



Client Alert

Financial Markets Developments

Delaware Court Interprets Material Adverse Effect Clause to Bar Hexion and Apollo from Abandoning Huntsman Deal

In an important development in the law relating to Material Adverse Effect (MAE) clauses in merger agreements, Vice Chancellor Stephen P. Lamb of the Delaware Court of Chancery ruled on September 29, that Hexion Specialty Chemicals, Inc., an affiliate of Apollo Management LP, may not walk away from its deal to acquire Huntsman Corp. for US\$6.5 billion. The case, *Hexion Specialty Chemicals, Inc. v. Huntsman Corp.*, is an important indicator of how courts may interpret MAE clauses and comes at a time when the current economic crisis makes it more likely that MAE clauses will be tested in other transactions. Significantly, the Delaware decision then was followed by a Texas court ruling on September 30 that bars affiliates of the Credit Suisse Group and Deutsche Bank from withdrawing financing for the deal.

Hexion, a producer of adhesives used in plywood, agreed to purchase Huntsman, the world's largest producer of epoxy additives, in July 2007. Apollo filed suit in June 2008, claiming both that it had no obligation to close the deal as the post-merger entity would be insolvent, and because Huntsman had suffered a MAE. The MAE language in the merger agreement provided that Apollo's obligation to close was conditioned on the absence of "any event, change or development that has had or is reasonably expected to have, individually or in the aggregate" a MAE. "MAE" was in turn defined as "any occurrence...that is materially adverse to the financial condition...of the Company..." *excluding* changes in "general economic or financial market conditions" or occurrences "affect[ing] the chemical industry generally." The Court rejected Apollo's insolvency argument, largely on the basis that its insolvency opinion was flawed,¹ and went on to address the MAE argument.

In finding that Huntsman had not suffered a MAE, the Court relied heavily on *In re IBP*, a leading Delaware case (applying New York law) on the interpretation of MAE clauses. Noting that, "absent clear language to the contrary" the party seeking to invoke an MAE clause bears the burden of proving that an MAE has occurred, the Court cited *In re IBP* for the proposition that "a buyer faces a heavy burden when it attempts to invoke a material adverse effect clause in order to avoid its obligation to close," and noted that "Delaware courts have never found a material adverse effect to have occurred in the context of a merger agreement." Elaborating on the oft-cited reasoning from *In re IBP* that "[a] short-term hiccup in earnings should not suffice" to succeed on a MAE claim, the Court explained that "a significant decline in earnings by the target corporation during the period after signing but prior...to closing" could constitute a MAE if those poor results can be "expected to persist significantly into the future."

¹ The Court found Apollo's insolvency opinion to be unreliable for three reasons: 1) it was produced with the knowledge that it could be used in litigation; 2) it was based on biased information provided by Apollo; 3) it was produced without any consultation with Huntsman management.



White & Case LLP is a leading global law firm with more than 2,400 lawyers in 37 offices in 25 countries. Whether in established or emerging markets, the hallmark of White & Case is our complete dedication to the business priorities and legal needs of our clients.

If you have questions or comments regarding this Alert, please contact one of the following lawyers:

Owen Pell
Partner, Litigation
+ 1 212 819 8891
opell@whitecase.com

Paul Carberry
Partner, Litigation
+ 1 212 819 8507
pacarberry@whitecase.com

White & Case LLP
1155 Avenue of the Americas
New York, NY 10036
+ 1 212 819 8200

www.whitecase.com

The Court then turned to the question of “what benchmarks to use in examining changes in the results of business operations post-signing of the merger agreement—EBITDA or earnings per share.” Finding earnings per share “problematic” in the context of a cash acquisition, the Court instead reasoned that “[w]hat matters is the results of the business,” and that the target’s “fortunes” should be “examined through the lens of changes in EBITDA.” In concluding, based on past and projected EBITDA figures, that Huntsman had not suffered a MAE, the Court also cited the “macroeconomic challenges Huntsman has faced since the middle of 2007 as a result of rapidly increased crude oil and natural gas prices and unfavorable foreign exchange rate changes.” The Court’s determination that EBITDA, rather than earnings per share, was a more appropriate benchmark for evaluating MAE claims, appears to be the first judicial pronouncement on this subject.

Having found that no MAE had occurred as to Huntsman as a whole, the Court rejected Apollo’s claim that (i) a five percent increase in Huntsman’s post-closing debt was not material to Apollo’s valuation of the transaction and (ii) problems with two Huntsman divisions amounted to a MAE, given that “Huntsman as a whole is not materially impaired by their results.”

Finally, the Court found that Apollo had engaged in a “knowing and intentional breach,” and that the liquidated damages clause of the merger agreement (by which Apollo’s damages were capped at US\$325 million) was therefore inapplicable. However, because the agreement also contained an express agreement that Apollo could not be made to specifically

perform the closing, the Court ordered Apollo to “specifically perform its obligations under the merger agreement, other than the obligation to close.” Thus, Apollo may decide whether or not it wishes to close, but if it chooses not to, and breaches the merger agreement in doing so, it will be liable in damages, and those damages will be uncapped.

Hexion is consistent with prior rulings in showing that purchasers face a heavy burden in attempting to use MAE clauses to avoid merger agreements. The case also highlights the importance of carve-outs often used in MAE clauses—as the parties here had excepted general economic or financial market changes, which language figured prominently in the Court’s ruling. *Hexion* suggests that parties negotiating MAE clauses seriously consider terms that might (i) shift the burden of proof regarding use of the clause and (ii) provide greater specificity in the types of changes that may constitute a MAE, *including* changes in general market or macroeconomic conditions.

Owen Pell and Paul Carberry are litigation partners in the New York office of White & Case. Aaron Chase assisted in the preparation of this article.

The Firm’s Banking and Litigation groups are following developments in this area closely and regularly advise on this and other issues relating to transaction termination. In addition to the authors, please call your White & Case contacts with any questions about this memo.

White & Case

White & Case is a leading global law firm with more than 2,400 lawyers in 37 offices in 25 countries. Among the first US-based law firms to establish a truly global presence, we provide counsel and representation in virtually every area of law that affects cross-border business. Our clients value both the breadth of our network and depth of our US, English and local law capabilities in each of our offices and rely on us for their complex cross-border transactions, arbitration and litigation. Whether in established or emerging markets, the hallmark of White & Case is our complete dedication to the business priorities and legal needs of our clients.

Our approach is based on listening to our clients' needs, taking the time to understand their business and responding with effective strategies and solutions, no matter how big the opportunity or formidable the challenge. With new technologies, globalization, consolidation and other forces continuously changing how business gets done, we help our clients evaluate the risks and rewards of ventures designed to advance their interests.

We work with the world's most established and respected companies, including two-thirds of the *Global Fortune 100* and half of the *Fortune 500*, as well as with start-up visionaries, governments and state-owned entities.

This Client Alert is provided for your convenience and does not constitute legal advice. It is prepared for the general information of our clients and other interested persons. This Client Alert should not be acted upon in any specific situation without appropriate legal advice and it may include links to websites other than the White & Case website.

White & Case has no responsibility for any websites other than its own and does not endorse the information, content, presentation or accuracy, or make any warranty, express or implied, regarding any other website.

This Client Alert is protected by copyright. Material appearing herein may be reproduced or translated with appropriate credit.