347, at *82–84.

the transaction may be terminated under a breach of the OC Covenant.[30] Because of this straightforward nature, effects and legal implications of OC Covenants have been rarely specified or examined.[31] Additionally, the covenant has not been heavily discussed in litigation, though other conditions like the MAE Provisions, often enforced alongside this covenant, had their proper moments in precedents.[32] However, with the recent developments in *AB Stable VIII LLC v. Maps Hotel and Resorts One LLC*, this underestimated covenant revealed its force over general risk allocations of the interim period which were considered to be fully occupied by the MAE Provisions.[33]

II. Risk Allocation Theories

Reflecting crucial relevance of risks in connection with the interim period, there have been numerous theories to explain relevant risk allocation schemes.[34] Before *Akorn, Inc. v. Fresenius Kabi AG*, where the Delaware Court of Chancery officially accepted that the four risks theory ("Four Risks Theory") proposed by Professor Robert Miller governed risk features of the interim period,[35] there were a stream of risk allocation theories that received notable academic recognition.[36] Besides the Four Risks Theory, which was accepted as an official risk feature, there were two other theories that had mentionable presence: symmetry theory ("Symmetry Theory") and investment theory ("Investment Theory").[37]

All of these risk theories examine and explain their risk structures and allocation analyses with an overarching assumption that those risks are generally allocated through the MAE Provisions.[38] This Article believes, however, that through recent Delaware decisions, some of the risk allocation

30 *See* Subramanian & Petrucci, *supra* note 1, at 1417–18.

31 *See id.* at 1426–28.

32 *See generally Akorn, Inc.*, 2018 WL 4719347. *See generally* AB Stable VIII LLC v. Maps Hotels & Resorts One LLC, No. 2020-0310-JTL, 2020 WL 7024929 (Del. Ch. Nov. 30, 2020), *aff'd*, 268 A.3d 198 (Del. 2021).

33 *See* Miller, *supra* note 10, at 696–700; *see also AB Stable VIII LLC*, 2020 WL 7024929, at *57–59.

34 *See generally* Miller, *supra* note 10.

35 *See Akorn, Inc.*, 2018 WL 4719347, at *49–50; *see also* Miller, *supra* note 10, at 2071–91.

36 *See* Miller, *supra* note 10, at 2052–53; *see also* Gilson & Schwartz, *supra* note 15, at 335–37.

37 *See* Miller, *supra* note 10, at 2052–53; *see also* Gilson & Schwartz, *supra* note 15, at 335–37.

38 *See* Miller, *supra* note 10, at 2008–10; *see also* Gilson & Schwartz, *supra* note 15, at 330–34.

function has moved to the OC Covenant. This Article further assumes that the risks proposed by such theories were meant to reiterate risks, such as the risks, which the MAE Provisions has to address, that the merger agreement should generally hedge. This assumption may appear to contradict the actual statements in these risk theories that presumed full governance of the MAE Provisions. Nonetheless, considering that all of those theories are essentially about risks occurring in the interim period,[39] if it is convincing that the OC Covenant shares certain risk allocation responsibilities of the MAE Provisions, the new role of the OC Covenant will nicely fit into the risk allocation structure of those theories.

A. The Symmetry Theory

The Symmetry Theory presents the simplest allocation scheme among the three theories, featuring only two types of risks: upside risk and downside risk.[40] The theory proclaims that downside risk shall be allocated to the seller as the buyer naturally bears upside risk.[41] Upside risk represents the risks happening when the value of the target increases during the interim period.[42] As the name makes apparent, downside risk represents the risks happening when the target value decreases.[43] After suggesting the risk variables, the theory proclaims that the merger agreement shall allocate downside risk to the seller and upside risk to the buyer, as the seller can find a new buyer when there comes a better price for the target.[44]

When there is a merger agreement, the seller and the buyer agree to transfer ownership of a certain number of the target's shares for a specific price.[45] If the transaction proceeds as a cash-for-share transaction, the target's share is exchanged for a cash payment that is fixed at the effective date of

[39] *See* Miller, *supra* note 10, at 2052–53; *see also* Gilson & Schwartz, *supra* note 15, at 336.

[40] *See* Miller, *supra* note 10, at 2052–53; *see also* Gilson & Schwartz, *supra* note 15, at 336.

[41] *See* Miller, *supra* note 10, at 2053–55; *see also* Gilson & Schwartz, *supra* note 15, at 336.

[42] *See generally* Miller, *supra* note 10, at 2053–55.

[43] *See id.* at 2052–55; *see also* Gilson & Schwartz, *supra* note 15, at 336.

[44] For example, when the target's share price increases during the interim period, the seller may terminate the merger agreement and move to sell the shares to the other buyer which causes some upside risk to the buyer. And, the theory proclaims that to be fair, the merger agreement shall assign the related downside risks that occurs when there is a price drop to the seller. *See* Miller, *supra* note 10, at 2052–57; *see also* Gilson & Schwartz, *supra* note 15, at 336.

[45] *See* Miller, *supra* note 10, at 2052–57; *see also* Gilson & Schwartz, *supra* note 15, at 336.

the merger agreement.[46] If the transaction proceeds as either a share-for-share transaction or a cash-and-share transaction, the target's share is exchanged for a certain number of shares of another company that is being mixed with certain cash payments at times.[47]

No matter which transaction type is chosen, because cash price and exchange ratio for the target's shares are settled when the merger agreement is finalized, the fact that the interim period exists prior to the closing inevitably brings the risk that the seller and the buyer have different incentives over the future value of the target's shares after the effective date of the merger agreement.[48] According to the Symmetry Theory, in extreme cases, such characteristic of the merger transactions may make the merger agreement a *de facto* put option that provides the seller with an unfair advantage in selling the target's shares until closing.[49] The theory warns that to protect the buyer, such unfairness risks shall be treated properly.[50]

As fluctuation of share prices alone cannot fully explain the complex risk scheme of the interim period, and as commercially, the buyer may bear lesser risk than the seller with more commercial options, the Symmetry Theory may be an oversimplification of reality.[51] For example, in the share-for-share transaction, because future value of the new shares affects the value that the seller receives in exchange for the target, the seller bears at least a portion of upside risk. Complex circumstances like this example clearly shows that the Symmetry Theory does not fully explain how much downside risk the seller actually bears.[52] The perfect balance that the Symmetry Theory proclaims may be a wonderland of oversimplication.[53]

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[46] *See* Miller, *supra* note 10, at 2052–57.

[47] *See id.* at 2052–57; *see also* Gilson & Schwartz, *supra* note 15, at 336.

[48] Professor Miller alleged that in share-for-share and cash-and-share transactions, both the seller and the buyer had interest in increasing the future value of the target during the interim period as both of them will own the shares whose valuation will be moved in accordance with the target's operational success. However, even in those types of transactions, the ratio and the amount of partial cash payments are confirmed at the effective date of the merger agreement, the extent of the interests of the seller and the buyer in connection with the target's future values ought to be different. *See* Miller, *supra* note 10, at 2052–57.

[49] *See* Miller, *supra* note 10, at 2052–57; *see also* Gilson & Schwartz, *supra* note 15, at 336.

[50] *See* Miller, *supra* note 10, at 2052–57; *see also* Gilson & Schwartz, *supra* note 15, at 336.

[51] *See* Miller, *supra* note 10, at 2054–57.

[52] *See id.* at 2052–57; *see also* Gilson & Schwartz, *supra* note 15, at 336.

[53] *See* Miller, *supra* note 10, at 2054–57.

Vol. 41, No. 2 (2023) ● ISSN: 2164-7984 (online) ● ISSN 0733-2491 (print)
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B. The Investment Theory

Another notable risk theory on the interim period is the Investment Theory.[54] This theory also tries to picture the interim period with two risks, but with more realistic definitive assumptions than the Symmetry Theory.[55] Under the Investment Theory, the merger agreement shall manage two types of interim risks, endogenous and exogenous risks.[56] To blately summarize, an efficient merger agreement will impose endogenous risk on the seller and exogenous risk on the buyer.[57]

Endogenous risks are risks that result from the target's business decisions, such as costs and benefits from actions that the seller took or failed to take.[58] Exogenous risks in turn are risks that occur from general and external factors that do not involve business decisions of the target,[59] such as costs and benefits in connection with economic and industrial conditions or systematic and natural disasters.[60]

Just like the Symmetry Theory, the Investment Theory constructs its risk allocation scheme under the assumption that it is the buyer who has more interest in long-term prosperity of the target than the seller.[61] Instead of focusing on change in valuation during the interim period, the Investment Theory establishes a risk feature that factors in the business operation directly. During the interim period, the seller is still in control of the target's operational and administrative affairs.[62] Thus, the seller must bear endogenous risks in connection with such affairs as the seller has better control over such risks than the buyer.[63] Meanwhile, the buyer should bear exogenous risks because the buyer, who would operate the target after closing, becomes the better risk bearer for the exogenous risks that have long-term effects.[64] In addition to this risk allocation feature, the theory designs

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[54] *See id.* at 2056–70; *see also* Gilson & Schwartz, *supra* note 15, at 337.
[55] *See* Miller, *supra* note 10, at 2056–70; *see also* Gilson & Schwartz, *supra* note 15, at 336.
[56] *See* Miller, *supra* note 10, at 2056–57; *see also* Gilson & Schwartz, *supra* note 15, at 339.
[57] *See* Miller, *supra* note 10, at 2057; *see also* Gilson & Schwartz, *supra* note 15, at 339.
[58] *See* Miller, *supra* note 10, at 2057; *see also* Gilson & Schwartz, *supra* note 15, at 355–56.
[59] *See* Miller, *supra* note 10, at 2056–70; *see also* Gilson & Schwartz, *supra* note 15, at 339–40.
[60] *See* Miller, *supra* note 10, at 2056–70; *see also* Gilson & Schwartz, *supra* note 15, at 339–40.
[61] *See* Miller, *supra* note 10, at 2065–66; *see also* Gilson & Schwartz, *supra* note 15, at 346.
[62] *See* Miller, *supra* note 10, at 2057–60; *see also* Gilson & Schwartz, *supra* note 15, at 345–46.
[63] *See* Miller, *supra* note 10, at 2058–60; *see also* Gilson & Schwartz, *supra* note 15, at 356–57.
[64] *See* Gilson & Schwartz, *supra* note 15, at 349.

Vol. 41, No. 2 (2023) ● ISSN: 2164-7984 (online) ● ISSN 0733-2491 (print)
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other specific structures, such as the types of endogenous risks and certain theories behind its allocation scheme.[65] However, considering the level of complexity that the current drafting of the merger agreements involves, the theory seems to include some hasty assumptions that may not reflect the reality of risk allocation.[66] Once again, just like the oversimplication of the Symmetry Theory, the risk allocation variables in real life may not allow the clear-cut distinctions that the Investment Theory proposes.

C. The Four Risks Theory

Among those suggested risk allocation theories, the Four Risks Theory proposed by Professor Robert Miller, is probably the only interim risk theory with official case recognition.[67] Unlike other risk theories which attempt to establish a specific ideal of risk allocation,[68] the Four Risks Theory focuses on distinguishing types of risks allocated through respective provisions of the merger agreement.[69] The theory does provide a general sense of allocation scheme, but does not try to acclaim a specific allocation scheme.[70] By avoiding fitting factors into an ideal solution, this theory is able to cover more risk allocations.

The theory starts with an outright rejection of the key assumption of the Symmetry and Investment Theories: it does not grant that the buyer has a greater interest in the long-term prosperity of the target than the seller.[71] According to Professor Miller, under the current merger structure with complex end results, many transactions often structure long-term ownership of the seller which will make the long-term prosperity no less important than

[65] *See* Miller, *supra* note 10, at 2057–59; *see also* Gilson & Schwartz, *supra* note 15, at 337–39.

[66] *See* Miller, *supra* note 10, at 2057–70.

[67] *See* Miller, *supra* note 10, at 2071–91; *see also* Akorn, Inc. v. Fresenius Kabi AG, No. 2018-0300-JTL, 2018 WL 4719347, at *49–50 (Del. Ch. Oct. 1, 2018), *aff'd*, 198 A.3d 724 (Del. 2018); *see also* AB Stable VIII LLC v. Maps Hotels & Resorts One LLC, No. 2020-0310-JTL, 2020 WL 7024929, at *60 (Del. Ch. Nov. 30, 2020), *aff'd*, 268 A.3d 198 (Del. 2021).

[68] *See* Miller, *supra* note 10, at 2050–53.

[69] *See generally id.* at 2070–91 (describing the Four Risks Theory).

[70] Professor Miller proposes that systematic risks and agreement risks are generally allocated to the buyer, and indicator risks and business risks are generally allocated to the seller. However, it is generally understood that indicator risks are allocated to the buyer as well. *See* Miller, *supra* note 10, at 2008; *see also Akorn, Inc.*, 2018 WL 4719347, at *49–50.

[71] *See* Miller, *supra* note 10, at 2037.

Vol. 41, No. 2 (2023) ● ISSN: 2164-7984 (online) ● ISSN 0733-2491 (print)
DOI 10.5195/jlc.2023.256 ● http://jlc.law.pitt.edu

for the buyer.[72] Under this presumption, this theory begins its realm with outright rejection of the two predecessors.

The Four Risks Theory pictures its allocation scheme with four types of allocated risks: systematic risks, agreement risks, indicator risks, and business risks.[73] The theory notes that systematic risks and agreement risks are usually, but not always, shifted to the buyer, indicator risks are shifted in a minority of cases, and business risks are virtually always assigned to the seller.[74] The theory does not present a specific ideal structure, but rather tries to set a guiding principle.[75]

Systematic risks are the risks beyond control of all parties even though either party may be able to take steps to cushion the effects of such risks and will generally affect firms beyond the parties to the transaction.[76] Examples of relevant factors include economic damages, changes in accounting standards, or ongoing litigation.[77] Indicator risks are the risks that relate to certain presentable indicators that may signal adverse effects.[78] Examples of such indicators include a drop in the seller's share price, a downgrade in the credit rating, and a failure to meet a financial projection. This type of risk shall be considered as revealing signs of the adverse effects, rather than actual occurrence as those indicators may end up giving no effects on valuation, but should still be treated as a type of risk with substantial influence since those indicators may lead to influence on the target valuation.[79] Agreement risks are the risks in connection with public announcement of the merger agreement and related actions and reactions of the parties. Examples of such risks are employee departures or loss of customers resulting from the merger announcement.[80] Finally, business risks are the risks arising from the

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[72] *See id.* at 2037.

[73] *See* Miller, *supra* note 10, at 2008; *see also Akorn, Inc.*, 2018 WL 4719347, at *49; *see also AB Stable VIII LLC*, 2020 WL 7024929, at *60.

[74] *See* Miller, *supra* note 10, at 2073.

[75] *See id.* at 2071–91.

[76] *See* Miller, *supra* note 10, at 2071; *see also Akorn, Inc.*, 2018 WL 4719347, at *49; *see also AB Stable VIII LLC*, 2020 WL 7024929, at *60.

[77] *See* Miller, *supra* note 10, at 2071; *see also Akorn, Inc.*, 2018 WL 4719347, at *49–50; *see also AB Stable VIII LLC*, 2020 WL 7024929, at *60.

[78] *See* Miller, *supra* note 10, at 2071.

[79] *See* Miller, *supra* note 10, at 2071–72; *see also Akorn, Inc.*, 2018 WL 4719347, at *49; *see also AB Stable VIII LLC*, 2020 WL 7024929, at *60.

[80] *See* Miller, *supra* note 10, at 2072–73; *see also Akorn, Inc.*, 2018 WL 4719347, at *50; *see also AB Stable VIII LLC*, 2020 WL 7024929, at *60.

ordinary operations of the seller's business. This type of risk is usually under significant control of the seller's side. The most obvious examples of such risks will be sudden downfalls in ordinary business operations of the target after the merger agreement. The indication will be clearer if the downfall results despite the operation maintaining the control system as disclosed.[81]

Since the respective Delaware precedent recognizes the Four Risks Theory as the official risk allocation scheme,[82] this Article will conduct risk allocation analysis with this Four Risks Theory.[83] Considering that this risk theory starts with presumption that the two previous theories stand with wrong basic assumptions, the courts' open acceptance may indirectly indicate that the Four Risks Theory may be the only theory with recognizable validity. Moreover, recent decisions that appear to empower the OC Covenant may indicate that Delaware courts are attempting to provide a broader scheme that invites the OC Covenant to the risk allocation duty that has traditionally been treated as a realm of the MAE Provisions.[84]

III. MAE Provisions

As is apparent from the allegations and structured definitions of the risk theories for the interim period, the MAE Provisions has been acknowledged as the sole governor of risk allocation during the interim period.[85] Since its first appearance around 1947, the MAE Provisions has continued to enhance structural complexity of interim risk allocation.[86] For a long time, the provision generally used a boilerplate form that simply presented an event, change, occurrence, fact, or effect that would have an MAE on the business

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[81] *See* Miller, *supra* note 10, at 2073; *see also Akorn, Inc.*, 2018 WL 4719347, at *50; *see also AB Stable VIII LLC*, 2020 WL 7024929, at *60.

[82] *See Akorn, Inc.*, 2018 WL 4719347, at *49–50; *see also AB Stable VIII LLC*, 2020 WL 7024929, at *60.

[83] This direction does not mean that this Article moves to reject the merit of previous theories. As Professor Miller rejects the theories by alleging that the two previous theories do not adequately explain the risk allocation feature of MAE Provisions, this Article which is alleging to share some of the risk allocation roles to OC Covenants may indirectly refute certain points of Professor Miller. *See generally* Miller, *supra* note 10.

[84] *See Akorn, Inc.*, 2018 WL 4719347, at *49–50; *see also AB Stable VIII LLC*, 2020 WL 7024929, at *60.

[85] *See* Prinzivalli, *supra* note 5, at 165; *see also* Bryant, *supra* note 4, at 816.

[86] *See* Prinzivalli, *supra* note 5, at 166.

operation of the target.[87] However, with a landmark 2001 Delaware decision, *In re IBP*, recognizing the validity of the provision that justified termination of the leading chicken distributor in the United States, the MAE Provisions began to evolve to build its current complexity.[88]

A. General Structure

The MAE Provisions is comprised of two parts: a definition and a condition in the representations and warranties section.[89] The definition section iterates the qualification standards to determine whether an event or a fact constitutes an MAE.[90] Then, as the path to enforce the termination, the pre-condition that there should be no event or situation that constitutes an MAE is included as one of the pre-conditions in the representations and warranties section.[91] The materials that have structural relevance for enforcement of MAE Provisions are included in the definition section, which provides scrutiny standards for relevant risk allocations.[92]

1. Basic Definition

In modern MAE Provisions, the definition section is usually comprised of three components: a basic definition, carveouts and carvebacks.[93] Firstly, the basic definition component provides the original boilerplate language of the MAE Provisions.[94] The first part is generally presented with typical language that defines material adverse effect to be any event, occurrence, or condition that is reasonably expected to have a material adverse effect on the business, finance, or operational condition of the target and its subsidiaries.[95]

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[87] *See id.* at 166; *see also* Subramanian & Petrucci, *supra* note 1, at 1417.

[88] *See* Prinzivalli, *supra* note 5, at 166–67; *see also* Subramanian & Petrucci, *supra* note 1, at 1417. *See generally In re* IBP, Inc. S'holders Litig. v. Tyson Foods, Inc., 789 A.2d 14 (Del. Ch. 2001).

[89] *See* Miller, *supra* note 15, at 110–13.

[90] *See id.*

[91] *See id.* at 114–15.

[92] *See id.* at 112–15.

[93] Subramanian & Petrucci, *supra* note 1, at 1414.

[94] *See id.*

[95] *See id.*

A holistic interpretation of all the terms in the basic definition provides the central standard for determining the general features of MAE.[96]

In 2021, Professor Guhan Subramanian conducted an analysis of MAE Provisions and OC Covenants for 1,293 merger agreements of merger data stored in the MergerMetrics Database.[97] The merger agreements in the database were comprised of the agreements for the mergers and acquisitions that occurred within a fifteen year period, from 2005 to 2020.[98] Based on data from the analysis of Professor Subramanian, this Article will extract the recent drafting trends for MAE Provisions and OC Covenants and will examine the relevant risk allocation trends accordingly. For detailed analysis, please see a hypothetical basic definition section below:

> "Material Adverse Effect" shall mean any event, change, circumstance, effect, development or state of facts that, individually or in the aggregate, (a) has or would be reasonably likely to have a material adverse effect on (b) the business, assets, financial conditions, properties, liabilities, prospects or results of operations of the Target and its Affiliates, taken as a whole;

The portions other than sections (a) and (b) usually follow this boilerplate language without much variance in form or interpretation.[99] The sections with notable variances are the highlighted (a) and (b) sections. The highlighted (a) section arguably determines the scope of events that constitutes an MAE.[100] If the section is shaped without "would be reasonably likely to" language, the section could be interpreted to have a narrower scope that excludes events that would reasonably cause an MAE but have not yet caused such effect.[101] If the scope is set forth in the narrow form, the basic definition should be viewed to be written in favor of the seller.[102]

Reflecting the relevance, merger agreements are split nearly in half in choosing between those two available formats.[103] Forty-eight percent of the

[96] *See id.*

[97] *Id.* at 1444–48.

[98] *Id.*

[99] *See* Subramanian & Petrucci, *supra* note 1, at 1416–17.

[100] *See id.* at 1414–17; *see also* AB Stable VIII LLC v. Maps Hotels & Resorts One LLC, No. 2020-0310-JTL, 2020 WL 7024929, at *61 (Del. Ch. Nov. 30, 2020), *aff'd*, 268 A.3d 198 (Del. 2021).

[101] Snow Phipps Grp. v. KCAKE Acquisition Inc., No. 2020-0282-KSJM, 2021 WL 1714202, at *30 (Del. Ch. Apr. 30, 2021).

[102] *See generally* Subramanian & Petrucci, *supra* note 1, at 1414–17 (to understand how slight variations in language can shift the risk between buyer and seller).

[103] *See id.* at 1448.

agreements included the "reasonably likely" language while the remaining 52% of the agreements did not include the language.[104] The recent *AB Stable VIII LLC v. MAPS Hotels & Resorts One LLC* decision, however, arguably watered down the relevance of this section by specifically assigning the forward-looking interpretation role to the highlighted (b) section, ruling that the forward-looking interpretation may require inclusion of a specific objective dimension in the highlighted (b).[105] Without specific designation in the highlighted (b), the "reasonably likely" language may not include any events not yet occurred to be MAE.

The highlighted (b) section defines the objects and dimensions that would determine whether an effect constitutes an MAE in the merger agreement.[106] Being apparent from the language, the layout works by specifying objects and dimensions that would make an event an MAE if some damage or affect occurs from the relevant event.[107] Even though there have been active negotiations and formatting suggestions for this section,[108] until the recent *AB Stable* decision, this section did not take much of the courts' attention as none of the major cases included analysis specifically devoted to this section.[109] However, *AB Stable* in its analysis specified that the parties shall have included "prospects" in such objects and dimensions sections to invite the forward-looking events causing the adverse effects into the realm of the MAE.[110] The decision may be interpreted to provide more definitive meanings to the objects and dimensions included in this highlighted (b) section. The nature of the decision will be examined more in detail.[111]

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[104] *Id.*

[105] *See AB Stable VIII LLC*, 2020 WL 7024929, at *61–62; *see also* Miller, *supra* note 15, at 137; *see also* Miller, *supra* note 10, at 2045.

[106] *See AB Stable VIII LLC*, 2020 WL 7024929, at *62 (providing an example of such a section).

[107] *See generally* Subramanian & Petrucci, *supra* note 1, at 1414–17.

[108] Subramanian & Petrucci, *supra* note 1, at 1448 (The forms of the merger agreements in the gathered data vary greatly. For example, 91.3% included results in operations, 75.6% included financial condition, 59.6% included assets or liabilities, 59.6% included business, 24.5% included properties, and 1.5% included prospects.).

[109] *See generally* Akorn, Inc. v. Fresenius Kabi AG, No. 2018-0300-JTL, 2018 WL 4719347 (Del. Ch. Oct. 1, 2018), *aff'd*, 198 A.3d 724 (Del. 2018); Frontier Oil Corp. v. Holly Corp., No. 20502, 2005 WL 1039027 (Del. Ch. Apr. 29, 2005); IBP, Inc. v. Tyson Foods, Inc. (*In re* IBP, Inc. S'holders Litig.), 789 A.2d 14 (Del. Ch. 2001).

[110] *AB Stable VIII LLC*, 2020 WL 7024929, at *62.

[111] *See* discussion *infra* Part IV, Section B (iv).

2. Carveouts

The carveout component is generally perceived as the most important section of modern MAE Provisions, and are incentivized by the Delaware Court of Chancery's advice, that "had IBP wished such an exclusion . . . IBP should have bargained for it."[112] The carveout component has been building its presence both in interpretational relevance and specifications. Many of the related decisions refer to this component for their major determinations,[113] and reflecting this reality, this component is generally where passionate negotiations take place. The layout of the component is not as complex as the basic definition component. The component lists a number of risk categories that would exclude the particular type of event that each category represents so that the buyer bears the excluded risks.[114] The exceptions that are generally known to be included are general changes in economy, business, relevant industry, financial market, laws and regulations, accounting standards, and events that are beyond the control of the seller or the target such as war, *force majeure* events like natural disasters, and the adverse effects from announcing the merger or related transactions.[115]

Certain merger agreements include a causality connector between the basic definition and the carveouts.[116] The inclusion may require events at issue to directly cause the MAE.[117] If the parties interpret the language narrowly, none of the carveouts will apply to events that do not arise or result in the MAE.[118] However, the recent precedent does not seem to agree with the narrow interpretation. Both *AB Stable* and *Snow Phipps Group, LLC v. KCAKE Acquisitions, Inc.* dismissed arguments based on this narrow

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[112] *In re* IBP, Inc. S'holders Litig. v. Tyson Foods, Inc., 789 A.2d 14 at 66; *see* Prinzivalli, *supra* note 5, at 166.

[113] *See generally* discussion *infra* Part III, Section B. *See generally* discussion *infra* Part IV, Section B.

[114] *See Akorn, Inc.*, 2018 WL 4719347, at *49; *see also AB Stable VIII LLC*, 2020 WL 7024929, at *59; *see also* Subramanian & Petrucci, *supra* note 1, at 1414.

[115] *See* Subramanian & Petrucci, *supra* note 1, at 1414.

[116] According to the analysis of Professor Subramanian, 47% of the merger agreements included this causal requirement by including the language, "arising out of or resulting from." *See* Subramanian & Petrucci, *supra* note 1, at 1458.

[117] *See* Subramanian & Petrucci, *supra* note 1, at 1458.

[118] *See id.*

interpretation of the causal relationship.[119] In other words, even though the agreements vary in form, since these recent decisions, the difference of inclusion and non-inclusion of the causality phrase might have become miniscule.[120]

According to the analysis of Professor Subramanian, who examined 1,293 merger agreements from the years 2005–2020, the distribution and relative frequency of different exceptions are partitioned as set forth below:

[119] *See AB Stable VIII LLC*, 2020 WL 7024929, at *55–56; *see also* Snow Phipps Grp., LLC v. KCAKE Acquisition Inc., No. 2020-0282-KSJM, 2021 WL 1714202, at *35 (Del. Ch. Apr. 30, 2021).

[120] *See AB Stable VIII LLC*, 2020 WL 7024929, at *55–56; *see also Snow Phipps Grp., LLC*, 2021 WL 1714202, at *35.

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Title	Description	Inclusion Rate
Economy exception	Exception for change in economy or business in general	99%
Industry exception	Exception for change in general conditions of the specific industry	86%
Cap-market exception	Exception for change in securities markets	82%
Share price exception	Exception for change in trading price or trading volume of the company's share	77%
Interest rate exception	Exception for change in interest rates	22%
Exchange rate exception	Exception for change in foreign exchange rates	32%
Human-made disaster exception	Exception for acts of war, terrorism or hostilities (human-made disasters)	90%
Natural disaster exception	Exception for acts of God (natural disasters)	68%
Announcement exception	Exception for effects of the announcement of the transaction	95%
Action exception	Exception for changes caused by the taking of any actions required or permitted or in any way resulting from or arising in connection with the agreement	75%
Accounting exception	Exception for changes in GAAP	90%
Legal exception	Exception for changes in laws and regulations	85%
Projection exception	Exception for failing to meet forecasts or analyst projections	79%

[121]

The data shows that even though inclusion rates have some variance, the types of carveouts are gradually becoming standardized over time.[122] When the given data was re-sampled for the years 2010–2020, the standardizing

[121] *See* Subramanian & Petrucci, *supra* note 1, at 1444–59; *see also* Miller *supra* note 10, at 685–86.

[122] *See* Subramanian & Petrucci, *supra* note 1, at 1444–59.

trend became more apparent.[123] For those mergers, five carveouts (economy exception, announcement exception, human-made disaster exception, accounting exception, and projection exception) almost ubiquitously appear (more than 90%), and six carveouts (industry exception, legal exception, cap-market exception, share price exception, action exception, and natural disaster exception) appear in more than 80% of those agreements.[124] The data shows that other than some that are rarely included (interest rate exception and exchange rate exception), most of the merger agreements commonly include all of the eleven prevalent exceptions.[125]

3. Carvebacks

After the carveouts are presented, the MAE Provisions usually include exceptions for the introduced carveouts, which are called carveback provisions. Carveback provisions generally function by specifying several exceptions that will be subject to the carveback. The carveback language sets forth that certain events subject to carveouts will be carved back into MAEs if they, taken as a whole, do not disproportionately affect the target company relative to the other companies in the same industry.[126] Depending on how the merger agreement is negotiated, the carveout and carveback section may include certain language limiting the application of the MAE Provisions in a way that is seller friendly.[127]

According to the data gathered by Professor Subramanian, many of the carveouts were actually subject to the carveback provisions in most of the merger agreements. Other than a few carveouts (projection exception, share price exception, and action exception) that were not usually subject to the carvebacks, most of the carveouts were subject to respective carvebacks being triggered when the impact was not disproportionate.[128] This trend once again affirms that MAE Provisions for merger agreements are in the process of standardization.

[123] *See supra* text accompanying note 1, at 1444–59.
[124] *See supra* text accompanying note 1, at 1444–59.
[125] *See supra* text accompanying note 1, at 1444–59.
[126] *See supra* text accompanying note 1, at 1444–59.
[127] *See supra* text accompanying note 1, at 1414–15.
[128] *See id.*

B. Case Precedents

In compliance with the standardizing trend, case law for MAE Provisions has also experienced the process of standardization. The landmark *Akorn* decision from the Delaware Chancery Court reshaped the risk allocation standard in connection with MAE Provisions, and the subsequent *AB Stable* and *Snow Phipps* decisions colored the *Akorn* standard with additional details.[129]

1. Cases Before Akorn, Inc. v. Fresenius Kabi AG

Until *Akorn* officially implemented Professor Miller's risk allocation concept into the case law, major cases in connection with MAE Provisions had focused on the materiality aspect of determining MAEs. More specifically, the previous lines of cases focused on the issue of whether an event or a circumstance constituted an MAE, as the following discussion will show:

a. In re IBP

The well-known landmark MAE case from the Delaware Chancery Court, *In re IBP*, established the first determination standard for the materiality of an MAE.[130] This specific performance claim that arose out of the $4.5 billion acquisition of IBP, a meat processor, against a chicken distribution giant, Tyson, legitimately determined the basic standard for MAE determination for the first time.[131] Prior to this landmark case, no Delaware precedent had decided on the MAE.[132] There had been some notable New York cases,[133] but none of the cases provided a clear direction in terms of confirming occurrence of an MAE.[134]

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[129] *See* Akorn, Inc. v. Fresenius Kabi AG, No. 2018-0300-JTL, 2018 WL 4719347, at *48–56 (Del. Ch. Oct. 1, 2018), *aff'd*, 198 A.3d 724 (Del. 2018); *see also* AB Stable VIII LLC v. Maps Hotels & Resorts One LLC, No. 2020-0310-JTL, 2020 WL 7024929, at *59–63 (Del. Ch. Nov. 30, 2020), *aff'd*, 2021 WL 5832875 (Del. 2021).

[130] *In re* IBP, Inc. S'holders Litig. v. Tyson Foods, Inc., 789 A.2d 14, 68 (Del. Ch. 2001).

[131] *Id.*

[132] *Id.*

[133] *See* Elken, *supra* note 3, at 311.

[134] *See In re* IBP, Inc. S'holders Litig., 789 A.2d at 68.

Whether intended or unintended, this influential case is significant in regard to settling two basic standards for MAE determinations. Firstly, this case sets forth that for the event to become an MAE, at least some substantial or long-term harm shall occur rather than a short-term dent.[135] The standard is confirmed by one of the most cited remarks on the MAE below:

> [m]erger contracts are heavily negotiated and cover a large number of specific risks explicitly. As a result, even where a [MAE] condition is as broadly written as the one in the Merger Agreement, that provision is best read as a backstop protecting the acquir[e]r from the occurrence of unknown events that substantially threaten the overall earnings potential of the target in a durationally-significant manner. A short-term hiccup in earnings should not suffice; rather the Material Adverse Effect should be material when viewed from the longer-term perspective of a reasonable acquir[e]r.[136]

As the chosen tones coming from "durationally-significant" and "short-term hiccup" obviously reveal, this ruling sets a very high threshold for an event to constitute an MAE.[137] In reality, this ruling became the starting point for a long lasting inference, where the Delaware Courts made the MAE Provisions almost a moot provision that was extremely unlikely to trigger termination.[138] Unless there were substantial long-term adverse consequences from the occurred event, the event would not be treated as an MAE even though there was enormous short-term significance. Here, the court proved the high threshold by ruling that the short-term decrease in IBP's share price did not constitute an MAE.[139] In the court's view, the decrease did not damage the long-term value.[140] This landmark case did not provide a specific methodology for determining the long-term effect specific comparison standard, but rather simply compared the short-term performance drops with existing projections and ruled that the event was not an MAE.[141] This ruling did succeed in establishing the general sentiment that an MAE would not be acknowledged without significant long-term consequences material to the defined objects and dimensions in the MAE

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[135] *See id.*

[136] *Id.*

[137] *See* Elken, *supra* note 3, at 312.

[138] *See* Bryant, *supra* note 4, at 816.

[139] *See In re* IBP, Inc. S'holders Litig. v. Tyson Foods, Inc., 789 A.2d 14, 65–68 (Del. Ch. June 18, 2001).

[140] *See* Bryant, *supra* note 4, at 821; *see also In re* IBP, Inc. S'holders Litig., 789 A.2d at 65–68.

[141] *See In re* IBP, Inc. S'holders Litig., 789 A.2d at 65–68.

Provisions.[142] Such sentiment continues to survive in the cases after *Akorn*, as this ruling is repeatedly cited as a fundamental concept for determining applicable MAE materiality.[143]

Secondly, this case initiated the conventional MAE drafting with an exhaustive list of exceptions. As the court directly noted, one of the intended results of *IBP* was to prevent producing extremely detailed MAE Provisions with numerous carveouts and qualifiers.[144] In the late 1990s, when this $4.5 billion transaction was negotiated, including a number of specific exceptions was not conventional for merger agreements.[145] And, following this trend, the MAE Provisions in *In re IBP* did not include exhaustive carveouts either.[146] However, as it rejected IBP's argument that the warranted financial documents warned of the risks in connection with the livestock supply, the court noted, "[h]ad IBP wished such an exclusion from the broad language of [MAE Provisions], IBP should have bargained for it."[147] The court specifically mentioned that it had no intention of expanding the negotiable language and terms of the MAE Provisions.[148] However, the side note made clear that if a party wanted to exclude a risk from constituting an MAE, an exception confirming such exclusion ought to be included.[149] And, this note evolved to establish current MAE language, including a nearly exhaustive list of carveouts.[150]

b. Frontier Oil Corp. v. Holly Corp.

While *IBP* did not suggest a specific methodology for MAE determination, another landmark case in 2005, *Frontier Oil Corp. v. Holly Corp.*, settled the determination standard for whether an event or a

[142] *See id.* at 79–82.
[143] *See* Akorn, Inc. v. Fresenius Kabi AG, No. 2018-0300-JTL, 2018 WL 4719347, at *53 (Del. Ch. Oct. 1, 2018), *aff'd*, 198 A.3d 724 (Del. 2018).
[144] *In re* IBP, Inc. S'holders Litig., 789 A.2d at 68 n.155.
[145] *See* Prinzivalli, *supra* note 5, at 166–67; *see also* Miller, *supra* note 15, at 138.
[146] *In re* IBP, Inc. S'holders Litig., 789 A.2d at 65–66.
[147] *Id.* at 66.
[148] *See id.* at 68 n.155.
[149] *See id.* at 65.
[150] *See* Prinzivalli, *supra* note 5, at 166–67; *see also* Miller, *supra* note 15, at 138.

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circumstance constitutes an MAE.[151] This $338 million merger case for an oil distributor determined whether prospective costs and financial impacts of a litigation defense against Erin Brockovich would constitute an MAE.[152] The buyer estimated the prospective cost for the litigation defense would be $40–50 million for the first trial alone, and ultimate exposure could potentially reach to the range of $500 million–$1 billion.[153]

Notably, this case was the first Delaware case that implemented the New York decision of *IBP*.[154] *IBP* applied New York law in compliance with the governing law provision of the merger agreement.[155] Thus, even though the decision was made in the shareholder's lawsuit in the Delaware Chancery Court, the case made determinations in regards to relevant New York law application.[156] This merger case of two oil distributors implemented the fundamental MAE standard established in *IBP* by affirming the Delaware application of the *IBP* standard.[157] Considering that many large corporations in the United States are established in Delaware, this case has expanded the effective scope of *IBP*, which was originally used to be limited to the corporations in New York, to most corporations in the United States.

Rather than simply unifying the MAE fundamentals of New York and Delaware, this case moved one step further by adding another layer to the MAE examination. Other than requiring a presence of long-term damages and impacts, the *IBP* ruling did not set forth a specific determination methodology for MAE determinations.[158] To supplement the rather simple analytical structure, *Frontier Oil* added another layer with the concept of qualitative and quantitative aspects.[159] Unlike *IBP*, whose analysis was solely based on comparisons to performance projections which were purely quantitative,[160] *Frontier Oil* attempted to emphasize that there was aspects

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[151] *See generally* Frontier Oil Corp. v. Holly Corp., No. 20502, 2005 WL 1039027 (Del. Ch. Apr. 29, 2005).
[152] *See id.* at 33.
[153] *See id.* at 21.
[154] Prinzivalli, *supra* note 5, at 167.
[155] *In re* IBP, Inc. S'holders Litig. v. Tyson Foods, Inc., 789 A.2d 14, 54–55 (Del. Ch. 2001).
[156] *See id.* at 65–68.
[157] *See* Prinzivalli, *supra* note 5, at 166; *see also Frontier Oil Corp.*, 2005 WL 1039027, at *34.
[158] *See In re* IBP, Inc. S'holders Litig., 789 A.2d at 68.
[159] *See Frontier Oil Corp.*, 2005 WL 1039027, at *37.
[160] *See In re* IBP, Inc. S'holders Litig., 789 A.2d at 68–69.

other than numeral aspects in regards to the MAE determination.[161] Specifically, the court ascertained that considering the enterprise value of Frontier Oil, the target would be able to pay the legal expenses in the long term so that the litigation conflict did not constitute an MAE.[162] This distinction, however, has not yet received much focus as later cases generally focus on the quantitative aspect of the MAE.

c. Hexion Specialty Chemicals Inc. v. Huntsman Corp.

Hexion Specialty Chemicals Inc. v. Huntsman Corp., a dispute among two chemical corporations over a $10 billion merger, provides reassurance that the application of the long-term impact set forth by *IBP* imposes a heavy scrutiny on MAE determination.[163] The Chancery Court ruled that the buyer shall have complied with the specific performance of the closing as the three alleged shortfalls did not constitute an MAE.[164] Specifically, the determination was threefold: (i) considering the macroeconomic challenges during the relevant time, the 19.9% drop in the EBITDA comparison of first quarter results from 2007 and 2008 did not constitute an MAE;[165] (ii) the 5% increase in net debt was immaterial for the MAE determination;[166] and (iii) underperformance of a certain portion of the business which constituted 25% of the target's operation could not constitute an MAE as the MAE determination shall take into account the operation as a whole.[167] In short, the *Hexion* decision reassured that the determination standard of *IBP* imposes a high bar.[168]

In addition to re-affirming *IBP*, this case also confirmed the rule for determining who had burden of proof for the MAE.[169] For the first time, the decision affirmed that the burden of proof shall be borne by the party who

[161] *See Frontier Oil Corp.*, 2005 WL 1039027, at *37.
[162] *See id.*
[163] *See* Prinzivalli, *supra* note 5, at 174.
[164] *See* Hexion Specialty Chems., Inc. v. Huntsman Corp., 965 A.2d 715, 740–44 (Del. Ch. 2008).
[165] *See id.* at 743.
[166] *See id.* at 744.
[167] *See id.* at 744–45.
[168] *See generally id.*
[169] *See id.* at 739–40 (stating that "the burden of proof with respect to a material adverse effect rests on the party seeking to excuse its performance under the contract").

would be excused from the performance under the merger agreement unless there was clear language to the contrary.[170]

2. Akorn, Inc. v. Fresenius Kabi AG

As explained above, in analyzing details such as rulings on exceptions, quantitative and qualitative aspects, and burden of proof, the cases following *IBP* did not go much further than re-affirmation of required long-term effects against the MAE objects. Moreover, as all of those cases rejected the alleged occurrences of the MAE, some asserted that the Delaware Courts made the MAE Provisions nearly toothless.[171] And, the landmark *Akorn* case, by recognizing the occurrence of the MAE for the first time since the modern MAE Provisions was established, effectively reshaped the general legal atmosphere of case law for MAE Provisions when compared with earlier cases.[172]

This landmark litigation broke out between two bio-chemical corporations, Fresenius Kabi AG and Akorn, Inc.[173] After discovering that the seller entity, Akorn, Inc. was hiding its significant incompliance with data and quality compliance standards, the buyer, Fresenius Kabi, declared that the inaccurate disclosure, combined with the operational downturn that the target was experiencing, amounted to a detrimental harm in corporate value that constituted an MAE.[174] Despite counter-arguments from the seller, the court held for the buyer and recognized presence of an MAE.[175] This 2018 case was the first MAE case to reach a final MAE judgment since the *Hexion* case in 2008, and considering that this case was the first Delaware case that recognized occurrence of the MAE, this case has remarkable significance. However, the central elements of this case comes from its specific legal elements.

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[170] Considering burden of proof for each section of the merger agreement generally has a specific allocation method for its burden of proof, this method that practically places a testing standard is pretty unique. *See id.* at 740.

[171] *See* Prinzivalli, *supra* note 5, at 174; *see also* ChyronHego Corp. v. Wight, No. 2017-0548-SG, 2018 WL 3642132, at *9 (Del. Ch. July 31, 2018).

[172] *See* Prinzivalli, *supra* note 5, at 174.

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

[174] *Id.*

[175] *See id.* at *4.

This landmark MAE case arising out of an acquisition of a bio-chemical specialist highlights a couple of notable points: (i) this case proved that recognition of an MAE through the material event was possible; and (ii) this case officially acknowledged Professor Miller's Four Risk Theory.[176]

As the first Delaware case to accept the presence of a general MAE,[177] *Akorn* ended the long-standing presumption that presence of a general MAE was not something a Delaware Court would ever recognize. Considering that the MAE Provisions is almost always included in most of the merger agreements prior to *Akorn*, it would be absolutely reasonable to presume that there existed a very high bar against acceptance of the general MAE which was nearly improbable to be satisfied, as no precedent accepted the general MAE.[178] By recognizing the existing general MAE, *Akorn* case made it clear that such recognition was possible in the Chancery and Supreme Court of Delaware. Because the reasoning focused on the quantitative analysis of the operational performance of *Akorn*, the case did not openly move to establish a new concrete examination standard.[179] However, as the case was the first official factual recognition of a general MAE,[180] the numerous justifications described by the court should leave strong benchmarks for later MAE cases.

The court in *Akorn* presented several reasons for recognizing the general MAE.[181] First, the court explained that the quarterly results for corporate earnings declined for more than 50% for two consecutive quarters during the interim period.[182] The court, making a reference to a 1990 Delaware case and some holdings from other states, ruled that drops with such size and extent must be treated as an MAE.[183] The comments and references of the *Akorn* holding made it clear that, when there are two consecutive drops in corporate earnings for longer than two consecutive quarters, the earnings results will

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[176] *See id.* at *49.

[177] *See* Bryant, *supra* note 4, at 824–26.

[178] *See id.*

[179] *See Akorn, Inc.*, 2018 WL 4719347, at *53–57.

[180] *See* Raskin v. Birmingham Steel Corp., Civ.A. No. 11365, 1990 WL 193326, at *5 (Del. Ch. Dec. 4, 1990) (explaining that the court indirectly set a quantitative threshold to the recognition of the MAE, stating "While it is possible that on a full record and placed in a larger context one might conclude that a reported 50% decline in earnings over two consecutive quarters might not be held to constitute a material adverse development, it is . . . unlikely to think that might happen").

[181] *See generally Akorn, Inc.*, 2018 WL 4719347, at *53–57.

[182] *See id.*

[183] *See id.* at *53.

be seriously considered to determine whether there is an MAE.[184] Additionally, the case held that the duration of the earnings drop was significant.[185] The court gave some weight to the fact that the downturn lasted for longer than a full year.[186] Relying on the expert reports, the court interpreted that such a trend had enough durational significance to constitute an MAE.[187]

Lastly, the court rejected the seller's notion that the loss resulting from the merger must be shown to prove the MAE for two reasons.[188] First, the court discussed that since considerations for the MAE were specifically dealing with the operational status of the target, examinations of the MAE should be conducted on a stand-alone basis for operations of the target.[189] Second, the court explained that if the merger resulted in a loss, acceptability of the merger was a matter of the common law doctrine frustration of purpose.[190] Specifically, as the issue of lost benefits of the merger already had a designated common law doctrine for it, requiring such a loss for the MAE determination would reduce the MAE provision to become a mere restatement of an existing common law doctrine, which would not likely be the intention of the parties with sophisticated contractual understanding.[191] By rejecting the application of all of these alleged exceptions, the Delaware Chancery Court decided to apply the general MAE provision.[192] The court also ruled that *Akorn*'s breach of disclosure standards for its testing results also had material enough adverse consequences to bring down the merger with breach of representation.[193] The rulings in connection with the testing results were about facts very specific to the case, which may not have as much significance as the general MAE holding.[194]

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[184] *See generally id.* at *53–55.
[185] *See id.* at *53.
[186] *See id.* at *55.
[187] *See id.*
[188] *See id.* at *57.
[189] *See id.* at *56.
[190] *See id.* at *57.
[191] *See id.* at *60.
[192] *See id.* at *61 (rejecting the application of an industry exception or an announcement exception).
[193] *See id.* at *64–67.
[194] *See id.*

This case became a landmark decision as the court implemented the Four Risks Theory into its decision for the first time.[195] The significance of this decision is discussed further in Part V.[196]

3. Akorn *and Thereafter*

As a show of significance of the *Akorn* ruling in terms of general MAE, recent cases decided after *Akorn* have focused on application of carveouts.[197] Some substantive rulings on the basic definition of MAE determined when qualifier "prospects" had to be specifically included to make forward-looking examination of an MAE event,[198] but all cases after *Akorn* rejected the MAE application based on applying an MAE carveout.[199] Moreover, these cases expanded analytic depth of the OC Covenant which shows that courts are moving to expand the role of the OC Covenant.[200] This trend and implementation of the Four Risks Theory will be explained further in detail in Part V.[201]

IV. OC COVENANT

Unlike the MAE Provisions, which has always stayed at the center of the risk allocation analysis of the interim period, the role of the OC Covenant in risk allocation for the interim period is an area that has not been explored expansively.[202] Since the MAE Provisions was introduced decades ago to deal with the risk allocation during the interim period between the signing and the closing, it has been treated as an absolute authority governing the interim risk allocation.[203] The OC Covenant has mainly been acknowledged

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[195] *See id.* at *49–50.

[196] *See infra* Part V.

[197] *See, e.g.*, Snow Phipps Grp., LLC, v. KCAKE Acquisition Inc., 2021 WL 1714202, at *30–35 (Del. Ch. Apr. 30, 2021); *see also, e.g.*, AB Stable VIII LLC v. Maps Hotels and Resorts One LLC, No. 2020-0310-JTL, 2020 WL 7024929, at *60–63 (Del. Ch. Nov. 30, 2020).

[198] *See AB Stable VIII LLC*, 2020 WL 7024929, at *62.

[199] *See, e.g.*, *AB Stable VIII LLC*, 2020 WL 7024929, at *58–59; *see also, e.g.*, *Snow Phipps Grp., LLC*, 2021 WL 1714202, at *34–35.

[200] *See infra* Part V.

[201] *See id.*

[202] Subramanian & Petrucci, *supra* note 1, at 1426.

[203] *See generally id.* at 1413–17.

for its preventive function against moral hazards in operational decisions of the seller and the target during the interim period.[204] However, the prevention of moral hazards did not attract strong legal or practical attention, as the MAE Provisions already appeared to govern all adverse consequences that may result from a moral hazard problem with its extensive definition structure and exceptions.[205]

In recent decisions, this standard provision is gaining more structural importance. Although the *Akorn* case provided for recognition of general MAE,[206] the convoluting structural application of the MAE Provisions is still a very strong hurdle against MAE recognition. Reflecting this reality, recent Delaware cases appear to uncover the allocation capability of the OC Covenant with more examinations and recognitions. The decision trends are revealing an enhanced role of the OC Covenant in risk allocation, which is discussed further in Part IV, Section B.[207]

A. General Structure

As briefly noted, the OC Covenant has a simpler drafting structure than the MAE Provisions.[208] Generally, relevant language of the covenant is placed in a portion of the covenant section of the merger agreement which lays out specific pre-conditions of closing.[209] Formatting of this covenant varies but typically requires the target to operate in a manner that preserves ordinary operational activities prior to signing a merger agreement.[210] Unlike the MAE Provisions, the OC Covenant normally does not have a designated definition section, but it provides the relevant terms in the covenant section with a straight forward form.[211]

The OC Covenant is typically structured in two parts: a general affirmative ordinary course covenant ("General Covenant") and a specific

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[204] *See id.* at 1417–18.

[205] *See id.*

[206] *See generally* Akorn, Inc. v. Fresenius Kabi AG, No. 2018-0300-JTL, 2018 WL 4719347 (Del. Ch. Oct. 1, 2018), *aff'd*, 198 A.3d 724 (Del. 2018).

[207] *See generally infra* Part IV, Section B.

[208] *See generally* Subramanian & Petrucci, *supra* note 1, at 1417–19.

[209] *See id.* at 1417.

[210] *See id.*

[211] *See generally id.* at 1417–19.

affirmative and negative covenant ("Special Covenant").[212] As the titles of sections make apparent, the General Covenant provides requirements to comply with operations in line with the ordinary courses that the target has been operating prior to signing the merger agreement.[213] Meanwhile, the Special Covenant provides more specific guidelines with particular affirmative or negative covenant provisions restricting actions of the target and the seller.[214] In layman's terms, the General Covenant grants maintenance of the ordinary course of business operation for the overall operation of the target, while the Special Covenant places specific restrictions on prohibited actions whose ban would preserve the ordinary course of business operations.[215] As noted, because the OC Covenant has not yet received much scholarly and practical attention, the formats of it are hardly standardized.[216] Nonetheless, with a number of qualifiers that are generally shared in the forms of OC Covenants, functionality of the covenant operates in a fairly predictable manner.

1. Three Important Qualifiers

Even though there has been relatively little standardization for the OC Covenant, most of the covenants share several key qualifiers for its scope of governance. In summary, there are three types of qualifiers commonly included in OC Covenants, namely the past practice qualifier; the materiality qualifier; and the efforts qualifier. Considering that the Delaware court has a tendency to interpret the language of OC Covenants quite literally,[217] each qualifier should be understood to have a strong significance of its own.

a. Past Practice Qualifier

The first key qualifier is a past practice qualifier. This prevalent qualifier for OC Covenants is usually included in the General Covenant with a

[212] *See id.* at 1462.
[213] *See id.* at 1419.
[214] *See id.*
[215] *See id.*
[216] *See id.*
[217] *See* AB Stable VIII LLC v. Maps Hotels & Resorts One LLC, No. 2020-0310-JTL, 2020 WL 7024929, at *70–71 (Del. Ch. Nov. 30, 2020), *aff'd*, 2021 WL 5832875 (Del. 2021).

common tailing format that is pretty much standardized as "consistent with past practice."[218] As its relevant language makes apparent, when this qualifier is included in the OC Covenant, the operations during the interim period will be compared with the operations before entering into the merger agreement.[219] When this qualifier is included, the general market practice of the competitor in the same industry will be ruled out of the considerations for the ordinary course of business.[220] Because the OC Covenant becomes more stringent with this qualifier, this qualifier is generally viewed to be buyer-friendly.[221] Specifically, when there is an abrupt event like an occurrence of a global epidemic, this qualifier may make the seller's urgent actions that comply with the industry standard constitute a breach of the OC Covenant.[222] According to Professor Subramanian's analysis of 1,293 merger agreements from 2005–2020, the inclusion rate of past practice qualifiers has gradually declined from 80% in 2005 to 60% in 2020.[223]

b. Materiality Qualifier

The second key qualifier is a materiality qualifier. This qualifier is generally included in both the General Covenant and the Specific Covenant and gives the OC Covenant's compliance some room by authorizing up to material compliances.[224] With such a loosening effect, this qualifier is generally perceived as seller-friendly.[225] The seller will be treated to comply with the OC Covenant when their respective operational actions are not flawless, but material.[226] Usually, this qualifier is inserted by including a

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[218] Subramanian & Petrucci, *supra* note 1, at 1419–20; *see also* Cooper Tire & Rubber Co. v. Apollo (Mauritius) Holdings Pvt. Ltd., No. 8980-VCG, 2014 WL 5654305, at *1, *12 (Del. Ch. Oct. 31, 2014); *AB Stable VIII LLC*, 2020 WL 7024929, at *70–71.

[219] *See AB Stable VIII LLC*, 2020 WL 7024929, at *70–71; *see also* AB Stable VIII LLC v. Maps Hotels & Resorts One LLC, 2021 WL 5832875, at *10–11 (Del. 2021).

[220] *See* Subramanian & Petrucci, *supra* note 1, at 1419–20; *see also AB Stable VIII LLC*, 2020 WL 7024929, at *70; *see also AB Stable VIII LLC*, 2021 WL 5832875, at *10–11; *see also* Akorn, Inc. v. Fresenius Kabi AG, No. 2018-0300-JTL, 2018 WL 4719347, at *88–89 (Del. Ch. Oct. 1, 2018), *aff'd*, 198 A.3d 724 (Del. 2018).

[221] *See* Subramanian & Petrucci, *supra* note 1, at 1419–20.

[222] *See AB Stable VIII LLC*, 2020 WL 7024929, at *70–71.

[223] *See* Subramanian & Petrucci, *supra* note 1, at 1463.

[224] *See id.* at 1420.

[225] *See id.*

[226] *See id.*

tailing condition in the relevant covenant language which is "in all material respects."[227] According to an analysis by Professor Subramanian, the inclusion rate of a materiality qualifier has been around 20–50% and has gradually increased from 20% in 2005 to 40% in 2020.[228]

As this qualifier involves the word, "material," there have been some arguments that materiality in this qualifier should align with materiality in the MAE Provisions. However, recent decisions have clearly segregated definitions of materiality in OC Covenants and MAE Provisions.[229] This confirmed segregation may mean that stand-alone functionality of the OC Covenant has been affirmed. Courts have made the OC Covenant's uniqueness more apparent by distinguishing its materiality from the common law concept of a material breach.[230] The fact that some cases have set a definition for materiality of the OC Covenant with a lower hurdle than materiality of the MAE Provisions[231] may grant some risk allocation for risks that are too low to satisfy scrutiny of the MAE Provisions. This risk allocation feature will be elaborated in the later section for more detail.[232]

c. Efforts Qualifier

Lastly, there is the efforts qualifier. This qualifier, which is generally implemented in the various provisions of the merger agreement, also can be implemented into the OC Covenant. The inclusion is possible for both the General Covenant and the Specific Covenant.[233] This qualifier "specif[ies] the amount of effort that a seller must expend to ensure that the target company operates in the ordinary course."[234] Without an efforts qualifier, the terms of the OC Covenant will impose strict liability against the non-

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[227] *See* Subramanian & Petrucci, *supra* note 1, at 1420; *see also AB Stable VIII LLC*, 2020 WL 7024929, at *65; *see also AB Stable VIII LLC*, 268 A.3d at 210.

[228] Subramanian & Petrucci, *supra* note 1, at 1463.

[229] *See AB Stable VIII LLC*, 2020 WL 7024929, at *73–75; *see also AB Stable VIII LLC*, 286 A.3d at 209–13.

[230] *See* Akorn, Inc. v. Fresenius Kabi AG, No. 2018-0300-JTL, 2018 WL 4719347, at *84–86 (Del. Ch. Oct. 1, 2018), *aff'd*, 198 A.3d 724 (Del. 2018).

[231] *See AB Stable VIII LLC*, 2020 WL 7024929, at *73–75; *see also AB Stable VIII LLC*, 268 A.3d at 209–13.

[232] *See infra* Part. V.

[233] *See, e.g.*, *Akorn, Inc.*, 2018 WL 4719347, at *86–88.

[234] *See* Subramanian & Petrucci, *supra* note 1, at 1420.

compliance which will in turn impose a heavier burden to the seller, as the seller may be liable for the breach regardless of what course of actions that he took.[235] The qualifier is included by putting a tailing conditional language such as "best efforts," "reasonably best efforts," or "reasonable efforts."[236]

In regards to the interpretation of the qualifier, practitioners and courts have differing points of view.[237] Deal practitioners generally believe that there are different hierarchical layers among efforts qualifiers.[238] According to the ABA Committee on Mergers and Acquisitions, depending on the chosen language, the qualifier is understood to have five different strength levels: (1) "best efforts;" (2) "reasonable best efforts;" (3) "reasonable efforts;" (4) "commercially reasonable efforts;" and (5) "good faith efforts."[239] However, some courts do not seem to agree with such complexity in labeling.[240] The authoritative treatise of Kling and Nugent acknowledges that there are probably two different types of efforts qualifiers: "best efforts" and qualifiers imposing less than "best efforts."[241] However, in citing the related case precedents, *Akorn* suggests that the courts of Delaware may not accept any interpretative difference between forms of efforts qualifiers.[242] Specifically, *Akorn* notes that the courts of Delaware do not seem to recognize that there are any interpretive differences for placing or removing the word, "best effort," from the efforts qualifier.[243]

In *William Companies v. Energy Transfer Equity, L.P.*, the Supreme Court of Delaware held that the qualifier language, "commercially reasonable efforts" and "reasonable best efforts," both impose "obligations to take all reasonable steps to solve problems and consummate transactions"

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[235] *See id.*

[236] *Id.* at 1420–21.

[237] *See* Subramanian & Petrucci, *supra* note 1, at 1421; *see also Akorn, Inc.*, 2018 WL 4719347, at *86–87.

[238] *See* Subramanian & Petrucci, *supra* note 1, at 1421; *see also Akorn, Inc.*, 2018 WL 4719347, at *86–87.

[239] *See* Subramanian & Petrucci, *supra* note 1, at 1421; *see also Akorn, Inc.*, 2018 WL 4719347, at *86–87.

[240] *See* Subramanian & Petrucci, *supra* note 1, at 1421; *see also Akorn, Inc.*, 2018 WL 4719347, at *86–87.

[241] *See Akorn, Inc.*, 2018 WL 4719347, at *87 (citing LOU R. KLING ET AL., NEGOTIATED ACQUISITIONS OF COMPANIES, SUBSIDIARIES AND DIVISIONS § 13.06, at 13–47 (2018 ed.)).

[242] *See Akorn, Inc.*, 2018 WL 4719347, at *87.

[243] *See id.*

without differentiating the two.[244] The *Akorn* decision held that "reasonable best efforts" meant complying under commercial reasonableness, which practically made "reasonable best efforts" and "commercially reasonable efforts" identical.[245] Considering this difference in views, the 2020 version of the Kling and Nugent treatise elaborates that rather than relying on the vague distinction of these efforts qualifier languages, the parties may need to specify what actions constitute best efforts and what actions do not.[246]

According to analysis from Professor Subramanian, inclusion rate of efforts qualifiers stand at around 10–30% and has gradually increased from 10% in 2005 to 30% in 2020.[247] The trend of the three qualifiers discussed above show that drafting trends of merger agreements have moved to become more seller friendly.[248] Along with expanding complexity of MAE carveouts,[249] merger agreements probably have been evolving in a way that is friendly to sellers. And, to give a turn to this trend, the Delaware courts may have re-sharpened the teeth of risk allocation provisions with recent decisions, which will be discussed in more detail in Part V.[250]

B. Case Precedents

Cases discussing OC Covenants have emerged very recently.[251] However, with the ruling of the Delaware Supreme Court in *AB Stable*, a new chapter for the scope of function of OC Covenants may have come.[252] The expanding role may mean structural change in theoretical allocation of risks in connection with the interim period of merger agreements.

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[244] *See* Subramanian & Petrucci, *supra* note 1, at 1421–22; *see also* William Cos. v. Energy Transfer Equity, L.P., 159 A.3d 264, 272 (Del. 2017).

[245] *See* Subramanian & Pertucci, *supra* note 1, at 1422.

[246] *See* LOU R. KLING ET AL., NEGOTIATED ACQUISITIONS OF COMPANIES, SUBSIDIARIES AND DIVISIONS § 13.06 (2020 ed.).

[247] Subramanian & Petrucci, *supra* note 1, at 1463.

[248] *See id.*

[249] *See supra* Part III, Section A (ii).

[250] *See infra* Part V.

[251] *See* Cooper Tire & Rubber Co. v. Apollo (Mauritius) Holdings Pvt. Ltd., No. 8980-VCG, 2014 WL 5654305, at *1 (Del. Ch. Oct. 31, 2014) (The first landmark OC Covenant case, decided in 2014.).

[252] *See* AB Stable VIII LLC v. Maps Hotels & Resorts One LLC, No. 2020-0310-JTL, 2020 WL 7024929 (Del. Ch. Nov. 30, 2020), *aff'd*, 2021 WL 5832875 (Del. 2021).

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1. Cooper Tire & Rubber Co. v. Apollo (Mauritius) Holdings Pvt. Ltd.

No one will disagree that the first historical OC Covenant case is *Cooper Tire & Rubber Co. v. Apollo (Mauritius) Holdings Pvt. Ltd.*[253] This landmark case is the first modern examination of the OC Covenant that recognized a breach of the OC Covenant and determined many basic legal standards for the OC Covenant.[254] The fact that this Delaware decision on the OC Covenant in merger agreements was rendered in 2014 reveals that laws on OC Covenants have started to be structured very recently.[255] In *Cooper Tire*, the buyer alleged a breach of the OC Covenant after workers of the Chinese subsidiary of the target, Cooper Tire, went on strike, which the target reacted to by cutting off payment for the subsidiary's supplies.[256]

Deserving the title of the first landmark OC Covenant case, *Cooper Tire* made several important clarifications for OC Covenants.[257] The case held that the buyer did not have to specifically perform obligations of the merger agreement as the seller breached the OC Covenant.[258] In this case, the OC Covenant had two parts: the General Covenant and the Specific Covenant.[259] The General Covenant required the target to maintain the general operational business conducts that were in compliance with ordinary course of business.[260] The General Covenant included two qualifiers, the past practice qualifier and the materiality qualifier.[261] The Specific Covenant portion required several specific conducts in compliance with the ordinary course of business such as preserving business organization, keeping services of employees available, and maintaining existing relationships and goodwill.[262] The Specific Covenant included an efforts qualifier in the form of "commercially reasonable efforts."[263]

[253] *See Cooper Tire & Rubber Co.*, 2014 WL 5654305, at *1.
[254] *See* Subramanian & Petrucci, *supra* note 1, at 1427.
[255] *See generally Cooper Tire & Rubber Co.*, 2014 WL 5654305, at *1.
[256] *See generally id.* at *4.
[257] *See generally id.* at *1.
[258] *See id.* at *19.
[259] *See id.* at *12.
[260] *See id.*
[261] *See id.*
[262] *See id.*
[263] *See id.*

Cooper Tire made a couple of notable affirmations.[264] First, the court clarified that qualifiers in the General Covenant and the Specific Covenant should be interpreted separately.[265] While the buyer alleged a breach of the General Covenant of the OC Covenant from occurrence of a strike, the seller tried to deny the breach by alleging that he acted in a commercially reasonable manner in compliance with the qualifier given in the Specific Covenant.[266] Agreeing with the buyer, the court held that the General Covenant had been breached by the strike of the subsidiary, and the commercially reasonable actions of the target taken to respond to the strike did not exempt the seller from its obligations under the General Covenant, even though the actions of the target were reasonable under the given circumstances.[267] In other words, the court held for the General Covenant that was breached, despite the target's reasonable actions in response, which indirectly rejected application of the efforts qualifier in the Specific Covenant to the General Covenant.[268] This holding affirmed that included qualifiers in different sections of an OC Covenant will likely be interpreted separately.[269]

Secondly, *Cooper Tire* segregated the contractual operations of OC Covenant and MAE Provisions for the first time.[270] In this case, the seller attempted to defend a breach of the OC Covenant by alleging that risk in connection with the strike was allocated to the buyer in accordance with one of the MAE carveouts of the merger agreement.[271] The court held that such risk allocation to the buyer is conditional upon the term not preventing the seller from compliance with the other terms of the merger agreement, and that the carveout of the MAE Provisions did not exempt the seller from an obligation to comply with the OC Covenant.[272] Even though the court ruled against application of the MAE carveout to the OC Covenant, the court did not yet confirm separate interpretations of OC Covenants and MAE

264 *See generally id.* at *1.
265 *See id.* at *15–17.
266 *See generally Cooper Tire & Rubber Co.*, 2014 WL 5654305, at *15–17.
267 *See id.*
268 *See id.*
269 *See id.*
270 *See id.* at *18.
271 *See id.*
272 *See id.* at *19.

Provisions.[273] Because this case examined the OC Covenant in detail, which had not been often done before, the language of the decision tried to avoid a strong determination as much as possible.[274] However, such a cautious holding did not stop the court from creating a channel for later cases with concrete determination standards for OC Covenants.

2. FleetBoston Financial Corp. v. Advanta Corp.

While *Cooper Tire* was the first modern examination of a breach of an OC Covenant, there are a number of other Delaware cases ruling on issues in connection with OC Covenants.[275] Many of those cases, however, involved a clear material misrepresentation of corporate information, so they did not provide much legal analysis or test standards for OC Covenants.[276] Most cases with notable legal examinations were rendered after the landmark *Cooper Tire*.[277]

However, prior to the *Cooper Tire* decision, a 2003 case, *FleetBoston Financial Corp. v. Advanta Corp.*, provided the most detailed analysis on breach of OC Covenant.[278] This notable case, which ended up rejecting the alleged breach, was decided in a fairly unclear manner.[279]

The OC Covenant of the merger agreement in *FleetBoston* had a General Covenant with a past practice qualifier and a Specific Covenant with the unique qualifier, "in substantial accordance with," that required compliance with disclosed marketing plans.[280] The ruling in this case was

[273] *Id.* at *19 (acknowledging, "it is axiomatic that contractual provisions must be read to make sense of the whole"). This admission opened the possibility of an argument that OC Covenants and MAE Provisions are interrelated, until the Delaware Supreme Court sorted out this issue in *AB Stable*. *See* AB Stable VIII LLC v. MAPS Hotels & Resorts One LLC, 268 A.3d 198, 217–18 (Del. 2021).

[274] *See generally Cooper Tire & Rubber Co.*, 2014 WL 5654305, at *1.

[275] *See, e.g.*, Ansultz Corp. v. Brown Robin Capital, LLC, No. 2019-0710-JRS, 2020 WL 3096744, at *10–12 (Del. Ch. June 11, 2020); *see also, e.g.*, ChyronHego Corp. v. Wight, No. 2017-0548-SG, 2018 WL 3642132, at *8 (Del. Ch. July 31, 2018); *see also, e.g.*, Osram Sylvania Inc. v. Townsend Ventures, LLC, No. 8123-VCP, 2013 WL 6199554, at *7 (Del. Ch. Nov. 19, 2013).

[276] *See, e.g.*, *Anschutz Corp.*, 2020 WL 3096744, at *10–12; *see also ChyronHego Corp.*, 2018 WL 3642132, at *8; *see also Osram Sylvania Inc.*, 2013 WL 6199554, at *7.

[277] *See generally infra* Part IV, Section B (iii & iv).

[278] *See generally* FleetBoston Financial Corp. v. Advanta Corp., No. Civ.A. 16912-NC, 2003 WL 240885, at *1 (Del. Ch. Jan. 22, 2003).

[279] *See id.* at *24–27.

[280] *See* FleetBoston Financial Corp. v. Advanta Corp., No. Civ.A. 16912-NC, 2003 WL 240885, at *25 (Del. Ch. Jan. 22, 2003).

that the target's aggressive marketing price for existing customers did comply with the past marketing conduct of the target.[281] The court also considered competitive atmosphere of the industry at that time that made the fierce pricing inevitable.[282] Collective analysis from this ruling, including both the past practice and the industry atmosphere, may mean that industrial environment is still a factor for consideration to determine breach of an OC Covenant, even when the covenant did not mandate commercial reasonability.[283] Although an efforts qualifier was not specifically included, by referring to the fierce market competition, the court in this case tried to take into account the perceptions of the industry, which seemed to go against literal interpretation of the covenant.[284] Despite the alleged inclusion of the industry practice, the court largely based its analysis on compliance with past practices, as the marketing practice was a standard that the target had referred to when deciding operational actions in the past.[285] This argument may be debatable considering that the current trend in *Akorn* and *AB Stable* emphasizes literal interpretation.[286]

Even though *FleetBoston* provides a notable analysis on the OC Covenant in detail, it does not seem to give a clear guideline for the OC Covenant interpretation for a couple of reasons: (1) it implemented market competition into analysis even though an efforts qualifier was not included in the relevant covenant; and (2) the OC Covenant in this case did not use the conventional form of current OC Covenants with qualifiers like "substantial accordance."[287] However, *FleetBoston* still provides pretty strong factual guidance that drastic marketing measures can constitute an operation within ordinary course when it is done in the past and a past practice qualifier is included.[288]

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[281] *See id.* at *26–27.
[282] *See id.*
[283] *See id.*
[284] *See id.*
[285] *See id.*
[286] *See generally* Akorn, Inc. v. Fresenius Kabi AG, No. 2018-0300-JTL, 2018 WL 4719347, at *1, *88–91 (Del. Ch. Oct. 1, 2018), *aff'd*, 198 A.3d 724 (Del. 2018). *See generally* AB Stable VIII LLC v. Maps Hotels & Resorts One LLC, No. 2020-0310-JTL, 2020 WL 7024929, at *1 (Del. Ch. Nov. 30, 2020), *aff'd*, 268 A.3d 198 (Del. 2021).
[287] *See* FleetBoston Financial Corp. v. Advanta Corp., No. Civ.A. 16912-NC, 2003 WL 240885, at *1, *26–27 (Del. Ch. Jan. 22, 2003).
[288] *See generally id.*

3. Akorn, Inc. v. Fresenius Kabi AG *in OC Covenant Perspective*

Along with its important MAE rulings, the *Akorn* case also sets forth some notable guidance for OC Covenants. In this case, because the OC Covenant indicated the violation of discovery and data control standards of the target, *Akorn*, the court held that the seller breached the OC Covenant with its conduct violations.[289] Unlike other cases that have ruled on the OC Covenant,[290] this case defined the different components of an OC Covenant in detail.[291] *Akorn* provided each component of an OC Covenant with clear legal definitions and standards.[292]

The OC Covenant in *Akorn* was comprised of usual features that modern OC Covenants generally have.[293] The covenant had two general components: the General Covenant and the Specific Covenant.[294] The General Covenant included an efforts qualifier with the language, "commercially reasonable efforts," and a materiality qualifier with the usual language, "in all material respects."[295] The Specific Covenant included an efforts qualifier with the language "commercially reasonable efforts," and required *Akorn* to preserve business organizations and business relationships.[296]

Despite its relatively straight forward nature of the factual analysis,[297] *Akorn* set forth definitions and examination standards for materiality qualifiers and efforts qualifiers, which provided general guidance for future cases.[298] The standard of the materiality qualifier was the most important feature of this case; for the first time, this case confirmed that the materiality qualifier in the OC Covenant utilized a system that was distinguished from

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[289] *See Akorn, Inc.*, 2018 WL 4719347, at *88–91.

[290] *See generally* Ansultz Corp. v. Brown Robin Capital, LLC, No. 2019-0710-JRS, 2020 WL 3096744, at *1 (Del. Ch. June 11, 2020); ChyronHego Corp. v. Wight, No. 2017-0548-SG, 2018 WL 3642132, at *1 (Del. Ch. July 31, 2018); Osram Sylvania Inc. v. Townsend Ventures, LLC, No. 8123-VCP, 2013 WL 6199554, at *1 (Del. Ch. Nov. 19, 2013).

[291] *See Akorn, Inc.*, 2018 WL 4719347, at *84.

[292] *See id.* at *84–87.

[293] *See id.* at *84.

[294] *See id.*

[295] *See id.*

[296] *See Akorn, Inc.*, 2018 WL 4719347, at *88.

[297] *See id.* at *84–87 (Akorn breached the OC Covenant with its disclosure and data maintenance violation).

[298] *See id.*

materiality in the common law concept of material breach and materiality in MAE Provisions.[299]

In short, *Akorn* asserted that materiality in OC Covenants is intended to limit operation of materiality qualifiers in OC Covenants to issues that are significant in context of the merger agreement, even if the subject breaches were not severe enough to excuse the counterparty's performance in accordance with the merger agreement.[300] While forming this definition, the case separated this materiality qualifier from materiality in the common law doctrine of material breach.[301] Moreover, this case also distinguished the definition from concept of materiality in the MAE Provisions as this definition neither referred to nor included the central terms discussed in the case of *In re IBP, Inc. Shareholders Litigation* for materiality in MAE Provisions, "durationally-significant" and "short-term hiccup."[302] Considering that this case cited those terms while determining whether there was an MAE, *Akorn* should be viewed to segregate an OC Covenant's materiality and an MAE's materiality.[303] This separation is also affirmed in the other landmark case, *AB Stable*, which provides a clue that the modern role in connection with risk allocation of the interim period of the merger agreement may operate with a stronger position than where it previously was agreed.[304]

Akorn confirmed the definitive standard for an efforts qualifier of an OC Covenant.[305] While an efforts qualifier has had piecemeal definitions spread out over a number of decisions, this case collected and summarized the standards and also successfully mentioned and distinguished the standard from the ones asserted by practitioners.[306] The details of this standard are introduced in the efforts qualifier section.[307] By providing these important definitions of the two important qualifiers, the case reiterated an important

[299] *See id.* at *84–86.
[300] *See id.* at *86.
[301] *See id.*
[302] *See id.* at *53.
[303] *See id.* at *53–57.
[304] *See generally* AB Stable VII LLC v. Maps Hotels & Resorts One LLC, No. 2020-0310-JTL, 2020 WL 7024929, at *1 (Del. Ch. Nov. 30, 2020), *aff'd*, 268 A.3d 198 (Del. 2021); AB Stable VII LLC v. Maps Hotels & Resorts One LLC, 268 A.3d 198 (Del. 2021).
[305] *See Akorn, Inc.*, 2018 WL 4719347, at *85–87.
[306] *See id.*
[307] *See supra* Part IV, Section A (i) (c).

legal aspect of the OC Covenant that had been overshadowed by the MAE Provisions in risk allocation for the interim period of the merger agreement.[308] Even though such an important determination was also sadly overshadowed by its relevant ruling in connection with the MAE Provisions,[309] the milestone determinations disclosed its true importance in the next landmark case, *AB Stable*.[310]

4. AB Stable VIII LLC v. Maps Hotel and Resorts One LLC's *OC Covenant Perspective*

As noted, even though a breach in an OC Covenant has been accepted more often than termination from MAE Provisions, an OC Covenant has not received the separated treatment for a long time.[311] Legal separation of the OC Covenant was established through gradual steps. It started with *Cooper Tire*'s blocked application of an MAE carveout and then flowed with *Akorn*'s differentiation of the materiality in an OC Covenant from the common law concept of a material breach.[312] However, none of these cases suggest that an OC Covenant alone could terminate a merger agreement when the termination event was not substantial enough to constitute an MAE. Then, the Delaware courts issued a ruling in *AB Stable*, which expanded the functional scope of the OC Covenant greatly.[313]

AB Stable is a landmark case comprised of the expansive Chancery Court decision and affirmation of the Supreme Court with important additional clarifications.[314] This was a specific performance case over a corporate purchase deal, which amounted to $5.8 billion, and was the first

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308 *See id.*

309 *See generally Akorn, Inc.*, 2018 WL 4719347, at *1 (excusing the buyer based on both the occurrence of an MAE and breach of the OC Covenant, and the occurrence of MAE attracted more attention with its practical relevance).

310 *See infra* Part IV, Section B (iv).

311 *See supra* Part IV, Section B (i) (discussing the first modern OC Covenant case, which is practically the *Cooper Tire* case decided in 2014).

312 *See* Cooper Tire & Rubber Co. v. Apollo (Mauritius) Holdings Pvt. Ltd., No. 8980-VCG, 2014 WL 5654305, at *1, *18–20 (Del. Ch. Oct. 31, 2014); *see also Akorn, Inc.*, 2018 WL 4719347, at *84–86.

313 *See generally* AB Stable VIII LLC v. Maps Hotels & Resorts One LLC, No. 2020-0310-JTL, 2020 WL 7024929, at *1 (Del. Ch. Nov. 30, 2020), *aff'd*, 2021 WL 5832875 (Del. 2021).

314 *See generally id.*

ruling that held for a breach of an OC Covenant while rejecting the presence of an MAE.[315] With this case's specific holdings, it asserted a concrete isolation of the examination standard for an OC Covenant.[316]

One notable aspect of *AB Stable* is that it narrowed the scope of MAE applications greatly.[317] When rejecting application of the MAE by triggering a natural disaster carveout, the court implemented a broad interpretation of the language "calamity" and held that the detrimental operational damage caused by COVID-19 should have constituted an event that fell within the plain-language definition of "calamity."[318] This MAE ruling openly widened the scope of application of MAE exceptions and made application of MAE Provisions more unlikely.[319] *AB Stable* also weakened the general language of the MAE Provisions by requiring inclusion of a specific term, "prospects," for its forward-looking interpretation that had been believed to be granted to an MAE interpretation.[320] With these two holdings expanding the scope of MAE carveouts and reducing the scope of the basic definition of an MAE, this landmark case imposed strong limitations on the likelihood of an MAE recognition.[321]

The OC Covenant in *AB Stable* was structured in a pretty particular fashion.[322] The General Covenant laid out some exemplary activities that must be complied as part of the ordinary course of operations: the target and its subsidiaries were obliged to maintain a commercially reasonable level of supplies, F&B, retail inventory, liquor assets, and FF&E consistent with past practices.[323] The listed activities, however, did not limit the types of activities that ought to become the general ordinary operations, but rather suggested examples.[324] Thus, the General Covenant was interpreted as a common General Covenant with past practice and materiality qualifiers.[325] The

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[315] *See generally id.*
[316] *See generally id.*
[317] *See generally id.*
[318] *See generally AB Stable VIII LLC*, 2020 WL 7024929, at *57–59; *see also* Miller, *supra* note 10, at 695–98.
[319] *See id.*
[320] *See AB Stable VIII LLC*, 2020 WL 7024929, at *62.
[321] *See id.* at *57–62.
[322] *See id.* at *65.
[323] *See id.*
[324] *See id.*
[325] *See id.* at *65–67.

Specific Covenant of the OC Covenant was not discussed in detail as its breach was not alleged.[326]

This fiercely debated litigation set landmark precedents for a number of important legal applications of the OC Covenant. First, the case organized and clarified the past precedents in connection with testing whether the operational actions constituted actions in the ordinary course of business.[327] Operational actions in the ordinary course of business were actions that did not depart significantly from routine actions of operations of the target.[328] With this clear definition, the court affirmed that past routines of the target had stronger comparative value than actions of the other market competitors.[329] By still keeping the competitor's actions in considerable variables when there was no past practice qualifier, the case did not rule out application of the industry practice completely.[330]

Moreover, the court in *AB Stable* strengthened the plain language of the covenant by holding that because the covenant stated that the target shall conduct "only ordinary course of action consistent with past practice," it bounded the target to operate only in ordinary fashion that was in compliance with past practices.[331] Due to the language, the target lost its authority to choose operational actions in accord with actions conducted by its market competitors, and it was obliged to act only in accordance with its past operational routines.[332] By applying this interpretation that was strictly literal, the court's ruling strengthened the force of specific terms of art in the OC Covenant.[333] With a similar reasoning, the case also rejected existence of an efforts qualifier in the General Covenant, stating the "commercially reasonable" language only subordinated specific examples of ordinary course of operations, not the overall definitive language of the General Covenant.[334]

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[326] *See id.* at *57–82.

[327] *See id.* at *65–70; *see also* Cooper Tire & Rubber Co. v. Apollo (Mauritius) Holdings Pvt. Ltd., No. 8980-VCG, 2014 WL 5654305, at *14–17 (Del. Ch. Oct. 31, 2014); *see also* FleetBoston Fin. Corp. v. Advanta Corp., No. Civ.A. 16912-NC, 2003 WL 240885, at *25–27 (Del. Ch. Jan. 22, 2003).

[328] *See AB Stable VIII LLC*, 2020 WL 7024929, at *65–68.

[329] *See id.*

[330] *See id.* at *70.

[331] *See id.*

[332] *See id.* at *70–71.

[333] *See id.*

[334] *See id.* at *72–73.

Finally, the case strengthened the segregated nature of an OC Covenant.[335] As mentioned in *Cooper Tire*, the court's viewpoint was that an OC Covenant must be examined and analyzed in a segregated fashion.[336] In *AB Stable*, the court made this perspective clearer by not only reaffirming that MAE carveouts did not exempt the target from complying with the OC Covenant but also presenting clear separation in the definitions of the MAE Provisions and the OC Covenant.[337] The court explained that an OC Covenant was attributed to actions that were specific to the operation of the target's business, while MAE Provisions was an all-inclusive concept that applied all events and effects that may have caused the MAE.[338] While affirming the Chancery Court ruling, the Supreme Court of Delaware reiterated the separation by providing an additional distinction that an OC Covenant was to prevent material changes in the business operations in the interim period, while MAE Provisions was to allocate risk of changes in the target's valuation.[339]

With such important conclusions, *AB Stable* held that the target's extraordinary operational actions including employee layoffs and halted hotel operations were a breach of the OC Covenant.[340] This decision became important not only because of noted examination standards that were re-affirmed in *Snow Phipps Group, LLC v. KCAKE Acquisition, Inc.*[341] but also with the groundbreaking nature of the decision. For the first time, *AB Stable* ruled for the rightful termination of a merger agreement with a breach of an OC Covenant while not recognizing the occurrence of an MAE.[342] The nature of this decision makes the independence of an OC Covenant clearer and expands the theoretical role of an OC Covenant in terms of the risk allocation for the interim period of merger agreements. This important expansion opens up a new theoretical understanding of the risk allocation of the interim period.

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[335] *See id.* at *73–75.
[336] *See* Cooper Tire & Rubber Co. v. Apollo (Mauritius) Holdings Pvt. Ltd., No. 8980-VCG, 2014 WL 5654305, at *1, *15–20 (Del. Ch. Oct. 31, 2014).
[337] *See AB Stable VIII LLC*, 2020 WL 7024929, at *73–75.
[338] *See id.*
[339] *See* AB Stable VIII LLC v. Maps Hotels & Resorts One LLC, 268 A.3d 198, 216–17 (Del. 2021).
[340] *See AB Stable VIII LLC*, 2020 WL 7024929, at *67.
[341] *See* Snow Phipps Grp., LLC v. KCAKE Acquisition Inc., No. 2020-0282-KSJM, 2021 WL 1714202, at *38–39 (Del. Ch. Apr. 30, 2021).
[342] *See generally AB Stable VIII LLC*, 268 A.3d at 198.

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V. CONCLUDING OBSERVATIONS

As the course of decisions on MAE Provisions reflects, the high hurdle towards MAE recognition still stands tall. Showing existence of this high bar is simple. Other than the decision in *Akorn*, the Delaware courts have never recognized a basic MAE in a merger agreement. Moreover, by rendering decisions dismissing alleged MAEs based on MAE carveouts,[343] and by allowing broad interpretation of the plain wording of the carveouts,[344] the courts affirm that an MAE is "like a Delaware tornado—frequently alleged but rarely shown to exist."[345]

If the courts concede to this Delaware tornado comparison, some may worry what would grant protection to buyers for risk management in connection with interim periods. Due to the vicious nature of merger negotiations,[346] it is true that if MAE Provisions, which has been acknowledged as the most important provision for risk allocation of the interim period, positions a strong wall against risk allocation to the seller,[347] the buyer's risk protection will be seriously endangered, potentially leading to harm of fairness in merger agreements generally. The courts of Delaware seem to be aware of this important concern and tackle this issue by strengthening the provision that has been relatively overlooked, an OC Covenant.

In connection with the interim period, bring-down conditions and covenants govern the general risk management of the contracting parties.[348] Most previous studies have focused on MAE Provisions as the provision perceived to be at the center of the interim period risk allocation. The presumption may make sense in a merger agreement, as MAE Provisions is one of the few conditions in regard to uncontrollable future events. However, as noted, the precedents of the Delaware courts placed a high bar for the

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[343] *See AB Stable VIII LLC*, 2020 WL 7024929, at *60–63; *see also Snow Phipps Grp., LLC*, 2021 WL 1714202, at *30–35.

[344] *See AB Stable VIII LLC*, 2020 WL 7024929, at *57–59 (holding that the plain language definition of "calamity" covered events in connection with COVID-19).

[345] ChyronHego Corp. v. Wight, No. 2017-0548-SG, 2018 WL 3642132, at *1, *9 (Del. Ch. July 31, 2018).

[346] For example, one side note in *IBP* stemmed out to become 11 common carveouts. *See supra* Part III, Section B (i) (a).

[347] *See* Miller, *supra* note 10, at 2064.

[348] *See* Gilson & Schwartz, *supra* note 15, at 337.

recognition of an MAE.[349] Until the *Akorn* decision, there had been practically no cases that recognized the occurrence of a basic MAE.[350] Expansive carveouts that have now become nearly the norm for all MAE drafting only makes matters worse. Courts appear to give a wide scope of governance for MAE carveouts, and the risk protection for buyers seems to be shrinking at an ever-increasing pace.

This structural understanding for the risk allocation of the interim period that practically assigns every controllership in MAE Provisions will definitely cause a serious fairness issue between buyers and sellers. And it appears that the recent court decision in *AB Stable* gives a solution to the Delaware courts to tackle this issue.[351]

A. AB Stable *and OC Covenant*

As noted, while terminating a $5.8 billion merger, *AB Stable* recognized a breach of an OC Covenant but rejected the occurrence of an MAE.[352] To back up this unprecedented ruling, the case provides for a strong segregation of the examination standard for OC Covenants. Considering there have been a number of attempts to reduce the application of OC Covenants by trying to impose MAE carveouts,[353] with this affirmed segregation alone, this case can be viewed to strengthen the governing power of OC Covenants greatly. Nonetheless, the ruling can be understood in both general and wide points of view.

Even though the ruling was strongly backed by the title fraud of the seller, both the Supreme Court and the Chancery Court of Delaware granted a merger termination based on an OC Covenant without MAE recognition for the first time.[354] Considering how the past cases and studies have emphasized the essential role of MAE Provisions, this decision deserves

[349] *See supra* Part III, Section B.

[350] *See* Prinzivalli, *supra* note 5, at 174.

[351] *See generally* AB Stable VIII LLC v. Maps Hotels & Resorts One LLC, No. 2020-0310-JTL, 2020 WL 7024929, at *1, (Del. Ch. Nov. 30, 2020), *aff'd* 2021 WL 583875 (Del. 2021).

[352] *See generally AB Stable VIII LLC*, 2020 WL 7024929, at *1.

[353] *See* Cooper Tire & Rubber Co. v. Apollo (Mauritius) Holdings Pvt. Ltd., No. 8980-VCG, 2014 WL 5654305, at *1, *18–20 (Del. Ch. Oct. 31, 2014); *see also* AB Stable VIII LLC v. Maps Hotels & Resorts One LLC, No. 2020-0310-JTL, 2020 WL 7024929, at *73–75 (Del. Ch. Nov. 30, 2020), *aff'd*, 268 A.3d 198 (Del. 2021).

[354] *See generally AB Stable VIII LLC*, 2020 WL 7024929, at *1; *AB Stable VIII LLC*, 268 A.3d at 198.

attention both practically and academically. From a practical standpoint, an OC Covenant now must be subject to extensive negotiation of the merger parties. In merger negotiations of the past, MAE Provisions has been understood to have the full governing force in connection with the risk allocation of the interim period. Under this perception, practitioners, academic theorists, and even courts have concentrated on confirming the considerations and theories behind MAE Provisions. Reflecting this misconception, compared with the highly standardized formats and conditional carveouts and carvebacks of MAE Provisions, an OC Covenant does not have an established clear standardization of its provisional structure. For example, the General Covenant part of the OC Covenant in *AB Stable* somehow implemented some specification of the ordinary course activities which is usually implemented in a Specific Covenant.[355] Watering down the value of listing language in a Specific Covenant beats the central purpose of having those separate sections.

Now with the *AB Stable* decision, the overlooked OC Covenant took back the place that it deserved.[356] Under structure of a merger agreement, the OC Covenant is one of the few conventional provisions that directly relates to and governs the managerial and operational changes during the interim period. As the OC Covenant functions by preventing further operational actions that may harm the value of the target, it may appear that the MAE Provisions, which grants the buyer the right to terminate the transaction out of certain extreme events that disrupt the purchase value of the target, is totally unrelated to functionality of the OC Covenant. However, by allocating risks during the interim period, the MAE Provisions attempts to govern every issue that possibly affects the purchase value of the target during that period. This means that an MAE should govern the adverse effects that occur during the interim period as a result of changes in operational decisions which should be within scope of governance of the OC Covenant. And, the *AB Stable* decision, which recognized a breach of the OC Covenant alone, definitively acknowledged that the long-lasting presumption that the MAE Provisions had sole authority in regards to risk allocation during the interim period should be reconsidered. Maybe the OC Covenant will start to fill in

[355] *See AB Stable VIII LLC*, 2020 WL 7024929, at *65–67.
[356] *See id.*

the vacancy of the MAE Provisions which has been turned into a Delaware tornado.[357] With this increasing relevance, more practical negotiations on OC Covenants will be inevitable.

B. The Four Risks Theory and OC Covenant

Academically, OC Covenants should be viewed to have some role in allocating risks of the interim period in accordance with the officially accepted Four Risks Theory. Under the Four Risks Theory, among the four risks partitioned between the buyer and the seller, business risks are generally borne by the seller.[358] When the Four Risks Theory was initially proposed by Professor Miller, indicator risks, which are risks in connection with fluctuations of general market indicators such as stock prices or interest rates, used to also be allocated to the seller.[359] But with related carveouts, it is more accurate to view that business risks which arise from the ordinary operations of the target's business are the only risks left to the seller to bear.[360] Considering the level of controllership that the seller has over the ordinary operations of the target during the interim period, allocation of such risks to the buyer would not be justifiable.

It is true that the initial proposal of the Four Risks Theory did not intend to analyze function of the OC Covenant. Professor Miller has stated that the role of the OC Covenant is very specific to operational actions motivated by moral hazards of the seller but openly accepted that occurrence and governance of the business risks pertained to ordinary operations of the target.[361] In other words, it would not be inadequate to include the OC Covenant into realm of the Four Risks Theory if that is necessary to adjust the theory into the current legal landscape.

The fact that merger agreements generally include OC Covenants plays a very important role in connection with allocation of business risks. Pursuant to the definition of business risks, matters governed by an OC Covenant

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[357] *See* ChyronHego Corp. v. Wight, No. 2017-0548-SG, 2018 WL 3642132, at *1, *9 (Del. Ch. July 31, 2018).

[358] *See AB Stable VIII LLC*, 2020 WL 7024929, at *60.

[359] *See* Miller, *supra* note 10, at 2008.

[360] *See AB Stable VIII LLC*, 2020 WL 7024929, at *60.

[361] *See* Miller, *supra* note 10, at 2038–40, 2062–63.

should definitely be viewed to involve the allocation of such risks.[362] The OC Covenant is generally understood to deal with the moral hazard problem in connection with operational decisions after the signing of a merger agreement.[363] However, rethinking the nature of possible variations of such operational moral hazards, most of those variations will be extreme business and operational decisions that may harm the target value during the interim period. Moreover, because the face value of the OC Covenant attempts to prohibit the seller and the target from taking further actions that are not in compliance with past practices and the general industrial practice of the target (the extent of the restriction varies by the drafting), the scope of governance may appear to be pretty limited, as all related parties that comply may be choosing inaction. However, maintaining business operations in ordinary course is not as simple as not doing anything further. For example, in *FleetBoston* the court held that implementing certain marketing policies that may seem somewhat excessive was within the scope of business actions in the ordinary course.[364] This understanding may later lead to a conclusion that a passive inaction constitutes a breach of the OC Covenant. In other words, compliance with the OC Covenant is not so straightforward that its restrictive force is strong enough to be treated to govern a significant portion of risk allocation in the interim period.

C. Inviting OC Covenant to the Four Risks Theory

Acknowledging this strong restrictive force, the OC Covenant deserves its strong role in governing business operations of the target during the interim period. While enforcing an MAE in terms of a merger is something that is difficult to be confirmed in the courts of Delaware,[365] the OC Covenant, which has a strong relationship with business risks, must be treated as part of the risk allocation scheme under the Four Risks Theory. Considering that business risks are essentially the only risk among the four risks of the Four Risks Theory that gets assigned to the seller, it makes sense to include an OC Covenant into the risk governance scheme. Even though

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[362] *See id.*

[363] *See* Subramanian & Petrucci, *supra* note 1, at 1418.

[364] *See* FleetBoston Fin. Corp. v. Advanta Corp., No. Civ.A. 16912-NC, 2003 WL 240885, at *1, *25–27 (Del. Ch. Jan. 22, 2003).

[365] *See generally supra* Part III, Section B.

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there have not been many analyses in regards to the reason why the role of the OC Covenant in risk allocations during the interim period has been overlooked, it appears that is because (i) theorists and practitioners assumed that the MAE Provisions was enough to govern the scheme and (ii) the restrictive force of an OC Covenant was not strong and significant enough to play a part in the allocation scheme.

If those two reasons are the causes behind exclusion of the OC Covenant in the risk allocation scheme of the Four Risks Theory, the OC Covenant must be invited. With the development of strong and influential carveouts and courts' reluctance towards recognizing the basic MAE,[366] the MAE Provisions does not seem to provide adequate protection for the buyers. Moreover, as significance of OC Covenants has been accepted with recent cases,[367] the restrictive force that is strong enough to protect the rights of the sellers in connection with risk allocation of the interim period has been proven. Therefore, practitioners and theorists will likely start to implement OC Covenants into the functional scheme of the interim risk allocation. Such implementation will not only be in compliance with court precedents which have placed a high bar against MAE recognition but also provide a fairer protection scheme that tackles the seller-friendly drafting trend in connection with MAE Provisions. The recent *AB Stable* decision may indicate that the courts of Delaware have already begun to give new emphasis to the OC Covenant.[368]

[366] *See generally supra* Section III, Part B.

[367] *See generally* Akorn, Inc. v. Fresenius Kabi AG, No. 2018-0300-JTL, 2018 WL 4719347, at *1 (Del. Ch. Oct. 1, 2018), *aff'd*, 198 A.3d 724 (Del. 2018); *see also generally* AB Stable VIII LLC v. Maps Hotels & Resorts One LLC, No. 2020-0310-JTL, 2020 WL 7024929, at 1, *73–75 (Del. Ch. Nov. 30, 2020), *aff'd*, 268 A.3d 198 (Del. 2021).

[368] *See generally AB Stable VIII LLC*, 2020 WL 7024929, at *1.