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BIG MAC BITES: THE AKORN V FRESENIUS DECISION

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Legal Briefings – By **Tony Damian and Katerina Jovanovska**

The Delaware Court of Chancery has recently handed down a decision enforcing a material adverse change (**MAC**) clause in a Merger Agreement, holding that the bidder validly terminated the Merger Agreement.

IN BRIEF

- Regulatory compliance representations made by the target in the Merger Agreement were untrue. The Court held that the deviation from the representations could not be cured by the completion date, and the degree of deviation would reasonably be expected to result in a MAC.
- This caused the big MAC in the Merger Agreement – that the target would not suffer any "effect, change, event or occurrence that, individually or in the aggregate, has had or would reasonably be expected to have a Material Adverse Effect" – to bite. The target could not compel the bidder to close.

BACKGROUND

In April 2017, Fresenius Kabi AG (**Fresenius**), a German pharmaceutical company, entered into a Merger Agreement to acquire Akorn, Inc. (**Akorn**), a NASDAQ-listed generic pharmaceutical company.

Fresenius's obligation to close was subject to three conditions:

1. Akorn's representations having been true and correct both at signing and at closing, except "where the failure to be true and correct would not, individually or in the aggregate, reasonably be expected to have a Material Adverse Effect" (**Representations Condition**);
2. Akorn having complied with or performed in all material respects its obligations required to be complied with or performed under the Merger Agreement; and
3. Akorn not having suffered any "effect, change, event or occurrence that, individually or in the aggregate, has had or would reasonably be expected to have a Material Adverse Effect" (**General MAE Condition**).

The failure of the Representations Condition gave Fresenius the right to terminate the Merger Agreement, but only if the breach that would give rise to the failure of the condition was incapable of being cured by the completion date, and Fresenius was not in material breach of the contract.

The failure of the General MAE Condition gave either party the right to refuse to close, and the right to terminate at the completion date, provided the terminating party had not itself breached the Merger Agreement in a manner that was a principal cause of the failure to close by that date.

THE MAC CLAUSE

A "material adverse effect" was defined, relevantly, as any effect, change, event or occurrence that, individually or in the aggregate, would have a material adverse effect on the business, results of operations or financial condition of the Akorn and its Subsidiaries, taken as a whole. The clause was also subject to other limitations.

AFTER SIGNING

FINANCIAL PERFORMANCE

Following signing, Akorn's business performance "fell off a cliff". It began delivering results that consistently fell materially below its prior-year performance. During the four quarters following signing, revenues declined between 29-34% on a year-over-year basis, operating income declined between 84-292% and EPS declined between 96-300%.

REGULATORY COMPLIANCE ISSUE

After signing, Fresenius received information from an anonymous whistleblower that Akorn had breached its regulatory compliance obligations. Fresenius undertook an investigation of Akorn. Fresenius discovered that Akorn had "serious and pervasive data integrity problems", such that Akorn's representations about its regulatory compliance were sufficiently inaccurate, likely resulting in a MAE.

FRESENIUS SEEKS TO WALK

In April 2018, Fresenius sought to terminate the Merger Agreement. It asserted that Akorn's representations regarding regulatory compliance matters were incorrect to a degree that would reasonably be expected to result in a MAE, and that Akorn had suffered a MAE.

Akorn commenced proceedings seeking a declaration that Fresenius' termination was invalid. It also sought an order for specific performance, compelling Fresenius to close.

DECISION – MAE HELD TO HAVE OCCURRED

The Court held Akorn could not obtain specific performance because Akorn had suffered a MAE. The Court declared that Fresenius validly terminated the Merger Agreement because Akorn's regulatory compliance representations were untrue, the deviation from the representations could not be cured by the completion date, and the degree of deviation would reasonably be expected to result in a MAE. This caused the Representations Condition to fail in an incurable manner and entitled Fresenius to terminate.

The presiding judicial officer, Vice Chancellor Laster, held that:

- Akorn's representations regarding its compliance with regulatory requirements were not true and correct, and the magnitude of the inaccuracies would reasonably be expected to result in a MAE. This was due to the fact that Akorn's regulatory violations were widespread and pervasive and had worsened between signing and closing, resulting in a financial impact on Akorn of approximately $900 million (approximately 20% of the merger price); and
- Akorn's deterioration in performance was both "material when viewed from the longer-term perspective of a reasonable acquirer" (given the size and consistency of the decline in performance) and "durationally significant" (continuing for a full year with no sign of abating), such that Akorn had suffered a MAE, justifying Fresenius' refusal to close.

Interestingly, Vice Chancellor Laster noted:

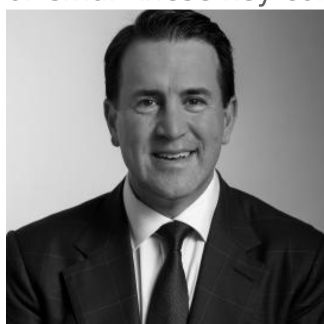
"In their influential treatise, Lou R. Kling and Eileen T. Nugent observe that most courts which have considered decreases in profits in the 40% or higher range found a material adverse effect to have occurred. Chancellor Allen posited that a decline in earnings of 50% over two consecutive quarters would likely be an MAE. Courts in other jurisdictions have reached similar conclusions. These precedents do not foreclose the possibility that a buyer could show that percentage changes of a lesser magnitude constituted an MAE. Nor does it exclude the possibility that a buyer might fail to prove that percentage changes of a greater magnitude constituted an MAE.

An example of the latter scenario is *IBP*, where Chief Justice Strine held while serving as a Vice Chancellor that a 64% drop in quarterly earnings did not constitute a material adverse effect."

Australian and English courts have traditionally looked to Delaware for guidance on MAC provisions. *Akorn v Fresenius* is another important chapter in that journey.

KEY CONTACTS

If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.



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