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Material Adverse Change Clauses

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If your planned acquisition encounters turbulence because your target's finances have suddenly taken a nosedive, you might want to consider one of a buyer's last-ditch remedies - the material adverse change (MAC) clause. Buyers should never claim a MAC without careful consideration, and they must understand that it won't guarantee an escape from a bad deal without penalties. But given current economic conditions, you should become familiar with the MAC option.

Nuts and Bolts

MAC clauses aren't just for large deals: Most transactions can include one of these provisions. These clauses generally have two main elements:

1. A definition of what constitutes a MAC for the purposes of the deal.
Generally, these provisions describe a MAC as a relatively sudden event that quickly and negatively affects a business's performance.

You may also want to try to include in your MAC definition a forward-looking component, such as requiring the provision to apply to any event that has a reasonable likelihood of causing a MAC in the future. MAC clauses typically cover the period of time between the signing of the acquisition agreement and the transaction's completion, making it a type of emergency escape clause for buyers.

2. The circumstances that would permit a buyer to withdraw from the deal without incurring a penalty.
MAC clauses contain a list of carve-outs - exceptions and qualifications that shouldn't be considered when determining if a target company has experienced a MAC. This list can include:

- General economic changes that affect the target company's industry,
- Law changes that hurt the target's business,
- Changes in the rules of Generally Accepted Accounting Principles, and
- Unpredictable events such as terrorism, war or other catastrophes (usually referred to as "Acts of God").

Market conditions usually dictate the number and breadth of exceptions included in the clause. In a seller's market MAC clauses typically included a wide range of exceptions, making it difficult for buyers to invoke one.

Not a Foolproof Solution

A MAC doesn't exempt you from the need to choose your acquisition target wisely and perform extensive due diligence. Instead, think of a MAC as a negotiating tool. During the negotiation process you and the seller will discuss what events constitute a MAC as a way to allocate risk between both parties. If you're unsure or uncomfortable about your target's exposure in certain areas, you might negotiate to include them in your agreement's MAC clause.

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