

KEN ADAMS ON “MATERIAL ADVERSE CHANGE” PROVISIONS

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Broc: You’ve just published in the Fordham Journal of Corporate and Financial Law an article entitled “A Legal-Usage Analysis of ‘Material Adverse Change’ Provisions.” (A copy is available [here](#).) What’s new with MAC provisions?

Ken: My article wasn’t prompted by recent developments in MAC case law or how MAC provisions are used. Instead, it was simply that I noticed that no one had written a comprehensive analysis of MAC provisions from the perspective of the drafter.

Broc: But it’s not as if there’s a shortage of articles on MAC provisions.

Ken: That’s true. After the 2001 Delaware case on the subject, *IBP, Inc. v. Tyson Foods, Inc.*, there appeared a slew of articles that poked around the entrails of that case. But analyzing the strengths and weaknesses of a court’s decision is very different from explicating the function of MAC provisions and the many variables that come into play in drafting them. The former approach reflects the perspective of the litigator, the latter that of the drafter, who is seeking to avoid problems rather than sort out the mess after a problem materializes. And while an article or two attempted a broader approach, they were far from comprehensive.

Broc: So what do you bring to the table?

Ken: The literature on drafting has for the most part been focused on broader strategic concerns—what a given contract provision should say, as opposed to how you should say it. This focus on the macroscale at the expense of the microscale helps explain why the modern contract, as an example of effective legal prose, leaves a lot to be desired: it’s an edifice built on a shaky foundation. In my writings, I focus on the building blocks of contract language and structure—what words you should use to express a given provision. That’s the topic of my book “A Manual of Style for Contract Drafting” (you can find out more about it [here](#), and if you want to buy the book, go to the ABA’s website by clicking [here](#)), but I’ve also explored in greater detail specific topics, such as [“best efforts” and its variants](#). This time around, I’ve subjected “material adverse change” provisions to this treatment.

Broc: What does the article discuss?

Ken: It considers how the term “material adverse change” is used and how MAC is defined.

Discussions of MAC will often focus on its use in a condition to closing. But it can in fact be used in different parts of a contract: representations, conditions to closing, obligations, and termination provisions.

In discussing how MAC is used, I draw a distinction between “absolute” MAC provisions, which address directly nonoccurrence of a MAC (*Since December 31, 2003, no MAC has occurred*), and “modifying” MAC provisions, which modify a provision so as to indicate the absence of anything leading to a MAC (*Acme’s books and records contain no inaccuracies except for inaccuracies that would not reasonably be expected to result in a MAC*).

Use of MAC raises various issues, such as verb use, the pros and cons of using “material adverse change” rather than “material adverse effect,” and what to use as the baseline date in absolute MAC provisions.

But more of the article is devoted to defining MAC. Here’s my basic form of definition: *“Material Adverse Change” means any material adverse change in the business, results of operations, assets, liabilities, or financial condition of the Seller, as determined from the perspective of a reasonable person in the Buyer’s position.*

Putting together a definition of MAC requires that one go through a number of analyses. The most significant inquiry goes to the meaning of “material” in MAC. In cases addressing securities laws violations and other matters, courts have held that whether a fact is material is a function of its effect on a given decision. Building on that, the court in the *IBP* case held that to constitute a MAC, change would have to be material when viewed from the longer-term perspective of the reasonable acquiror. The phrase at the end of my recommended definition (*as determined from the perspective of a reasonable person in the Buyer’s position*) reflects a more general application of the *IBP* court’s reasoning.

I suspect that most practitioners think of “material” as meaning “significant,” without considering whose perspective is to apply in determining materiality. The result is confusion. If, for example, in an asset purchase agreement the seller represents that it has disclosed all material litigation currently pending to which it is party, and if it is not made clear somehow that the materiality of a fact is a function of its effect on a given decision, then what standard does one use to determine if any undisclosed litigation is material? Its significance—however established—to the seller? To the buyer? The ratio of undisclosed cases to the total number of cases? Or what is at stake in the undisclosed cases (measured in dollars or otherwise) as compared to what is at stake in the other pending cases? Restricting your use of the word “material” to MAC provisions, and using the definition of MAC that I recommend, would allow you to avoid such confusion.

But the meaning of “material” is just one factor that you have to consider in defining MAC. Here are some others:

- Should you include a quantitative guideline?—I conclude that in most cases, there are more drawbacks than advantages to specifying that an adverse change isn’t material unless it exceeds a stated value.
- What needs to suffer a material adverse change in order for a MAC to occur?—I refer to the group of nouns in question as the “field of change.”

- In particular, what are the pros and cons of including “prospects” in the field of change?—I conclude that with careful drafting of MAC provisions, a buyer can secure the protection that would be afforded by “prospects” without raising the seller’s hackles by seeking to include “prospects” in the field of change.
- Should you draft the definition of MAC to encompass adverse changes to one party or to more than one party?
- What is the role of carve-outs in the definition of MAC?

Broc: This obviously isn’t the place to go into great detail, but is there some aspect of this topic that came as a surprise to you?

Ken: I have a soft spot for what I refer to as drafting “urban legends,” namely bits of practical wisdom that, it turns out, don’t have much of a grounding in reality. In the context of MAC provisions, one urban legend is that drafters should be on the lookout for “double materiality.” It ostensibly arises when a representation that is qualified by materiality is tested by a condition that is itself qualified by materiality. Drafters often seek to neutralize double materiality by having the bringdown condition state—the exact wording can vary—that representations must be accurate *in all respects (in the case of any representation containing any materiality qualification) or in all material respects (in the case of any representation that does not contain any materiality qualification)*.

I’ve used this sort of language myself, but in the course of writing the article I concluded that such contortions should serve no purpose. The concept of double materiality feeds off the confusion that results from taking *material* to mean “significant” without reference to the perspective of a given party. If you use *material* only in the context of MAC provisions and use the definition of MAC that I recommend, it would be clear that the materiality of a given fact is a function of its effect on a given decision. One result would be that materiality would mean the same thing in representations and in the bringdown condition, with the result that the two elements of the double-materiality analysis would be collapsed: an inaccuracy in a representation containing a MAC provision that is sufficiently inaccurate to trigger that MAC provision would automatically fail to satisfy a bringdown condition that is itself qualified by a MAC provision.

In any event, the absence of any case law discussing double materiality suggests that it’s a theoretical construct with no real-world implications.

Broc: Thanks very much, Ken. Again, a copy is available [here](#).