

Pandemic Risk and the Interpretation of Exceptions in MAE Clauses

Robert T. Miller¹

I. TYPICAL MAE CLAUSES AND THE ALLOCATION OF RISK	683
II. THE ALLOCATION OF PANDEMIC RISK IN MAE DEFINITIONS	690
A. <i>MAE Exceptions Related to Force Majeure Events Distinguished from Force Majeure Clauses</i>	693
B. <i>Pandemics in MAE Exceptions for Force Majeure Events</i>	695
III. THE INTERPRETATION OF MAE EXCEPTIONS AND THE CAUSAL AMBIGUITY PROBLEM.....	700
A. <i>Two Key Features of MAE Definitions</i>	701
B. <i>What is Allocated When an MAE Definition Allocates a Risk</i>	702
C. <i>How MAE Definitions Should be Applied in Causally Complex Situations</i>	704
D. <i>Why the Courts Have Misapplied MAE Exceptions</i>	710
IV. CONCLUSION	714

In business combination transactions, Material Adverse Effect (MAE) clauses allocate risks to the target's business that arise between signing and closing. The COVID-19 pandemic adversely affected many businesses and so led to a series of broken deals in which acquirers claimed they were entitled to terminate a pending merger agreement because the pandemic had had a material adverse effect on the target. MAE clauses typically allocate to the acquirer many systematic risks to the target's business by removing them from the definition of "Material Adverse Effect" in broadly worded exceptions. A key

1. Professor of Law and F. Arnold Daum Fellow in Corporate Law at the University of Iowa College of Law; Fellow and Program Affiliated Scholar at the Classical Liberal Institute at New York University Law School. I thank Jennifer L. Miller, Barbara Becker, William J. Carney, Mihailis Diamantis, Richard A. Epstein, Thomas P. Gallanis, Joel I. Greenberg, Caley Petrucci, Andrew A. Schwartz, Keith Sharfman, Guhan Subramanian, Matthew L. Strand, Leo E. Strine, Jr., Sean P. Sullivan, Michael Swidler, Glenn West, Aurora Jok Deng Kuol Arop, Sydney Eibschutz, Jackson Esker, Jessica Lowe, Chandler Mores, Girindra Selleck, and Peter Sotos for helpful comments and discussions related to this paper. I also thank the members of the Mergers & Acquisitions Committee of the Business Law Section of the American Bar Association and the members of the California Society of Certified Public Accountants, to whom I presented portions of the research presented here. Parts of this Article are based on my working papers. Robert T. Miller, *Material Adverse Effect Clauses and the COVID-19 Pandemic* (Univ. Iowa Legal Stud., Rsch. Paper No. 2020-21), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3603055 [<https://perma.cc/NHA6-EXL7>] [hereinafter Miller, *MAE Clauses*]; Robert T. Miller, *Material Adverse Effect Clauses and the COVID-19 Pandemic: How Sophisticated Commercial Parties Allocate Risk by Contract* (Univ. Iowa Legal Stud., Rsch. Paper No. 2020-33), https://papers.ssrn.com/sol3/abstract_id=3707282 [<https://perma.cc/RUW9-WLDP>]. Some material in Part I.A, discussing the structure of typical MAE clauses, is drawn from Robert T. Miller, *A New Theory of Material Adverse Effects*, BUS. LAW. (forthcoming 2021), https://papers.ssrn.com/sol3/abstract_id=3706580 [<https://perma.cc/6BBC-J76C>] [hereinafter Miller, *New Theory*].

issue in the MAE disputes arising from the pandemic has thus been whether one or more of these exceptions shifted the relevant risk to the acquirer. In some cases, the issue has been the relatively straightforward one of whether the pandemic should count as a “natural disaster” or “calamity” in an exception related to force majeure events. In other cases, however, the issues have been considerably more complicated. In particular, when the causal chain from the pandemic to the material adverse effect on the company passes through multiple events (e.g., from pandemic to governmental lock-down orders to a drop in demand for the company’s products or services to the material adverse effect), and when, further, some of these events fall into exceptions in the MAE definition but others do not, the ultimate allocation of the risk depends on how we should understand the relation between the exceptions and the base part of the definition and the interrelations among the exceptions themselves. Working from the assumption that the sophisticated commercial parties that enter into business combination transactions are rational profit-maximizers who intend to allocate risks in a predictable way, this Article presents a general theory of how exceptions from MAE definitions should be interpreted in order to respect the intentions of the parties. It argues that the conclusions reached in dicta on the relevant issues in *AB Stable* and other cases are wrong, in large part because they confuse Material Adverse Effects with material adverse effects (i.e., events causing material adverse effects with the material adverse effects themselves).

Any shock to the economy tends to reverberate through the market for corporate control. Such has been the case with the COVID-19 pandemic, which reduced the gross domestic product in the United States by some 32.9% in the second quarter of 2020² and triggered a string of broken deals.³ As happened during the last major shock to the economy, the financial crisis of 2007–08, acquirers in several pending mergers claimed their targets had suffered a material adverse effect (MAE), with the result that the acquirer had a right to terminate the merger agreement between the parties without closing and

2. Press Release, Bureau Econ. Analysis, U.S. Dep’t. of Com., Gross Domestic Product, 2nd Quarter 2020 (Advance Estimate) and Annual Update (July 30, 2020), [https://www.bea.gov/news/2020/gross-domestic-product-2nd-quarter-2020-advance-estimate-and-annual-update#:~:text=Real%20gross%20domestic%20product%20\(GDP,real%20GDP%20decreased%205.0%20percent](https://www.bea.gov/news/2020/gross-domestic-product-2nd-quarter-2020-advance-estimate-and-annual-update#:~:text=Real%20gross%20domestic%20product%20(GDP,real%20GDP%20decreased%205.0%20percent) [https://perma.cc/5Z59-RSTX].

3. E.g., *AB Stable VIII LLC v. Maps Hotels & Resorts One LLC*, No. 2020-0310-JTL, 2020 WL 7024929 (Del. Ch. Nov. 30, 2020); *Fairstone Fin. Holdings Inc. v. Duo Bank of Can.*, 2020 CanLII 7397 (Can. Ont. Super. Ct. J.); *Travelport Ltd. v. WEX Inc.* [2020] EWHC (Comm) 2670 (Eng.); Alison Frankel, *Sycamore Partners Invokes MAE Clause in Bid to Escape Victoria’s Secret Deal*, REUTERS (Apr. 22, 2020, 4:29 PM), <https://www.reuters.com/article/us-otc-mae-idUSKCN2243CK> [https://perma.cc/5ZVR-K4QK]; *Realogy Holdings Corp. v. SIRVA Worldwide*, No. 2020-0311-MTZ, 2020 WL 4559519 (Del. Ch. Aug. 7, 2020) (providing judgment on grounds not related to the MAE clause); Natalie Wong & Sebastian Tong, *Simon, Taubman Settle Mall Takeover Dispute With Price Cut*, BLOOMBERG (Nov. 16, 2020, 12:46 PM), <https://www.bloomberg.com/news/articles/2020-11-15/simon-property-taubman-resolve-takeover-spat-with-lower-price> [https://perma.cc/8VK5-DAFT] (discussing the settlement); *Tiffany & Co. Shareholders Approve Renegotiated \$15.8 Billion LVMH Merger*, FASHION L. (Dec. 30, 2020), <https://www.thefashionlaw.com/tiffany-co-shareholders-approve-renegotiated-15-8-billion-lvmh-merger/> [https://perma.cc/6W56-Y87H] (discussing the settlement following dispute over the MAE Clause); Joshua Franklin, *Third Point-Backed Far Point Green Lights \$2.6 Billion Global Blue Deal*, REUTERS (Aug. 24, 2020, 2:21 PM), <https://www.reuters.com/article/us-far-point-m-a-global-blue-vote/third-point-backed-far-point-green-lights-2-6-billion-global-blue-deal-idUSKBN25K2AS> [https://perma.cc/MM67-5X2V] (describing how the parties renegotiated agreement without litigation).

without further liability. Some of the resulting MAE disputes have been settled,⁴ but four have been litigated to completion, leading to two judicial opinions in the Delaware Court of Chancery,⁵ one the Commercial Court of the United Kingdom,⁶ and one in the Superior Court of Justice in Ontario.⁷ These cases have each developed the law of MAEs in significant ways, but probably the most important of these developments concern how exceptions in MAE clauses ought to be interpreted. Such exceptions often pertain to systematic risks, such as general changes in business or industry conditions or *force majeure* events like pandemics, and how they should be interpreted raises difficult issues, mostly related to how we should understand the causes of the material adverse effect on the company. This Article explores these issues and presents a general theory of how exceptions in MAE definitions should be interpreted, both in relation to the main body of the MAE definition and to each other.

In Part I, I review the logical structure of typical MAE clauses and explain the context in which the interpretive problems concerning the functioning of the exceptions in the clauses have arisen. In Part II, partly because of its current relevance and partly because of the light it throws on general problems of interpreting MAE clauses, I consider how MAE clauses allocate pandemic risk, focusing on the *force majeure* exception in the MAE definition. In Part III, I take up the considerably more complex problems related to causal ambiguities in the exceptions to the MAE definition and present a general account of how they ought to be resolved. In Part IV, I make some concluding remarks.

I. TYPICAL MAE CLAUSES AND THE ALLOCATION OF RISK

The MAE disputes related to the COVID-19 pandemic arise in a familiar context. In any large business combination transaction, the need to obtain approvals from shareholders and consents from governmental authorities requires that there be a significant delay between the time the parties enter into the merger agreement (the signing) and the time the business being sold changes hands and the acquirer pays the purchase price (the closing). Hence, even as they enter into the agreement, acquirers and targets both know that there are innumerable risks that could materialize after signing and adversely affect the target's business.⁸ The parties allocate these risks in the agreement—some to the acquirer and some to the target—generally in accordance with the principle that each risk should be allocated to the party that can bear it most efficiently,⁹ thus maximizing the joint surplus created by

4. See sources cited *supra* note 3 (discussing settlements).

5. *AB Stable VIII LLC*, 2020 WL 7024929.

6. *Travelport Limited*, [2020] EWHC (Comm) 2670.

7. *Fairstone Fin. Holdings Inc.*, 2020 CanLII 7397. The *Realogy* case also ended in a final judgment, but the grounds did not concern the MAE clause. See generally *Realogy Holdings Corp. v. SIRVA Worldwide*, No. CV 2020-0311-MTZ, 2020 WL 4559519 (Del. Ch. Aug. 7, 2020).

8. For the sake of simplicity, this Article assumes an asymmetrical transaction between a buyer and a seller as happens when the merger consideration is cash. When the merger consideration is stock of the acquirer, as in a stock-for-stock merger between public companies, the situation becomes symmetric, and typically each party's obligation to close is conditioned on the non-occurrence of an MAE with respect to the other party. Robert T. Miller, *The Economics of Deal Risk: Allocating Risk Through MAC Clauses in Business Combination Agreements*, 50 WM. & MARY L. REV. 2007, 2073–82 [hereinafter Miller, *Deal Risk*].

9. *Id.* at 2013; *Akorn, Inc. v. Fresenius Kabi AG*, No. 2018-0300-JTL, 2018 WL 4719347, at *52 (Del. Ch. Oct. 1, 2018).

the transaction and allowing both parties to profit to the greatest extent possible.

This allocation of risks proceeds in two stages. First, the parties identify a great many specific risks, which they allocate to one party or the other in specific provisions of the agreement. Second, the parties deal with the remaining risks through an MAE clause,¹⁰ allocating certain broad categories of risks to the acquirer and leaving the remaining risks on the target, including, to be sure, some risks that were known and appreciated at the time of signing, but also all risks not known at signing and thus not otherwise allocated in the agreement.¹¹ Although the exact terms vary from agreement to agreement, the definitions of “Material Adverse Effect” in public company merger agreements tend to follow a common pattern. As shown in Table 1 below, a typical MAE definition¹² begins with a complicated base definition (the Base Definition), followed by exceptions that shift various broad categories of risks to the acquirer (MAE Exceptions), some of which are further qualified in ways that shift disproportionate materializations of the relevant risks back to the target (Disproportionality Exclusions).

10. When speaking of MAE “clauses,” I am referring to the combination of contractual provisions the effect of which is to relieve the acquirer of its obligation to complete the transaction if an MAE has occurred. As is well known, this contractual result can be achieved (a) by a closing condition in favor of the acquirer providing that an MAE has not occurred, or (b) by a representation by the target that, since a certain date (usually the date of its most recent audited financial statements), there has occurred no MAE, combined with a closing condition in favor of the acquirer providing that this representation remains true at closing. LOU R. KLING & EILEEN T. NUGENT, NEGOTIATED ACQUISITIONS OF COMPANIES, SUBSIDIARIES AND DIVISIONS §11.04[9], n.94.1, §14.11[5]. As I am using the terms, therefore, the “MAE definition” is a proper part of the “MAE clause.”

11. The text here reflects the holding in *Akorn* that rejected the argument, made by the target and previously endorsed by some commentators, that any risk of which the acquirer was aware at the time of signing is automatically allocated to the acquirer. *Akorn, Inc.*, 2018 WL 4719347, at *60–62, *76–81. I regard that holding as reflecting a correct reading of *IBP*, as certainly in accordance with the understanding of sophisticated parties entering into merger agreements, and as producing the efficient result. Miller, *New Theory*, *supra* note 1, at 28.

12. See generally Miller, *Deal Risk*, *supra* note 8 (discussing typical MAE definitions on the basis of an empirical study of such clauses in business combination agreements filed with the SEC between July 1, 2007, and June 30, 2008).

Table 1
Typical Definition of “Material Adverse Effect”
in Business Combination Agreements¹³

“Material Adverse Effect” shall mean

Base Definition	<p><u>Underlying Predicate Event</u></p> <p><u>Expectation Metric</u></p>	<p>any event, fact, occurrence, circumstance, development or change that, either singly or in the aggregate,</p> <p>has, or would (alternatively <i>could</i>) reasonably be expected to have,</p>
	<u>Undefined Term</u>	a material adverse effect on
	<u>MAE Objects</u>	<p>the company and its subsidiaries taken as a whole, or its</p> <p>(a) business,</p> <p>(b) financial condition,</p> <p>(c) results of operations,</p> <p>(d) assets,</p> <p>(e) properties,</p> <p>(f) liabilities,</p> <p>(g) condition, other than financial condition,</p> <p>(h) capitalization, or</p> <p>(i) prospects,</p>
MAE Exceptions		<p>except that none of the following, nor any event, fact, occurrence, circumstance, development or change, arising from any of the following,¹⁴ shall constitute a Material Adverse Effect:</p>
	<i>Systematic Risks</i>	<p>(a) general changes in the economy or economic or business conditions,</p> <p>(b) general changes in conditions in financial, credit, debt, capital,</p>

13. This table is drawn from Miller, *New Theory*, supra note 1, at 6–8, and is an updated and expanded version of the one published in Miller, *Deal Risk*, supra note 8, at 2049.

14. On the potential importance of this language introducing the MAE Exceptions, see notes 19 and 81 *infra*.

- or securities markets,
- (c) general changes in the industries or lines of business in which the company operates,
- (d) general changes in law or legal or regulatory conditions,
- (e) general changes in GAAP,
- (f) general changes in political or social conditions,
- (g) general changes in weather or climatic conditions,
- (h) acts of war, terrorism, or sabotage,
- (i) hurricanes, tornadoes, earthquakes, tsunamis, floods, or pandemics,
- (j) calamities or natural disasters,

Indicator Risks

- (k) failures to meet financial projections prepared by the company, industry or securities analysts, or other parties (but not the underlying cause of any such failure),
- (l) downgrades or similar adverse actions by rating agencies relating to the company or its debt or equity securities (but not the underlying causes of any such downgrades or actions),
- (m) changes in the prices or trading volumes of the company's shares or other securities (but not the underlying causes of any such changes),

Agreement Risks

- (n) the agreement between the parties,**
- (o) the public announcement or disclosure of the agreement between the parties,**
- (p) any action (or omission) taken (or omitted) by the company as required or permitted by the agreement, or**
- (q) any action (or omission) taken (or omitted) by the company with the prior written consent of the acquirer,**

**Disproportionality
Exclusion**

except, with respect to (a) through (j) above, to the extent that such events, facts, occurrences, circumstances, developments or changes disproportionately affect the company as compared to other companies or persons operating in the same industries and geographical regions.

In previous work, I have analyzed the various parts of a typical MAE definition¹⁵ and argued why systematic risks, indicator risks, and agreement risks are typically allocated to the acquirer and why business risks (i.e., all other risks) are typically allocated to the target.¹⁶ I do not repeat those analyses and arguments here.

In this Article, rather, I concentrate on the relationship between the Base Definition and the MAE Exceptions. The key point is that the MAE definition refers to an event, the Underlying Predicate Event, that already has, or would reasonably be expected in the future to have,¹⁷ a material adverse effect on the company. The MAE definition thus refers to two separate events that are related as cause and effect: an Underlying Predicate Event, which may be any event at all, that causes another event, which is a material adverse effect on the company. It is counterintuitive but apparent from the face of the definition that the capitalized term “Material Adverse Effect” thus refers not to the uncapitalized material adverse effect but to the Underlying Predicate Event that causes the material adverse effect.

15. See Miller, *New Theory*, *supra* note 1, at 8–10.

16. Miller, *Deal Risk*, *supra* note 8, at 2070–90; *Akorn, Inc.*, 2018 WL 4719347, at *49–50; *AB Stable VIII LLC v. Maps Hotels & Resorts One LLC*, No. 2020-0310-JTL, 2020 WL 7024929, at *60 (Del. Ch. Nov. 30, 2020).

17. Sometimes the language is that the Underlying Predicate Event has “or is reasonably likely to have” a material adverse effect on the company. I do not see any difference in meaning between this formulation and the “would reasonably be expected” language, but since my sense is that the second formulation is more common, I use that formulation consistently in the text.

That is, a Material Adverse Effect is *not* a material adverse effect on the target but rather an Underlying Predicate Event that causes such an effect. Since an Underlying Predicate Event may occur that has not yet had, but is reasonably expected to have, a material adverse effect on the company, it can happen that there has occurred a Material Adverse Effect (the Underlying Predicate Event) but no material adverse effect, at least not yet. This distinction between Material Adverse Effects and material adverse effects turns out to be crucially important in what follows, and therefore I shall assiduously distinguish between (uncapitalized) material adverse effects and (capitalized) Material Adverse Effects, which are Underlying Predicate Events causing material adverse effects.¹⁸

Now, as mentioned above, under the terms of the Base Definition, an Underlying Predicate Event may be any event whatsoever that has the requisite material adverse effect on the company. The purpose of the MAE Exceptions is to remove certain events from the scope of the capitalized term “Material Adverse Effect.” If one of these excepted events comes to pass and has, or would reasonably be expected to have, a material adverse effect on the company, it will *not* count as a Material Adverse Effect within the meaning of the MAE definition. Everyone understands that MAE clauses allocate risk between the parties, and this litany of MAE Exceptions is how they do it: of all the possible events that could occur after signing and cause a material adverse effect on the target, the risk related to some of those events is shifted to the acquirer by excepting those events from the MAE definition by means of MAE Exceptions; for all the remaining events—the ones not excepted—the risk related to these events is borne by the target.¹⁹

18. In the text, I have assumed that the MAE definition provides that the Underlying Predicate Event has *or would reasonably be expected to have* a material adverse effect on the company. Professor Subramanian and Ms. Petrucci find in an impressive empirical study that only 48% of the agreements in their sample include this forward-looking italicized language; the rest include only language to the effect that the Underlying Predicate Event *has* a material adverse effect on the company, and they suggest that this might be of great importance in the interpretation of the agreement. Guhan Subramanian & Caley Petrucci, *Deals in a Time of Pandemic*, 121 COLUM. L. REV. __ (forthcoming) at 40. I do not share this view. For one thing, even when the MAE definition itself does not include the “would reasonably be expected” language, such language often appears in the agreement when the defined term is used. Thus, in the crucial closing condition bringing down the representations, a common formula is that the representations and warranties of the company are true (generally with a materiality scrape) “except . . . where the failure of such representations and warranties to be so true and correct would not, individually or in the aggregate, reasonably be expected to have a Company Material Adverse Effect.” ABA Model Merger Agreement, §5.1; *see also* KLING & NUGENT, *supra* note 10, at §14.02[3], 1413 (“except as would not individually or in the aggregate have a material adverse effect’ [as defined in the agreement]”); *AB Stable*, 2020 WL 7024929, at *62 (interpreting “would have” language as being synonymous with “would reasonably be expected to have.”). Even more important, however, is that, as interpreted by the Delaware courts, the (uncapitalized) “concept of a material adverse effect is inherently forward looking,” *id.* at *61, because “a material adverse effect is really a change in the reasonable valuation of the company,” *id.* at *74 (cleaned up), and “the value of a company is determined by the present value of its future cash flows.” *Id.* at *61 (cleaned up). Hence, even to say that an Underlying Predicate Event *has had* a material adverse effect on the company is to say that the value of the company has been materially reduced; but that can only happen if the present value of its future cashflows has been materially reduced, which makes any use of the (uncapitalized) term “material adverse effect” inherently forward looking. *See id.* at *62 (describing a contractual provision that required a Material Adverse Effect “be measured only against past performance of the Company and its Subsidiaries, and not against any forward-looking statements, financial projections or forecasts of the Company” as “only inject[ing] doubt into an inherently forward-looking inquiry.”).

19. Professor Subramanian and Ms. Petrucci have called attention to the fact that the text introducing the

MAE Exceptions, which I have given as, “except that none of the following, nor any event, fact, occurrence, circumstance, development or change, arising from any of the following, shall constitute a Material Adverse Effect,” may involve causal language (e.g., by including events “arising from” the events covered by the MAE Exceptions) or non-causal language (e.g., by including events merely “relating to” such events). Subramanian & Petrucci, *supra* note 18, at 50–53. They argue that there is an important difference here because “[w]hen there is a causal requirement, the carve-out [i.e., the MAE Exception] must cause the MAE (e.g., a pandemic must cause the material adverse effect on the business in order to be carved out),” which is more buyer-friendly, but “[w]hen there is no causal requirement, the carved-out category must merely relate to the MAE in order to be carved out (e.g., a general economic downturn must relate to the material adverse effect on the business),” which is more seller-friendly. *Id.* This is an important point. The general idea in an MAE definition is that we begin with the universe of all possible events, these events being of interest because of their potential to cause a material adverse effect on the target. The MAE definition allocates risk between the target and the acquirer by dividing these events into two classes, with the risk of events in one class (the Target Underlying Predicate Events) being allocated to the target and the risk of events in the other class (the Acquirer Underlying Predicate Events) being allocated to the acquirer. In the simplest case, the lead-in to the MAE Exceptions would just say that none of the excepted events “is” (or “constitutes”) a Material Adverse Effect (i.e., the definition would just stipulate that certain events—the excepted ones—are not to count as “Material Adverse Effects” even if they in fact cause a material adverse effect). As Professor Subramanian and Ms. Petrucci point out, however, the introductory language can go further and expand the set of excepted events. Any “causal” language in the lead-in to the MAE Exceptions thus means that an event that might not otherwise be an excepted event will count as an excepted event if it is caused by an excepted event. In other words, events caused by excepted events are excepted. I argue in Part III that, even without such language in the lead-in, the MAE Exceptions ought to be read this way; the “causal” language just makes explicit what would otherwise be implied. *See* text at note 81 *infra*. As to the “related” language, however, it would make nonsense of the definition if it meant merely “related in anyway whatsoever,” for in that case there could be an Underlying Predicate Event that (a) causes a material adverse effect on the target, and (b) does not itself fall into an MAE Exception, and yet (c) would not count as a Material Adverse Effect merely because it was (d) “related” in anyway whatsoever to any other event that *did* fall into an MAE Exception. For example, in *Akorn*, the emergence of new competitors had a material adverse effect on the target, and the emergence of these competitors did not fall into an MAE Exception. *Akorn, Inc.*, 2018 WL 4719347, at *58–60. Suppose that, while the competitors were entering the market, the economy slipped into recession, the recession being an event that would fall within an MAE Exception. Had the Fresenius-Akorn merger agreement used the “related” language rather than the “arising from” language, would there have been no Material Adverse Effect because the emergence of the new competitors occurred simultaneously with (and thus was in a sense “related to”) the recession, an excepted event, even though the recession had no causal relation to either the emergence of the competitors or the material adverse effect on the company? Such an interpretation of the contract would serve no ascertainable economic purpose. Under such a reading, an event that sophisticated commercial parties would normally think was a Material Adverse Effect could suddenly and unexpectedly become excepted from the definition and not be a Material Adverse Effect after all merely because it was “related” in some trivial and unforeseeable way to an excepted event that played no role at all in the material adverse effect on the target. No rational acquirer would agree to such a provision. Indeed, it is even worse than that, for this interpretation of the “related to” language (i.e., “related in any way whatsoever”) would almost certainly result in there *never* being a Material Adverse Effect. For, whenever a non-excepted event caused a material adverse effect on the target, we could always find some excepted event—some change in business, economic, market or industry conditions, or some change in law or GAAP, or some *force majeure* event—that was “related,” in some way or other, to the event causing the material adverse effect, which would mean there was no Material Adverse Effect. For such reasons, when the lead-in to the MAE Exceptions refers to “related” events, the meaning is not that the events be related in just any way, such as occurring simultaneously or being discussed in the same edition of *The Wall Street Journal*; the meaning must be more restricted than that. In *Snow Phipps Group, LLC v. KCake Acquisition, Inc.*, No. 2020-0282-KSJM, 2021 WL 1714202, at *35 (Del. Ch. April 30, 2021), the Court stated that the “arising from or related to” language “is broad in scope under Delaware law,” but it did not further construe it. In dicta, the court said that declines in the company’s revenues were excepted from the MAE definition because they were “related to” changes in law (an event covered by an MAE Exception), but it was apparent on the facts that the relation was a causal one (the changes in law caused the revenue declines). *Id.* If the “related to” language is to

With this background in place, I turn to the particular question of how MAE definitions allocate the risk of a pandemic.

II. THE ALLOCATION OF PANDEMIC RISK IN MAE DEFINITIONS

Under a typical MAE definition, a pandemic is an event, fact, occurrence, circumstance, development, or change (i.e., an Underlying Predicate Event) that, in relevant cases, has had an adverse effect on the target's business. The question then becomes whether that adverse effect is severe enough to amount to a material adverse effect, a term that is generally not further defined in the agreement.²⁰ Much of the caselaw in Delaware has been devoted to interpreting that term,²¹ and while much remains unclear, everyone agrees that a material adverse effect requires a significant (e.g., perhaps 20%)²²

have meaning beyond that of "arising from" but not be so expansive as to amount to "related to in anyway whatsoever," perhaps it could be construed to mean "arising from or *correlated with*." In that case, an event would be "related to" an excepted event if the related event either arose from the excepted event or else both the related event and the excepted event arose from the same cause. But even this seems odd, for it would mean that there could be an Underlying Predicate Event that (a) causes a material adverse effect on the target, and (b) does not itself fall into an MAE Exception, and yet (c) would not count as a Material Adverse Effect merely because it (d) arose from some event that also caused an event that *did* fall into an MAE Exception. It is difficult to see why rational commercial parties would care about the otherwise unrelated side-effects of the cause of the Underlying Predicate Event. Perhaps the best view is to construe "arising from or related to" as a legal doublet like "null and void" or "cease and desist" and limit the meaning to the causal interpretation. If that is right, then it makes no difference whether the lead-in to the MAE Exceptions speaks in terms of events "arising from" or "related to" the events covered by such exceptions. Although transactional lawyers may sometimes argue about this issue as if it mattered, Subramanian & Petrucci, *supra* note 18, at 53, the case may be analogous to distinctions between the various kinds of efforts clauses, about which transactional lawyers also argue but among which the Delaware courts have been unable to meaningfully distinguish. *Akorn, Inc.*, 2018 WL 4719347, at *8687; *Williams Cos. v. Energy Transfer Equity, L.P.*, 159 A.3d 264, 272 (Del. 2017).

20. See *Akorn, Inc.*, 2018 WL 4719347, at *48 ("Despite the attention that contracting parties give to these provisions, MAE clauses typically do not define what is 'material.'"); *Channel Medsystems, Inc. v. Bos. Sci. Corp.*, No. 2018-0673-AGB, 2019 WL 6896462, at *24 (Del. Ch. Dec. 18, 2019) (stating, "[a]s is typical with MAE clauses, the Agreement does not define what 'material' means for purposes of an MAE."). Although the phrase "material adverse effect" has been used in commercial agreements at least since the 1970s and may go back to the 1940s or earlier, it is almost never defined. See Miller, *New Theory*, *supra* note 1, at 10 n.26 (citing sources). Some scholars have argued that leaving the term undefined creates uncertainty, which increases the risks involved in litigation and so encourages renegotiation when an event occurs after signing that arguably has resulted in a material adverse effect on the target. Albert Choi & George Triantis, *Strategic Vagueness in Contract Design: The Case of Corporate Acquisitions*, 119 YALE L.J. 848, 854 (2010). Another explanation, not incompatible with the first, is that agreeing on a definition would be highly contentious. Claire A. Hill, *Bargaining in the Shadow of the Lawsuit: A Social Norms Theory of Incomplete Contracts*, 34 DEL. J. CORP. L. 191, 198 (2009). Since the chance that the exact meaning of the definition will ever matter is remote (most companies do not suffer material adverse effects after signing), it is in the parties' interests to leave the term undefined and gamble on a favorable outcome in litigation in the small fraction of cases in which serious disputes arise. See *Colfax Envelope Corp. v. Local No. 458-3M, Chi. Graphic Commc'ns Int'l Union*, 20 F.3d 750, 754 (7th Cir. 1994) (stating that "[w]hen parties agree to a patently ambiguous term, they submit to have any dispute over it resolved by interpretation. That is what courts and arbitrators are *for* in contract cases—to resolve interpretive questions founded on ambiguity.") (Posner, J.).

21. See generally *In re IBP S'holders Litig.*, 789 A.2d 14 (Del. Ch. 2001); *Frontier Oil Corp. v. Holly Corp.*, No. Civ.A. 20502, 2005 WL 1039027 (Del. Ch. Apr. 29, 2005); *Hexion Specialty Chems., Inc. v. Huntsman Corp.*, 965 A.2d 715 (2008); *Akorn, Inc.*, 2018 WL 4719347; *Channel Medsystems, Inc.*, 2019 WL 6896462 (all analyzing the meaning of "material adverse effect").

22. See *Akorn, Inc.*, 2018 WL 4719347, at *73–74.

diminution in the standalone value of the target.²³ The valuation question is difficult and complex, for it involves considering changes in the expected future cashflows of the company and related factors.²⁴ As a question of valuation, however, it concerns the *magnitude* of the adverse effect, not its *cause*; whether the adverse effect arises from a pandemic, problems internal to the operations of the company, or any other cause is thus irrelevant to the inquiry. Material adverse effects caused by a pandemic present no special issues in this regard.

Assuming that the pandemic has had an (uncapitalized) material adverse effect on the target, we come to the critical question, which is whether the MAE definition has shifted the risk of a pandemic to the acquirer under one or more MAE Exceptions. As the MAE definition set out in Table 1 above indicates, MAE definitions commonly include an MAE Exception for *force majeure* events, and even before the COVID-19 pandemic such MAE Exceptions expressly referred to pandemics in a significant fraction of cases.²⁵ The MAE Exception for *force majeure* events, assuming there is one in the relevant agreement, is thus the natural place to begin.

In the easiest case, the MAE Exception expressly refers to pandemics, and then of course the risk of a pandemic has been allocated to the acquirer. Only a little more difficult are cases in which an MAE Exception does not expressly refer to pandemics but includes some general term such as “natural disasters” or “calamities” or “*force majeure* events” under which pandemics would almost certainly fall. Instances in which the MAE Exception speaks in general terms (“natural disasters”) or in general terms with an enumeration of events meant to be included (“natural disasters, including hurricanes, tornadoes and tsunamis”) may differ in technical respects from instances in which the MAE Exception enumerates certain kinds of events and then rounds out the enumeration with a general term (“hurricanes, tornadoes, tsunamis and other natural disasters”), but such issues can be resolved using standards principles of contract interpretation. I discuss such questions in Part II.B below.

Things become considerably more complicated, however, when the agreement contains no MAE Exception for *force majeure* events or contains such an exception, but the exception does not include pandemics. In such cases, targets may argue that, even if the risk of pandemics has been allocated to the target, nevertheless the material adverse effect on its business arises proximately from *effects* of the pandemic, such as reductions in demand for the company’s products or services (as in the airline or cruise-ship industries) or governmental lockdown orders that have curtailed its operations (as in the retail or restaurant industries), and only remotely from the pandemic itself.²⁶ If the MAE

23. See *id.* at *56 (stating that “the plain language of the definition of an MAE makes clear that any MAE must be evaluated on a standalone basis” and noting that “every prior [MAE] decision has looked at changes in value relative to the seller as a standalone company”); *Channel Medsystems, Inc.*, 2019 WL 6896462, at *35 (referring to “this court’s uniform approach to valuing a target on a standalone basis in determining whether an MAE has occurred”). See also Miller, *New Theory*, *supra* note 1, at 37 n.160 (discussing material adverse effects as being changes in the value of the company on a standalone basis).

24. See Miller, *New Theory*, *supra* note 1, at 38–39.

25. Subramanian & Petrucci, *supra* note 18, at 46 (finding pandemics in MAE Exceptions in 30% of the sample agreements executed in 2019).

26. E.g., *Tiffany & Co.’s Answer to Verified Counterclaim at 5, Tiffany & Co. v. LVMH Moët Hennessy-Louis Vuitton SE*, C.A. No. 2020-0768-JRS (Del. Ch. filed Oct. 13, 2020) (target arguing that, although MAE

definition contains MAE Exceptions related to general changes in business conditions or the conditions in the industry which the company operates (for reductions in consumer demand) or for changes in law (for lockdown orders),²⁷ then the target may argue that the relevant risks were allocated to the acquirer under such an exception. Indeed, an acquirer can play the same game: for example, if the agreement contains an MAE Exception covering pandemics, so that this risk has been allocated to the acquirer, but no MAE Exception for changes in law, then the *acquirer* may argue that the material adverse effect on the target's business arose not from the pandemic but from lockdown orders curtailing the company's operations, and, in the absence of an MAE Exception related to changes in law, the relevant risk was allocated to the target. In each case, the question is further complicated because the language introducing the MAE Exceptions commonly expand their scope to include not only events falling into the exceptions but also events "arising from" such events or even events merely "related to" such events.

This welter of arguments arises because the MAE disputes engendered by the COVID-19 pandemic have uncovered an ambiguity in MAE definitions that litigants on both sides may seek to exploit. That is, the typical MAE definition implicitly assumes a simple situation involving one cause and one effect: an Underlying Predicate Event causes an adverse effect on the company, it being a separate issue whether this adverse effect is material.²⁸ Except perhaps in connection with the language introducing the MAE Exceptions, the definition does not contemplate the more complex situation in which a remote event causes a proximate event, and the proximate event causes the material adverse effect. If a particular MAE definition allocates both risks—the risk of the materialization of the more remote event and the risk of the materialization of the more proximate event—to the same party, no issue arises: that party bears the risk, no matter how we resolve the causal ambiguity inherent in the MAE definition. But when an MAE definition allocates the risk of the materialization of the remote event to one party and the risk of the materialization of the proximate event to the other party, then each party will have a litigation-driven incentive to argue for a self-serving resolution of the ambiguity. The party bearing the risk of the materialization of the proximate event will say that it the remote event that matters for purposes of the MAE definition (i.e., the court should look through the proximate event to its cause in the remote event), and the party bearing the risk of the

definition did not refer to pandemics, MAE Exception for changes in the industries in which the target operated shifted relevant risk to acquirer); *see also* AB Stable VIII LLC v. Maps Hotel & Resorts One LLC, No. 2020-0310-JTL, 2020 WL 7024929, at *55 (Del. Ch. Nov. 3, 2020) (discussing how target argued that, even if the risk of a pandemic was not covered by an MAE Exception, MAE Exceptions for changes in industry conditions or business conditions or changes in law would shift the relevant risk to the acquirer).

27. Miller, *Deal Risk*, *supra* note 8, at 2091–101; Richard F. Langan, Jr. et al., *MAC Survey NP 2020 Report*, NIXON PEABODY 8, 11–12 (2021), https://www.nixonpeabody.com/-/media/Files/PDF-Others/NP_MAC_SURVEY_2020.ashx?la=en&hash=41116207B7C918092071745EF5BF65B3 [<https://perma.cc/5G9A-D857>].

28. Here and elsewhere in this Article I ignore the "singly or in the aggregate" language that is virtually universal in MAE definitions and allows an acquirer to point to various different events, each having an adverse effect on the company, and then aggregate their effects to determine whether the aggregate adverse effect is material. Even when there are multiple events causing each an adverse effect, the assumption is still that each event singly causes one effect, not, as in the problems considered in this Article, that there is a first event that causes a second event, which in turn causes the adverse effect on the company. The problem of multiple events causing multiple adverse effects is an important one, but it is a different problem from the one considered here.

remote event will say it is the proximate event that matters for purposes of the MAE definition (i.e., that court should *not* look through the proximate event to its cause in the remote event). I discuss this problem in Part III below.

As noted above, if a particular merger agreement contains an MAE Exception for *force majeure* events, then that exception is the natural point of departure in determining how a particular agreement allocates pandemic risk between the acquirer and the target. As a preliminary matter, however, it is helpful to understand clearly the differences between ordinary *force majeure* clauses in commercial agreements and MAE Exceptions related to *force majeure* events in MAE definitions in business combination agreements. The two are very different animals, and I begin by explaining the key differences.

A. *MAE Exceptions Related to Force Majeure Events Distinguished from Force Majeure Clauses*

Force majeure clauses in commercial agreements²⁹ and MAE definitions with MAE Exceptions related to *force majeure* events both refer to extraordinary events arising without human agency³⁰ that tend to disrupt commercial transactions, and both become important when a party seeks to be excused from performing a contractual promise. At that point, however, the similarity ends. In all other respects, the two are almost exact opposites.

In particular, a *force majeure* clause provides that, if one of the enumerated *force majeure* events occurs and makes a party's performance impossible, impracticable, or even merely commercially unreasonable (the exact language varies), then the party is not required to perform.³¹ In the typical case, the party seeking discharge of its obligation is a seller, and the occurrence of the *force majeure* event has greatly increased the cost of the seller's providing the promised goods or services. A *force majeure* clause is thus a standard-clause analogue to the common-law doctrine of impracticability,³² with the clause

29. See RICHARD A. LORD, 30 WILLISTON ON CONTRACTS § 77:31 (4th ed. 2020) (discussing *force majeure* clauses); EDWARD ALLAN FARNSWORTH, 2 FARNSWORTH ON CONTRACTS § 9.6, 633; P.J.M. Declercq, *Modern Analysis of the Legal Effect of Force Majeure Clauses in Situations of Commercial Impracticability*, 15 J.L. & COM. 213, 227–28 (1995). On *force majeure* clauses and the COVID-19 pandemic, see generally Russell Lewis et al., *COVID-19: Force Majeure to the Rescue?*, 56 TENN. BAR J. 20, 20 (May 2020).

30. Sometimes *force majeure* events are taken to include such things as acts of war, terrorism, sabotage, strikes, and labor unrest, which do, of course, arise from the actions of human beings, even though such actions are not—and this is the critical point—within the control of either party to the agreement. Perhaps to reflect this difference, MAE definitions often have separate MAE Exceptions for natural disasters and for acts of war, terrorism, or sabotage. Miller, *Deal Risk*, *supra* note 8, at 2095–97. Exceptions for labor issues are extremely rare, no doubt because business combination agreements typically include specific representations on labor matters. KLING & NUGENT, *supra* note 10, at § 11.04[16][j].

31. See Andrew A. Schwartz, A “Standard Clause Analysis” of the Frustration Doctrine and the Material Adverse Change Clause, 57 UCLA L. REV. 789, 801 n.49 (2010) (collecting sources) [hereinafter Schwartz, *Standard Clause Analysis*]; see also Declercq, *supra* note 29, at 249 (discussing how a *force majeure* clause “must set forth a standard by which ‘inability to perform’ is measured”).

32. See Schwartz, *Standard Clause Analysis*, *supra* note 31, at 792 (“The Force Majeure clause, for instance, is the standard clause analog of the impracticability doctrine.”); see also Declercq, *supra* note 29, at 229 (stating that “a *force majeure* clause is relevant only if it differs from the doctrine that would be applicable without the existence of a *force majeure* clause. No purpose is served in contracting for something that both parties already have without the creation of a contractual provision.”). The seminal case is *Taylor v. Caldwell* (1863) 122 Eng. Rep. 310, in which the plaintiffs agreed to rent the defendant's music hall and the court discharged the defendant's

being considerably more favorable to the party seeking discharge than the common law doctrine.³³ Neither the *force majeure* clause nor the doctrine of impracticability applies, however, when the obligation for which the party seeks discharge involves only paying money,³⁴ as is generally the case for buyers. The reason is that a change in circumstances, even a *force majeure* event, does not increase the cost of paying, which is fixed by the dollar amount owed. For buyers paying money, the analogues to the doctrine of impracticability and the *force majeure* clause are the doctrine of frustration of purpose and the MAE clause,³⁵ again with the clause being more favorable than the common-law doctrine to the party seeking to avoid performing.³⁶ The idea, under both the clause and the doctrine, is that the party should be excused from paying, not because its costs of

obligation when the building was destroyed by fire. *See generally* RESTATEMENT (SECOND) OF CONTS. § 261 (AM. L. INST. 1981); FARNSWORTH, *supra* note 29, at §9.5, 627–28; U.C.C. Section 2-615. For applications to the COVID-19 pandemic, see Andrew A. Schwartz, *Contracts and COVID-19*, 73 STAN. L. REV. ONLINE 48 (2020) [hereinafter Schwartz, *Contracts*]; Russell Lewis et al., *COVID-19: Force Majeure to the Rescue?*, HOUS. LAW., Mar.–Apr. 2020, at 40. The idea of a contractual clause allowing a party not to perform on a contractual promise because of a change in circumstances goes all the way back to *Paradine v. Jane*, (1647) 82 Eng. Rep. 897, where the court stated that “[w]hen the party by his own contract creates a duty or charge upon himself, he is bound to make it good, if he may, notwithstanding any accident by inevitable necessity, because he might have provided against it by his own contract.” (emphasis added).

33. The clause is more friendly to the party seeking discharge because (a) the clause is triggered by any of the enumerated *force majeure* events and does not require the occurrence of an event the non-occurrence of which was a “basic assumption” of the contract, and (b) the clause applies when the costs to the party would make performing “commercially unreasonable” or some other standard lower than the high one demanded by the doctrine. The clause is also more certain in its operation than the doctrine because it is usually not open to reasonable dispute whether the *force majeure* event has occurred, whereas it is almost always open to reasonable dispute whether the occurrence of the extraordinary event violates a “basic assumption” of the contract. *See* Schwartz, *Standard Clause Analysis*, *supra* note 31, at 829 (explaining that, although the MAE standard is a high one, it is lower than that required by the frustration doctrine); *see generally*, RESTATEMENT (SECOND) OF CONTS. § 261 (AM. L. INST. 1981) (requiring a violation of a basic assumption to invoke the doctrine); FARNSWORTH, *supra* note 29, at §9.6, 64041 (same); Declercq, *supra* note 29, at 219–20 (discussing the concept of a “basic assumption” in impracticability doctrine). Note, however, that in some jurisdictions courts read *force majeure* clauses, regardless of what they actually say, as applying only in cases where the *force majeure* event was unforeseeable or beyond the control of the party seeking discharge. *E.g.*, *Goldstein v. Orsenanz Events, LLC*, 146 A.D.3d 492 (2017).

34. *E.g.*, RESTATEMENT (SECOND) OF CONTS. § 261, cmt. d (AM. L. INST. 1981). *See also* *Hoosier Energy Rural Elec. Coop. v. John Hancock Life Ins. Co.*, 582 F.3d 721, 727–28 (7th Cir. 2009).

35. Schwartz, *Standard Clause Analysis*, *supra* note 31, at 792. The seminal case is *Krell v. Henry*, (1903) 2 KB 740, where the court held that the defendant’s obligation to pay rent to the plaintiff to use his flat to watch the coronation parade of Edward VII should be discharged when the king fell ill and the parade was canceled. *See generally* RESTATEMENT (SECOND) OF CONTS. § 261 (AM. L. INST. 1981); FARNSWORTH, *supra* note 29, at §9.7, 650.

36. The MAE clause is more favorable to the acquirer than the frustration doctrine because (a) it is triggered by any event that has a material adverse effect on the target, not just an event the non-occurrence of which was basic assumption of the contract (i.e., any event can be an Underlying Predicate Event), and (b) the diminution in value of the target need only be “material” and need not wholly frustrate the acquirer’s purpose in entering into the transaction (a standard that might require the target to be insolvent). *See* Schwartz, *Standard Clause Analysis*, *supra* note 31, at 789–90; *Akorn, Inc. v. Fresenius Kabi AG*, No. 2018-0300-JTL, 2018 WL 4719347, at *53 (Del. Ch. Oct. 1, 2018). Whether, like a *force majeure* clause, an MAE clause is also more predictable in its operation is doubtful. *See* Choi & Triantis, *supra* note 20, at 854 (describing the sources of “uncertainty in MAC application”). Indeed, the frustration doctrine would be highly predictable in its operation in the mergers-and-acquisitions context; because the required showing would be so high, acquirers would almost always lose. This is the primary reason that MAE clauses exist.

performing have increased, but because the value of the counterparty's performance has decreased.

As explained above, any event may trigger an MAE clause (i.e., be an Underlying Predicate Event) if the event has, or is reasonably expected to have, a material adverse effect on the target—any event, that is, other than those events excepted from the definition under MAE Exceptions. An MAE Exception for *force majeure* events is just that—an exception—and its purpose and effect is to remove from the MAE definition *force majeure* events that, but for the exception, could have counted as Material Adverse Effects. This makes the legal effect of an MAE Exception for *force majeure* events essentially the exact opposite of that of a *force majeure* clause. That is, under a *force majeure* clause, the occurrence of the *force majeure* event *discharges* the obligation of the *seller*. Under an MAE clause with an MAE Exception for *force majeure* events, the occurrence of the *force majeure* event does *not* discharge the obligation of the *purchaser*.³⁷ The effect of the MAE Exception is to take an event that, but for the exception, would have been an Material Adverse Effect and so would have excused the acquirer from closing the transaction and to reverse this result: even if the company has suffered a material adverse effect, if the effect results from a *force majeure* event, the acquirer still has to close.

The two types of provisions thus pertain to different parties—the *force majeure* clause to the seller, the MAE Exception for *force majeure* events to the acquirer—and their effects are opposite—the *force majeure* clause discharges an obligation because of the *force majeure* event, but the MAE Exception for *force majeure* events prevents a discharge of an obligation that the MAE clause would otherwise discharge. An MAE clause with an MAE Exception for *force majeure* events is thus not so much a *force majeure* clause as an anti-*force majeure* clause. It makes express in the contract what the common law already implies, that *force majeure* events do *not* relieve the acquirer of its obligation to pay the purchase price and close the transaction. Needless to say, the economic justifications for discharging the obligation of a seller are not likely to be the same as those for *not* discharging the obligation of a buyer.

B. *Pandemics in MAE Exceptions for Force Majeure Events*

Like many contractual provisions involving various items that fall under a generic term, MAE Exceptions for *force majeure* events can be drafted in several ways: the exception can enumerate various kinds of *force majeure* events (e.g., “hurricanes, tornadoes and tsunamis”), or it can simply use one or more general terms meant to cover all such events (e.g., “natural disasters” or “calamities” or “acts of God”), or it can combine these approaches, either by using a generic term with an inclusive enumeration of particulars (e.g., “natural disasters, including hurricanes, tornadoes and tsunamis”) or by

37. It is thus not correct to say that *force majeure* clauses and MAE clauses “work pretty much the same way, conditioning a party's (usually the buyer's) duty to close a deal on the non-occurrence of a specific set of contingencies.” Matthew Jennejohn et al., *COVID-19 as a Force Majeure in Corporate Transactions 2* (Columbia L. & Econ. Working Paper, Paper No. 625, 2020), https://papers.ssrn.com/sol3/abstract_id=3577701 [<https://perma.cc/78E6-K4BL>]. As explained in the text, in a *force majeure* clause, the occurrence of the *force majeure* event excuses a seller from performing, but in an MAE clause with an MAE Exception for *force majeure* events, the occurrence of the *force majeure* event does *not* excuse a *buyer* from performing. The difference is apparent, and as noted in the text, there is no reason to think the economic justifications for such clearly different provisions would be the same.

an enumeration of particulars with a generic term added at the end to cover other similar items not enumerated (e.g., “hurricanes, tornadoes, tsunamis and other natural disasters”).³⁸ Clearly, if an MAE Exception for *force majeure* events expressly mentions pandemics, then there can be no doubt that the MAE Exception shifts to the acquirer risks to the target’s business arising from pandemics. If the MAE Exception does not expressly mention pandemics, matters become more complicated.

To take the simplest case first, if the MAE Exception includes no generic terms but merely enumerates various kinds of *force majeure* events but omits pandemics (e.g., “hurricanes, tornadoes and tsunamis”), then risks to the target’s business arising from pandemics remain with the target. This is an elementary application of *expressio unius est exclusio alterius*.³⁹ The application of that maxim is always highly dependent on the context,⁴⁰ but in the context of an MAE definition in a business combination agreement, where sophisticated and well-advised commercial parties are deliberately allocating various kinds of risks and where, even before the COVID-19 pandemic, such parties were familiar with pandemic risk and often expressly allocated that risk,⁴¹ an MAE Exception that includes certain *force majeure* events but not others is certainly best read to include only those events mentioned and to exclude others. This result is especially clear under Delaware law, for part of Delaware’s particularly strong commitment to freedom of contract⁴² is the principle that, in Delaware, sophisticated parties are expected to be familiar with contractual provisions commonly used in commercial agreements, and thus Delaware courts will infer that, if the parties did not include a particular kind of provision commonly used in agreements in the relevant market, then they must have deliberately omitted that kind of provision because they intended that such a provision *not* be part of the agreement.⁴³ In such cases, Delaware courts will not imply what the parties themselves have omitted. Hence, an MAE Exception that enumerates some kinds of *force majeure* events but omits pandemics will not be read to include pandemics.

As noted above, however, not all MAE Exceptions related to *force majeure* events enumerate various kinds of such events; some merely refer to them generically, by means of general terms like “calamities,” “natural disasters,” “acts of God,” or even “*force majeure* events.” In such cases, the MAE Exception should be read as including pandemics. In *AB Stable v. Maps Hotels & Resorts One LLC*, for example, the MAE Exception referred

38. See *AB Stable VIII LLC v. Maps Hotel & Resorts One LLC*, No. 2020-0310-JTL, 2020 WL 7024929, at *64 (Del. Ch. Nov. 3, 2020) (discussing expert’s study concerning different ways MAE Exceptions related to *force majeure* events treat pandemics). *Force majeure* clauses also usually involve an enumeration of certain types of events and a general term as a catchall for events not mentioned. Declercq, *supra* note 29, at 232.

39. E.g., *Expressio unius est exclusio alterius*, BLACK’S LAW DICTIONARY (6th ed. 1990) (“When certain persons or things are specified in a law, contract or will, an intention to exclude all others from its operation may be inferred”). Delaware recognizes this principle of interpretation. *Leatherbury v. Greenspun*, 939 A.2d 1284, 1290–92 (Del. 2007) (Holland, J.). See generally ANTONIN SCALIA & BRYAN A. GARNER, *READING LAW: THE INTERPRETATION OF LEGAL TEXTS* 107–11 (2012) (discussing the canon of *expressio unius est exclusio alterius*).

40. SCALIA & GARNER, *supra* note 39, at 107.

41. Jennejohn et al., *supra* note 37; Subramanian & Petrucci, *supra* note 18, at 46 (finding pandemics in MAE Exceptions in 30% of the sample agreements executed in 2019).

42. *Abry Partners V, L.P. v. F & W Acquisition LLC*, 891 A.2d 1032, 1059–60 (Del. Ch. 2006) (stating that the “strong American tradition of freedom of contract . . . is especially strong in our State, which prides itself on having commercial laws that are efficient”) (Strine, V.C.).

43. *Akorn, Inc. v. Fresenius Kabi AG*, No. 2018-0300-JTL, 2018 WL 4719347, at *60–61, *80 (Del. Ch. Oct. 1, 2018).

to “calamities” and “natural disasters,” and Vice Chancellor Laster held that, on the basis of the plain meaning of both terms as determined by their dictionary definitions, both terms included the COVID-19 pandemic.⁴⁴ He bolstered this reasoning by noting that MAE definitions typically shift many systematic risks to the acquirer, and the risk of a pandemic is certainly a systematic risk.⁴⁵ In addition, the Vice Chancellor concluded that general terms in MAE Exceptions should generally be given broad meanings because parties allocating systematic risks in MAE definitions want to be able to allocate “the three Rumsfeldian categories of risk: known knowns, known unknowns, and unknown unknowns,”⁴⁶ and parties can allocate risks in the third category only by using general terms interpreted broadly, from which they can expressly exclude risks in the other two categories if they so choose.⁴⁷ All of these arguments seem clearly correct.⁴⁸

The acquirer’s argument against the commonsense position that the COVID-19 pandemic was a “calamity” and “natural disaster” was that these terms should be given the same meaning (a dubious move, as it would tend to make one term surplusage) and that “natural disasters” generally involve sudden and singular events, attributable to the four classical elements of nature (earth, water, fire, and air), and generally cause direct damage to physical property.⁴⁹ Under such an understanding, the acquirer argued, a pandemic does not qualify as a natural disaster. Vice Chancellor Laster made short work of this argument, pointing out that droughts and meteor strikes are surely natural disasters, but the former do not happen suddenly, and the latter do not involve the classical four natural elements.⁵⁰ More generally, this understanding of the contract would be “unreal to men of business and practical affairs.”⁵¹ Sophisticated commercial parties are not likely to allocate risks on the basis of a physical theory from the time of Aristotle. What matters from a commercial point of view about a *force majeure* event is that it disrupts commerce on a grand scale (i.e., is a systematic risk)⁵² and is independent of human agency in the sense that no human being has the power to cause a *force majeure* event and no human being has the power to prevent

44. *AB Stable VIII LLC v. Maps Hotels & Resorts One LLC*, No. 2020-0310-JTL, 2020 WL 7024929, at *57–59 (Del. Ch. Nov. 30, 2020).

45. *Id.* at *59. See also *Fairstone Fin. Holdings Inc. v. Duo Bank of Can.*, 2020 CanLII 7397, paras. 100, 104 (Can. Ont. Super. Ct.) (treating the risk of a pandemic as a systematic risk rationally allocated to the acquirer).

46. *AB Stable VIII LLC*, 2020 WL 7024929, at *65.

47. *Id.*; see also Declercq, *supra* note 29, at 234 (arguing that general terms in *force majeure* clauses should be read broadly because “the function of a *force majeure* clause is to protect parties against the unusual”).

48. In *Fairstone*, the Superior Court of Justice of Ontario reached a similar conclusion, holding that the COVID-19 pandemic was an “emergency” as such term was used in an MAE Exception. *Fairstone Fin. Holdings Inc.*, 2020 CanLII 7397 at para. 103. In the same context, the court also held that the pandemic was a “worldwide, national, provincial or local circumstance,” which seems correct, although one has to wonder at the underlying drafting here, for any circumstance affecting any person or entity besides the company would seem to come within such astonishingly broad language. *Id.* at para. 101.

49. *AB Stable VIII LLC*, 2020 WL 7024929, at *58.

50. *Id.* The Vice Chancellor’s meteor strike example is superbly chosen, for he is alluding to the fact that the ancients held that the heavenly bodies were material but imperishable because they were composed of a fifth element—the quintessence—beyond the four found in this terrestrial realm. See Aristotle, *De Caelo*, lib. I, cap. 2 (268b11-269b18); G.E.R. LLOYD, EARLY GREEK SCIENCE: THALES TO ARISTOTLE 109–12 (1970).

51. *In re IBP, Inc. S’holders Litig.*, 789 A.2d 14, 57 (Del. Ch. 2001) (quoting *Wendel Found. v. Moredall Realty Corp.*, 26 N.E.2d 241, 243 (N.Y. 1940)).

52. Miller, *Deal Risk*, *supra* note 8, at 2073–82.

one,⁵³ which ensures that no one can manipulate such events opportunistically.⁵⁴ On that understanding of *force majeure*, pandemics are definitely *force majeure* events.

Nor does this conclusion change if the MAE Exception speaks in general terms but then adds an inclusive enumeration that does not mention pandemics (“natural disasters, including earthquakes, tornadoes and tsunamis”). The accepted usage in all kinds of commercial agreements, usually expressly confirmed in merger agreements, is that statements of inclusion are taken as being without limitation,⁵⁵ and so the addition of an enumeration not mentioning pandemics cannot be taken to imply that pandemics are being excluded.

This leaves cases in which the MAE Exception enumerates certain kinds of *force majeure* events not including pandemics but concludes with language such as “and other natural disasters” or “and other calamities.” The MAE Exception for *force majeure* events in the merger agreement between LVMH Moët Hennessy-Louis Vuitton and Tiffany & Co., for example, referred to “any hurricane, tornado, flood, earthquake or other natural disaster.”⁵⁶ One way of proceeding in such cases would be to read this enumeration followed by a generic term for similar events as being synonymous with the generic term followed by an inclusive enumeration: that is, we could read “any hurricane, tornado, flood, earthquake or other natural disaster” as being synonymous with “natural disasters, including hurricanes, tornados, floods and earthquakes.” My sense is that most transactional lawyers would agree that these two phrases are indeed synonymous. Since, as explained above, the latter definitely includes pandemics, so too would the former.

But we could also construe the enumeration followed by the generic term (“any hurricane, tornado, flood, earthquake or other natural disaster”) in accordance with the canon of *ejusdem generis*.⁵⁷ As explained by the Delaware Supreme Court, that “well-

53. Disasters caused by human agency, such as acts of war, terrorism or sabotage, are commonly separately enumerated in MAE Exceptions. *Id.* at 2049. The reason for this, presumably, is that while such events are typically beyond the control of the parties to the agreement (and thus functionally equivalent to natural disasters), this may not always be so; some parties may in fact be in a position to influence decisions of war and peace, or at least be significantly better placed than others to prognosticate them.

54. When an event is within the control of a party to the agreement, in the sense that the party can affect at a reasonable cost the likelihood of the risk materializing, a sophisticated commercial agreement will typically assign that risk to that party. *See id.* at 2050–51 (discussing efficient allocation of risk between parties). In business combination agreements, systematic risks, which are beyond the control of all parties, are assigned to the acquirer (in a stock-for-stock deal, the counterparty), not because the counterparty can prevent the risk from materializing or even quantify the risk better than the target (it manifestly cannot), but because the materialization of the risk during the executory period of a business combination transaction, as opposed to under more normal circumstances, can exacerbate the damage resulting from the materialization. Assigning the risk to the acquirer gives the acquirer strong incentives to prevent that magnification, whereas leaving it on the target would invite the acquirer to behave opportunistically to renegotiate the contract. *See id.* at 2073–82 (discussing shifting systematic risk between parties).

55. *See* Stephen L. Sepinuck, *Including Without Limitation*, 9 TRANSACTIONAL LAW. 4, 5 (2019) (“[C]ourts almost invariably conclude[] that the ‘including’ clause at issue was not limiting”); *see also* Fairstone Fin. Holdings Inc. v. Duo Bank of Can., 2020 CanLII 7397, para. 102 (Can. Ont. Super. Ct.) (reading “including” in an MAE Exception as meaning “including without limitation” on the express terms of the agreement).

56. *See, e.g.*, Tiffany & Co., Current Report (Form 8-K) 8 (Nov. 25, 2019) (MAE Exception relating to “any hurricane, tornado, flood, earthquake or other natural disaster”). Similar issues will arise from catchall phrases like “and other acts of God” or “and other *force majeure* events.”

57. *E.g., ejusdem generis*, BLACK’S LAW DICTIONARY (6th ed. 1990) (“In the construction of laws, wills,

established rule of construction” entails that “where general language follows an enumeration of persons or things, by words of a particular and specific meaning, such general words are not to be construed in their widest extent, but are to be held as applying only to persons or things of the same general kind or class as those specifically mentioned.”⁵⁸ The reason for this is that, if the general phrase at the end of the enumeration is given its widest meaning and is not restricted by the preceding enumeration, the enumeration becomes surplusage.⁵⁹ Hence, in an MAE Exception related to natural disasters, when a phrase such as “and other natural disasters” follows an enumeration of various kinds of natural disasters, the phrase does not mean *all* natural disasters but only natural disasters relevantly like those already specifically enumerated in the clause; it is as if the phrase “and other natural disasters” were really “and other *similar* natural disasters.” As a result, the phrase “any hurricane, tornado, flood, earthquake or other natural disaster” would exclude some natural disasters and thus be narrower than the phrase “natural disasters, including hurricanes, tornados, floods and earthquakes.” As stated above, I think most transactional lawyers would find this result counterintuitive and very likely wrong.

Furthermore, if the phrase is construed in accordance with *ejusdem generis*, much would depend on which types of natural disasters were enumerated in the MAE Exception, for all other natural disasters included in the scope of the exception would have to be relevantly similar to these. This creates a problem, for it is difficult to imagine there being various classes of natural disasters, some of which rational parties would have wanted to include within the meaning of the MAE Exception and others that they would have wanted to exclude.⁶⁰ For instance, it is highly implausible that the parties meant to include atmospheric disasters, such as hurricanes and tornadoes, and geological disasters, such as earthquakes and volcanic eruptions, but not aquatic disasters such as tsunamis and floods. This would be to include disasters related to two of the classical elements (air and earth) but not a third (water), which is just as fanciful as the acquirer’s argument in *AB Stable* that

and other instruments, the ‘ejusdem generis rule’ is, that where general words follow an enumeration of persons or things, by words of a particular and specific meaning, such general words are not to be construed in their widest extent, but are to be held as applying only to persons or things of the same general kind or class as those specifically mentioned.”). See generally SCALIA & GARNER, *supra* note 39, at 199–213 (discussing the canon of *ejusdem generis*); see also FARNSWORTH, *supra* note 29, at §9.9(a), 676 (discussing *ejusdem generis* in connection with the interpretation of *force majeure* clauses); Declercq, *supra* note 29, at 234 (same).

58. Aspen Advisors LLC v. United Artists Theater Co., 861 A.2d 1251, 1265 (Del. 2004) (Holland, J.).

59. See SCALIA & GARNER, *supra* note 39, at 199–200 (stating that “when the [general] tagalong term is given its broadest application, it renders the prior enumeration superfluous” and that one “avoids this contradiction by giving the enumeration the effect of limiting the general phrase (while still not giving the general phrase a meaning that it will not bear)”). Scalia and Garner cite Lord Kenyon, who held that the phrase “cities, towns corporate, boroughs, and places” applied not to all places but only to places of the same sort, stating, “[o]therwise the Legislature would have used only one compendious word, which would have included places of every denomination.” *Id.* at 200 (citing *Rex v. Wallis* (1793) 101 Eng. Rep. 210); see also Declercq, *supra* note 29, at 234 (noting that, in the context of interpreting *force majeure* clauses, following “the doctrine of *ejusdem generis* as a canon of interpretation of a catch-all provision, general words are not given an expansive meaning; they are confined to things of the *same kind or nature* as the particular matters mentioned in the non-exhaustive list”) (emphasis in original).

60. But see *supra* note 30 about the distinction between natural disasters, on the one hand, and acts of war, terrorism or sabotage on the other. If an MAE Exception referred to “hurricanes, tornadoes, tsunamis and other *force majeure* events,” there would be a serious argument under the canon of *ejusdem generis* that pandemics (as being entirely beyond human agency) would be included (unless, of course, intentionally created) but acts of war, terrorism and sabotage would be excluded.

disasters related to all four classical elements were included but not other kinds of disasters. Indeed, as noted above, what seems relevant for purposes of MAE Exceptions related to *force majeure* events is that an event disrupt commerce on a grand scale (i.e., be systematic) and be independent of human agency, which ensures that no one can manipulate the event opportunistically.⁶¹ Within the class of all such events, it is difficult to discern any distinctions that would matter to sophisticated commercial parties allocating risk in a business combination agreement.⁶² If construing a phrase like “and other natural disasters” in an MAE Exception thus involves identifying such distinctions, it is unclear how a Delaware court would resolve this problem.

Most likely, in my view, is that, if the court decided to apply the *ejusdem generis* canon, it would side-step the issue of what sort of natural disasters are meant to be included by the phrase “and other natural disasters” and decide only the narrow issue of whether a pandemic like COVID-19 is meant to be included within the scope of the MAE Exception. That is, it is “often not . . . necessary to identify the genus with specificity in order to decide the case at hand” because “the evident purpose of the provision” makes the resolution of the particular issue clear.⁶³ Assuming that the purpose of the relevant MAE Exception is to shift to the acquirer any risks related to naturally occurring events that disrupt commerce on a large scale and are beyond the control of human beings, then pandemic risk is very likely included within the meaning of an MAE Exception that refers to “other natural disasters” or “other *force majeure* events.” It thus seems very likely that the Delaware courts would interpret such a phrase in an MAE Exception to include pandemics.⁶⁴

III. THE INTERPRETATION OF MAE EXCEPTIONS AND THE CAUSAL AMBIGUITY PROBLEM

As indicated above, the MAE disputes arising from the COVID-19 pandemic, including *AB Stable*⁶⁵ and *KCake*⁶⁶ in Delaware and *Fairstone*⁶⁷ in Canada, have brought

61. See discussion *supra* notes 53–54.

62. Difficult, but not impossible, for it could be that some businesses are more vulnerable to certain kinds of natural disasters than others. A chain of resort hotels in the Caribbean would be more vulnerable to hurricanes than to tornadoes, and a windfarm in Kansas would be more vulnerable to tornados than hurricanes. But when a business is especially vulnerable to a particular kind of *force majeure* event, the parties are very likely to allocate the risk of such an event expressly. It is extremely unlikely that they would allocate risks of less likely *force majeure* events expressly and rely on the general term to allocate the risk that is likely to matter most.

63. SCALIA & GARNER, *supra* note 39, at 208.

64. A fascinating but difficult issue would arise if it were established that, although the SARS CoV-2 virus is naturally occurring, the COVID-19 pandemic began as a result of an accidental release of the virus from the Wuhan Institute of Virology. See Warren P. Strobel & Dustin Volz, *In Rare Move, U.S. Intelligence Agencies Confirm Investigating if Coronavirus Emerged from Lab Accident*, WALL ST. J. (April 30, 2020, 6:53 PM), <https://www.wsj.com/articles/u-s-intelligence-agencies-say-coronavirus-originated-in-china-wasnt-man-made-or-genetically-modified-11588260228> [https://perma.cc/9NJE-TZ3S]. In that case, the pandemic would likely *not* be a natural disaster, but something like a catastrophic industrial accident, and so an MAE Exception not mentioning pandemics but only “natural disasters” would seem not to apply. Of course, if the release were intentional, then an MAE Exception related to acts of war, terrorism, or sabotage likely *would* apply.

65. *AB Stable VIII LLC v. Maps Hotels & Resorts One LLC*, No. 2020-0310-JTL, 2020 WL 7024929 (Del. Ch. Nov. 30, 2020).

66. *Snow Phipps Group, LLC v. KCake Acquisition, Inc.*, No. 2020-0282-KSJM, 2021 WL 1714202 (Del. Ch. April 30, 2021).

67. *Fairstone Fin. Holdings Inc. v. Duo Bank of Can.*, 2020 CanLII 7397 (Can. Ont. Super. Ct. J.).

to light a latent ambiguity in typical MAE definitions: sometimes the causal background of a material adverse effect on the target is complex, with an earlier event E_1 (such as a pandemic) causing a later event E_2 (such as governmental lockdown orders) and the later event E_2 (the lockdown orders) causing the material adverse effect. As noted above, if the MAE definition allocates the risk of both events to the same party, then clearly that party bears the risk of the material adverse effect, but if the definition allocates the risk of one event (say, a pandemic) to one party and the risk of the other event (say, governmental lockdown orders) to the other party, then it is unclear whether there has been a Material Adverse Effect or not. Albeit only in dicta, the courts in *AB Stable*,⁶⁸ *Fairstone*,⁶⁹ and *KCake*⁷⁰ all resolved this issue in negative, saying that there was no Material Adverse Effect. The issue is difficult because a typical MAE definition assumes a simpler situation involving one cause that results in one effect. How the definition should apply when this assumption arguably no longer holds is unclear.

A. *Two Key Features of MAE Definitions*

To make progress on this problem, we should begin by recalling two basic features of MAE definitions. First, recall that, in MAE definitions, the term “Material Adverse Effect” is defined to mean any event (i.e., any Underlying Predicate Event) that has or would reasonably be expected to have (the exact language varies) a material adverse effect on the target. The definition thus involves two separate things, an event and a material adverse effect, related as cause to effect. As noted above, although perhaps surprising, it follows that a Material Adverse Effect is not a material adverse effect. Rather, a Material Adverse Effect is an event that causes (i.e., “has or would reasonably be expected to have”) a material adverse effect.

Of course, good transactional lawyers know all this, but they nevertheless often speak imprecisely, running together Material Adverse Effects and material adverse effects, an infelicitous habit that is greatly facilitated by the fact that the three-letter abbreviation “MAE” is used indiscriminately for both concepts. Such confusions crop up in ordinary speech when someone says that a company “has suffered a Material Adverse Effect,” when the correct view is that, if anything, the company suffered a material adverse effect because some event occurred that was a Material Adverse Effect. More surprising, such confusions even appear in the text of merger agreements negotiated by expert counsel, as when an agreement provides that a representation shall be true except for “such inaccuracies that would not have a Material Adverse Effect.” The correct view is that, if anything, the inaccuracies just are a Material Adverse Effect because they are facts or events that would reasonably be expected to have a material adverse effect on the company. As we shall see, such confusions are not always harmless.

The second feature of MAE definitions I want to emphasize is that MAE definitions allocate risk between the parties on the basis of Underlying Predicate Events, that is, on the basis of events causing material adverse effects, not on the basis of material adverse effects arising from such events. That is, the definition takes the universe of all events that could adversely affect the target, and it then divides these events into two classes—events

68. *AB Stable VIII LLC*, No. 2020-0310, at *55-56.

69. *Fairstone Fin. Holdings Inc.*, 2020 CanLII 7397, at paras. 105-108.

70. *KCake Acquisition, Inc.*, No. 2020-0282, at *35.

the risk of which is allocated to the target and events the risk of which is allocated to the acquirer. Put another way, MAE definitions allocate risk on the basis of causes, not effects. Like the distinction between Material Adverse Effects and material adverse effects, this principle is evident from the face of the typical MAE definition, which defines some events to be Material Adverse Effects (events the risk of which is allocated to the target) and other events to be not Material Adverse Effects, even if such events would reasonably be expected to result in a material adverse effect (events the risk of which is allocated to the acquirer). This point may seem elementary, but it turns out to be crucially important in understanding how MAE definitions function.

B. What is Allocated When an MAE Definition Allocates a Risk

Now, when MAE definitions allocate risks between the parties by allocating the risks that certain events may occur, such definitions do this not because the parties care about those events in and of themselves. Rather, MAE definitions allocate the risks that certain events may occur because those events may have a material adverse effect on the target. That is why MAE definitions define Material Adverse Effects in terms of their having, or being reasonably expected to have, a material adverse effect. Therefore, when an MAE definition allocates to one party or the other the risk that a certain event may occur, what the definition is allocating is the risk of that the event occurs *along with all of the event's reasonably-expected consequences*, up to and including any reasonably-expected material adverse effect on the target.

To see just what that means, reflect that events rarely have material adverse effects on a company immediately and directly. On the contrary, events typically result in material adverse effects, if at all, only through generally predictable causal pathways. Indeed, parties single out certain kinds of events and specifically allocate the risks of those events precisely because the parties know that such events tend to set in motion a sequence of events that often lead to a material adverse effect. For example, suppose the MAE definition allocates to one party or the other the risk of “a change in interest rates,” and after the agreement is signed the Federal Reserve’s Federal Open Market Committee (the “FOMC”) announces that it has decided to increase its target Federal Funds Rate. This decision is a “change in interest rates,” and the risk of any material adverse effect reasonably expected to follow from that change is allocated to the party that bears the risk of the change. But any adverse effect on the target resulting from this decision by the FOMC would come about only through a long and complicated, but nevertheless reasonably-expected, sequence of events. In particular, the FOMC’s decision to increase the *target* Federal Funds Rate will result in the Trading Desk at the New York Federal Reserve Bank making certain purchases of securities in the open market, and this, via the decisions of bond traders and commercial bankers, will likely result in a change in the *effective* Federal Funds Rate, that is, the rates that depository institutions actually charge each other for overnight loans of banking reserves. That change, via the trading decisions of innumerable market participants, will filter through the credit markets, eventually increasing the yield on long-term Treasury bonds, which will (under accepted principles of corporate finance) increase the company’s cost of equity capital, thus reducing the present value of its future cashflows. When the parties allocate the risk of a change in interest rates, they do so precisely because they understand that changes in interest rates tend to have such consequences, up to and including a reduction in the value of the target when the

present value of its future cashflows is reduced in the manner stated. It would subvert the intention of the parties were someone to later argue that, because the causal sequence from the decision by the FOMC to the reduction in the present value of the company's future cashflows runs through a great many other events, the material adverse effect on the target should be attributed not the decision by the FOMC but to some intermediate event in the causal sequence, such as the decisions of bond traders reacting to the FOMC's decision. On the contrary, in allocating the risk of a change in interest rates, the parties are allocating the risks of all events that would reasonably be expected to follow from a change in interest rates, up to and including any reasonably-expected material adverse effect on the company. More generally, when an MAE definition allocates the risk of a certain event, it allocates the risk of all other events reasonably expected to follow from that event. Indeed, the whole point of allocating the risk of the event is to allocate the risk of any material adverse effect reasonably expected to result from it, and it is impossible to allocate the risk of the event itself and the risk of the material adverse effect it may cause without also allocating the risk of the events in the causal sequence beginning with the event and ending with the material adverse effect.⁷¹ To allocate the risk of the *terminus a quo* and the risk of the reasonably-expected *terminus ad quem* is to allocate the risk of all reasonably-expected events connecting them.

Conversely, *not* allocated with the risk of the event in question are risks of events actually following from the event in question that are *not* reasonably expected to follow from that event. That is, every event has multifarious and ramifying but-for consequences most of which would *not* reasonably be expected to follow from the event but which in fact do follow from it. The change in interest rates from the example above, for instance, could result in two people getting married (because they met at the press conference following the meeting of the FOMC) or in some individual winning a Nobel Prize in economics forty years later (because as a teenager her interest in economics was first stimulated by a chance reading of a news account about the change in interest rates). There is simply no telling what events may follow from the event in question if we consider all of the but-for consequences of the event. Hence, if, for purposes of the MAE definition, we included all these but-for consequences, the parties could not know at signing which risks were included, which excluded, when they allocate the risk of the event in question in the MAE definition. For this reason, mere but-for consequences are *not* included along with the event. Therefore, included with the event are *all and only* the consequences of the event reasonably expected to follow from the event. This is the only way for the parties, at the

71. Notice that, when we ask what is reasonably expected to follow from an event, we ask what is reasonably expected to follow from the actual event that occurs, not what is reasonably expected to follow from an "average" or "typical" event of the relevant kind. That is, if one party bears the risk of a pandemic and a pandemic occurs, we ask what is reasonably expected to follow from the actual pandemic that has occurred, which will depend on the nature of the actual pandemic occurring. Some pandemics are much worse than others (compare the H1N1 pandemic of 2009 with the COVID-19 pandemic of 2020), and so what would reasonably be expected to follow from one particular pandemic might not reasonably be expected to follow from another particular pandemic. Similarly, what is reasonably expected to follow from an increase in the target Federal Funds Rate of 25 basis points is not what is reasonably expected to follow from an increase in that rate of 500 basis points. Hence, in asking what is reasonably expected to follow from an event, we are asking what would reasonably be expected to follow from the actual event that has occurred, in all its existential particularity. The reason for this is that the MAE definition expressly speaks of events and what is reasonably expected to follow from them, not of kinds or types of events or of "average" or "typical" events of certain kinds.

time of signing, to know what is being included, what excluded, when they allocate the risk of a certain kind of event to one party or the other.

C. *How MAE Definitions Should be Applied in Causally Complex Situations*

Such considerations show us how we should apply MAE definitions when the causal background of a material adverse effect runs through multiple events and the definition allocates the risks of different events to different parties. Thus, suppose that a first event E_1 (say a pandemic) causes a second event E_2 (such as governmental lockdown orders) and the second event E_2 (the lockdown orders) causes a material adverse effect on the company (because the orders curtail its operations), and suppose further that the MAE definition allocates the risk of E_1 (the pandemic) to the target and the risk of E_2 (the lockdown orders, under an exception for changes in law) to the acquirer. In such cases, when event E_1 (the pandemic) occurs, the relevant question under the MAE definition is whether that event would reasonably be expected to have a material adverse effect on the target. If so, since the target bore the risk that event E_1 (the pandemic) would occur, E_1 is a Material Adverse Effect. This is true even though the causal pathway from E_1 (the pandemic) to the material adverse effect runs through another event E_2 (the lockdown orders) that is of a kind that, generally speaking, falls into an MAE exception, which would shift the risk of such an event to the acquirer. The reason is that, in allocating to the target the risk of a pandemic, the MAE definition also allocated to the target the risk of everything that is reasonably expected to follow from a pandemic, and if a pandemic actually occurs and is such that it would reasonably be expected to result in certain lockdown orders, then the risk of such orders was included with the risk of the pandemic. As a matter of contract construction, the specific governs over the general, and even if the risk of changes in law was generally allocated to the acquirer, nevertheless in allocating the risk of a pandemic to the target, the MAE definition also allocated to the target the specific risk of lockdown orders reasonably-expected to follow from a pandemic. This is the only reasonable way of giving effect to both allocations of risk made by the MAE definition.

Now, although in allocating the risk of a pandemic to the target, the MAE definition also allocated the risk of all events reasonably expected to follow from a pandemic, including any reasonably-expected lockdown orders, nevertheless the acquirer could concede *arguendo* that the risk of lockdown orders resulting from a pandemic was allocated to it under the exception for changes in law *and yet still prevail*. The reason is that, in situations like this, where the risk of the more remote event E_1 (here the pandemic) is allocated to the target and the risk of the more proximate event E_2 (here the lockdown orders) is allocated to the acquirer, there is an even stronger argument available to the acquirer, an argument that does not require the acquirer to rely on the fact that, in allocating a risk, an MAE definition allocates the risk of everything reasonably expected to follow from that risk. That is, the acquirer can argue that, if the more remote event E_1 (the pandemic) occurs and would reasonably be expected to have a material adverse effect on the target, then that event is a Material Adverse Effect under the express terms of the MAE definition. It may well be perfectly true, the acquirer can say, that *some other event* E_2 (the lockdown orders) also occurs, would reasonably be expected to have a material adverse effect on the target, and is *not* a Material Adverse Effect because the risk of such an event was allocated to the acquirer. But the fact that *some other event* is not a Material Adverse Effect in no way changes the fact that E_1 (the pandemic), the risk of which was allocated

to the target, *is* a Material Adverse Effect. In arguing that the risk of a change in law was allocated to the acquirer and so cannot be a Material Adverse Effect, the target is like the defendant who, charged with the murder of Jones, proves he did not kill Smith.

Now, what is good for the goose is good for the gander, or, more accurately, MAE definitions treat all events in the same way, whether the risk of the event is allocated to the target or to the acquirer. Thus, suppose again that a first event E_1 (a pandemic) causes a second event E_2 (lockdown orders), with E_2 (the lockdown orders) causing a material adverse effect on the company, but this time suppose that the MAE definition allocates the risk of event E_1 (the pandemic) to the acquirer and the risk of event E_2 (the lockdown orders) to the target (because there is no exception for changes in law). If a pandemic occurs and is such that it would reasonably be expected to have a material adverse effect on the target, then that risk has been allocated to the acquirer, and so the pandemic is not a Material Adverse Effect. If the acquirer says that it bore the risk of a pandemic but not the risk of changes in law, and the material adverse effect on the target resulted from governmental lockdown orders (albeit ones that themselves resulted from the pandemic), with the result that there is no Material Adverse Effect, the answer is that in allocating the risk of a pandemic to the acquirer, the MAE definition also allocated to the acquirer the risk of all events reasonably to be expected to follow from the pandemic up to and including any material adverse effect on the target. Hence, if the pandemic results in lockdown orders of a kind reasonably expected to follow from the pandemic, and by curtailing the company's operations those orders adversely affect its business, the risk of such orders was allocated to the acquirer along with the risk of the pandemic itself. It does not matter that, in general, the MAE definition allocated the risks of changes in law to the target. In this specific case (and the specific governs over the general), the risk of *these* changes in law (the lockdown orders reasonably to be expected to follow from the pandemic) were specifically allocated to the acquirer when the acquirer agreed to bear the risk of a pandemic and, by implication, everything reasonably to be expected to follow from any pandemic that actually occurs.

It is important to understand, however, that the target *cannot* concede *arguendo* that the risk of the change in law was allocated to it and still claim it is entitled to prevail in the way the acquirer could when the roles were reversed and the target bore the risk of the more remote event E_1 (the pandemic) and the acquirer bore the risk of the more proximate event E_2 (the lockdown orders). The acquirer could make this concession and still prevail because it could argue that the more remote event, E_1 (the pandemic), the risk of which was allocated to the target, was still a Material Adverse Effect even if some other event, such as E_2 (the lockdown orders), was not a Material Adverse Effect because that other event fell into an exception. The target cannot make an analogous argument because such an argument would amount to saying that, since the more remote event E_1 (the pandemic) is *not* a Material Adverse Effect (because the risk of such an event was allocated to the acquirer), it does not matter that the more proximate event E_2 (the lockdown orders), the risk of which was allocated to the target, *is* a Material Adverse Effect. Clearly, such an argument does nothing to help the target, for it most certainly *would* matter that there was another event that *was* a Material Adverse Effect. Indeed, such a point would be decisive. This form of the argument (as long as one event *is* a Material Adverse Effect, it does not matter that some other event is *not*) is available to the acquirer while the analogous form of argument (as long as one event is *not* a Material Adverse Effect, it does not matter than

another event *is*) is not available to the target because of the fundamental asymmetry between acquirers and targets in relation to MAE clauses. That is, for the acquirer to prevail, there need be only one event that is a Material Adverse Effect, and so the acquirer can shrug off the existence of events that are not Material Adverse Effects; but for the target to prevail, there need be no events that are Material Adverse Effects, and so the target *cannot* shrug off events that are Material Adverse Effects.

This asymmetry puts the target at a disadvantage in cases where the risk of the more remote event E_1 is allocated to the acquirer and the risk of the more proximate event E_2 at least appears to be allocated to the target in the sense that it is not covered by an exception in the MAE definition. As explained above, under the correct interpretation of the MAE definition, the allocation of the risk of event E_1 includes the allocation of the risk of all events reasonably expected to follow from event E_1 , including event E_2 (assuming E_2 really would reasonably be expected to follow from E_1). But because the target cannot make an argument analogous to the argument the acquirer can make when the roles are reversed, the target has to argue that, in allocating the risk of the more remote event E_1 (the pandemic) to the acquirer, the MAE definition also allocated the risk of all events reasonably expected to follow from E_1 (the pandemic), which would include event E_2 (the lockdown orders). This argument is perfectly sound, but the target would still have to make it. The target can be relieved of that burden, however, by a simple drafting solution: the MAE definition can make explicit what is already implied by expressly providing that, when the risk of a certain event is allocated to the acquirer under an MAE exception, allocated along with that risk are the risks of all events reasonably expected to follow from that event. And, in fact, the language introducing the MAE Exceptions in the MAE definition typically does exactly this by expressly stating that excepted from the definition are not only events falling into the exceptions but also all events “arising from” events falling into the exceptions. This language thus restores parity between the target and the acquirer in the sense that it ensures that the risks of events allocated to them are treated in the same way.⁷²

The final conclusion is that (a) an event is a Material Adverse Effect if the event (1) has, or would reasonably be expected to have, a material adverse effect on the company, (2) does not fall into an exception in the MAE definition, and (3) there is no earlier excepted event that makes the event reasonably to be expected, and (b) this remains true regardless of whether *any other event* that falls into an exception would also reasonably be expected to have a material adverse effect. Comparing this conclusion to the text of the typical MAE definition in Table 1 above shows that the clauses of the conclusion in (a)(1) and (a)(2) following immediately from the plain text of the definition. The clause in (a)(3) follows from the principle that, in allocating the risk of an event, the MAE definition allocates as

72. For this parity to exist, the phrase “arising from” in the language introducing the MAE Exceptions should be read to except not events that arise from excepted events in a mere but-for sense but only events that would reasonably be expected to follow from an excepted event. As discussed above, every event has multifarious and ramifying but-for consequences, most of which would not reasonably be expected to follow from the event even though they in fact do follow from it in a but-for sense. There is thus simply no telling what events may arise from an excepted event if we consider all the but-for consequences of the event, and so reading the “arising from” language in the introductory language to the MAE Exceptions as involving but-for causality (rather than in the sense of “what would reasonably be expected to follow”) would make the MAE clause yield unpredictable results not related to any rational allocation of risks made at the time of signing. It is implausible that sophisticated commercial parties would intend such random results

well the risk of all events reasonably expected to follow from it, but (3) also follows immediately from the plain text of the language introducing the MAE Exceptions that provides that not only events falling within the exceptions but also events arising from such events are excepted. The clause in (b) is a matter of pure logic.⁷³ In effect, the conclusion merely follows the plain language of the MAE definition.

It is instructive to see how this conclusion works out in the range of possible cases. Given that the problem of causal ambiguity in applying MAE definitions arises only if there are two events, E_1 and E_2 , such that the MAE definition allocates the risk of one of the events to one party and the risk of the other event to the other party, there are thus four cases. Further, at least one of event E_1 and event E_2 must be such that, given such event, the material adverse effect is reasonably to be expected (if this is not the case, neither event would be a Material Adverse Effect and the case is moot), and if event E_1 would reasonably be expected to have a material adverse effect on the company, then so too must event E_2 (for the causal chain runs from E_1 through E_2 to the material adverse effect). Given these constraints and writing $E_i \rightarrow \mathbf{mae}$ to mean that event E_i is reasonably expected to have a material adverse effect on the target and $E_i \nrightarrow \mathbf{mae}$ to mean that this is not the case, there are only four possibilities as set out in the table below:

73. Technically, “There exists an event x such that it is not the case that both x has or would reasonably be expected to have a material adverse effect and x is neither excepted nor arises from an event that is excepted” does not logically imply “There is no event x such that both x has or would reasonably be expected to have a material adverse effect and x is neither excepted nor arises from an event that is excepted,” or in symbols “ $\exists x \neg (Mx \wedge \neg Ex \wedge \neg \exists y (Ey \wedge Rxy))$ ” does not imply “ $\neg \exists x (Mx \wedge \neg Ex \wedge \neg \exists y (Ey \wedge Rxy))$.” Thinking the implication holds would amount to a simple operator-shift fallacy (“ $\exists x \neg$ ” becomes “ $\neg \exists x$ ”), which, given the evident complexity of the formulas, goes far towards explaining how even careful thinkers could fall into error here.

Table 2
Causal Sequences and Material Adverse Effects

<u>Case</u>	<u>E₁ Risk</u>	<u>E₂ Risk</u>	<u>Effect of E₁</u>	<u>Effect of E₂</u>	<u>Result</u>
(1)	Target	Acquirer	$E_1 \rightarrow \text{mae}$	$E_2 \rightarrow \text{mae}$	$E_1 = \text{MAE}$ $E_2 \neq \text{MAE}$
(2)	Target	Acquirer	$E_1 \nrightarrow \text{mae}$	$E_2 \rightarrow \text{mae}$	$E_1 \neq \text{MAE}$ $E_2 \neq \text{MAE}$
(3)	Acquirer	Target	$E_1 \rightarrow \text{mae}$	$E_2 \rightarrow \text{mae}$	$E_1 \neq \text{MAE}$ $E_2 \neq \text{MAE}$
(4)	Acquirer	Target	$E_1 \nrightarrow \text{mae}$	$E_2 \rightarrow \text{mae}$	$E_1 \neq \text{MAE}$ $E_2 = \text{MAE}$

In Case 1, the risk of the remote event E_1 is allocated to the target, the risk of the proximate event E_2 is allocated to the acquirer, the remote event E_1 would reasonably be expected to have a material adverse effect on the target, and thus so too would the proximate event E_2 . For example, the pandemic risk is allocated to the target, the risk of general changes in industry conditions to the acquirer, and the pandemic would reasonably be expected to have a material adverse effect on the target via general changes in industry conditions, such as collapsing demand. The account here entails that, in this case, the pandemic is an Material Adverse Effect, an outcome, I think, that respects the intentions of the parties. The change in industry conditions, since it follows from the pandemic, is a risk allocated to the target along with the risk of a pandemic, but even if we regard the risk of such a change as being allocated to the acquirer, although the change in industry conditions is not a Material Adverse Effect, this does not alter the fact that the pandemic is a Material Adverse Effect within the meaning of the MAE definition.

In Case 2, once again the risk of the remote event E_1 is allocated to the target, and the risk of the proximate event E_2 is allocated to the acquirer, but this time the remote event E_1 would *not* reasonably be expected to have a material adverse effect on the target, even though the proximate event E_2 would, which implies that the remote event would not reasonably be expected to result in the proximate event either. For example, the risk of terrorism is allocated to the target, and the risk of changes in law to the acquirer. After a terrorist attack, which neither has nor would *not* reasonably be expected to have a material adverse effect on the target, Congress begins to consider new anti-terrorism legislation and eventually passes a statute that makes much of the target's business illegal (imagine the target provides certain kinds of financial services, and Congress worries such services could be used by terrorists to finance their operations, even though there is no reasonable basis for such a worry). The account advanced here implies that the terrorist attack is not a Material Adverse Effect (since its effects would not reasonably be expected to extend to a material adverse effect on the target, even if its but-for effects do), and the change in law

is not a Material Adverse Effect either (since the risk of such changes was allocated to the acquirer). Therefore, there was no Material Adverse Effect.

In Case 3, the risk of the remote event E_1 is allocated to the acquirer, the risk of the proximate event E_2 is allocated to the target, and the remote event E_2 would reasonably be expected to result in a material adverse effect on the target via the proximate event E_2 , which thus would also be reasonably expected to have a material adverse effect on the target. For instance, the pandemic risk is allocated to the acquirer, the risk of a change in law to the target, and the pandemic makes lockdown orders (a change in law) and the ultimate material adverse effect on the target reasonably to be expected. Under the account advanced here, the pandemic is not a Material Adverse Effect since the risk of a pandemic was allocated to the acquirer. Although the target bore the risk of changes in law, the risk of the particular change in law at issue (lockdown orders) was allocated to the acquirer along with the pandemic risk, and, in any case, the language introducing the exceptions in the MAE definition provides that events arising from excepted events (lockdown orders arising from a pandemic) are excepted. Hence, the lockdown orders are not a Material Adverse Effect either.

Finally, in Case 4, the risk of the remote event E_1 is allocated to the acquirer, the risk of the proximate event E_2 is allocated to the target, and although the remote event E_1 would not reasonably be expected to have a material adverse effect on the target, the proximate event E_2 would. For instance, imagine that the risk of terrorism is allocated to the acquirer, and although a terrorist attack occurs, it has no effect of any kind on the target except that the target's founder and chief executive, who is essential to the business, is so moved by seeing images of the victims of the attack that she decides to retire and devote her energies to helping victims of terrorism around the world. The executive's departure is reasonably expected to have a material adverse effect on the company. Under the account advanced here, the risk of the terrorist attack is not a Material Adverse Effect because the terrorism risk was allocated to the acquirer. Although the departure of the executive results in a but-for sense from the terrorist attack, the departure would not reasonably be expected to result from such an event, and so the risk of the departure was not allocated to the acquirer along with the terrorist risk, even if the language introducing the exceptions in the MAE definition provides that events arising from excepted events are excepted (such language is to be read not in a but-for sense but in the sense of what would reasonably be expected to follow from excepted events).⁷⁴ Nor does the departure fall into any other exception. Hence, the target bore the risk of the executive's departure, and since that event would reasonably be expected to have a material adverse effect, it is a Material Adverse Effect.⁷⁵

The key point in this analysis has been the principle that, in allocating the risk of an event, the MAE definition allocates as well the consequences of that event that are reasonably expected to follow from it, though not any further consequences that follow in merely a but-for sense. I find confirmation of this principle in *Commonwealth Edison Co. v. Allied-General Nuclear Services*, where Judge Posner confronted a situation highly analogous to the problems treated in this Article.⁷⁶ In that case, the parties had entered into

74. See *supra* note 72.

75. Notice that the result would be different if the terrorist attack killed the company's chief executive officer; in that case, the attack *would* reasonably be expected to have a material adverse effect on the target.

76. 731 F.Supp. 850, 857 (N.D. Ill. 1990) (Posner, J., sitting as a district judge by designation) (emphasis in original).

a contract containing a clause that excused the seller from providing services at a certain facility “if there was a *force majeure* event unless the *force majeure* event consists in a failure to obtain an operating license” for the facility. “Suppose,” Judge Posner said, “a flood had severely damaged” the facility “and as a result the [relevant governmental authority] would not issue an operating license.”⁷⁷ The contract expressly mentioned floods as *force majeure* events, thus allocating the risk of such events to the buyer.⁷⁸ Would the general *force majeure* provision as applied to the flood excuse the seller from performing, or would the exception to the *force majeure* clause for failing to obtain a license apply, with the result that the seller was not excused? Clearly, this case fits into the pattern of Case 3 above, where the risk of the remote event (the flood) is allocated to the acquirer (here, the buyer of the services), the risk of the proximate event (the failure to obtain the license) is allocated to the target (here, the seller), and the occurrence of the remote event (the flood) makes both the proximate event (the failure to obtain the license) and ultimate effect (here, the seller’s inability to perform) reasonably to be expected. The principle underlying the analysis in this Article entails that, since the occurrence of the remote event (the flood) would reasonably be expected to result in the proximate event (the failure to obtain the license), the risk of the latter was allocated along with the risk of the former. Since the buyer bore the risk of the flood, it bore as well the risk of the seller’s failure to obtain the license as a result of the flood. That, indeed, is what Judge Posner thought too: he concluded that, if the flood caused the failure to obtain the license, the seller was excused, it being irrelevant that the flood made its effect on the company felt through the medium of the government’s refusing to issue the license.⁷⁹

D. Why the Courts Have Misapplied MAE Exceptions

If all this correct, then the courts that have thus far confronted these issues have been misreading the exceptions in the MAE definitions before them in rather serious ways. Take *AB Stable*, by far the best-reasoned of these cases. Albeit only in dicta,⁸⁰ the court in that case suggested that, even if the target had borne the risk of a pandemic, exceptions in the MAE definition for changes in business conditions, changes in industry conditions, and changes in law would each have applied, with the result that there was no Material Adverse Effect.⁸¹ Now, the court’s argument for that conclusion has three main steps. In the first, the court stated that the various exceptions to the MAE definition are to be read independently of each other in the sense that whether an event falls into an exception depends on the language in that exception and is independent of whether the event falls also into some other exception.⁸² That proposition, I think, is entirely correct.

In the second step, however, the court said that whether an event falls into an exception is also independent of whether any event causing that event falls into an exception, and

77. *Id.*

78. *Id.*

79. *Id.*

80. The court ultimately held that the acquirer bore the risk of a pandemic because an exception in the MAE definition included the terms “natural disaster” and “calamity,” and the COVID-19 pandemic was both of these. *AB Stable VIII LLC*, No. 2020-0310, at *57-59. Hence, the court’s discussion of whether other exceptions in the MAE definition would have applied if the target had borne the risk of a pandemic is dicta.

81. *Id.* at *55-57.

82. *Id.* at *56.

thus, for example, governmental lockdown orders would fall into an exception related to changes in law even if the orders resulted from a pandemic and the pandemic was not excepted.⁸³ Although I myself once argued for exactly that proposition⁸⁴ (and the court cited one of my working papers in reaching that conclusion),⁸⁵ for the reasons given above I now think this proposition is false. The better view is that, when the MAE definition allocates the risk of an event, it allocates along with the risk of that event the risk of all the reasonably-expected consequences of the event. Hence, if a pandemic is such that it would reasonably be expected to result in lockdown orders, then the risk of those orders is allocated along with the risk of the pandemic. It was a mistake for the court to treat events reasonably expected to follow from the pandemic as being separate events under the MAE definition.

But even making this mistake, the *AB Stable* court could still have reached the right result, for it was still open to the acquirer to argue that, although the lockdown orders were not a Material Adverse Effect (because falling into the exception for changes in law), nevertheless the pandemic, a quite different event, *was* a Material Adverse Effect, for *it* did not fall into any exception and *it* would reasonably be expected to have a material adverse effect on the target. As explained above, this reasoning is perfectly sound, and although it is not clear whether the acquirer made this argument, it *is* clear that the court would have rejected it because of an additional and even more serious mistake in the third and final step of the court's argument. That step is left mostly implicit, but from what the court says explicitly elsewhere in the opinion, we know that the court thinks that if "the cause of the [material adverse] effect fell within an exception to the MAE Definition," then "the *effect* could not constitute a Material Adverse Effect."⁸⁶

That sounds right, but in fact it conflates material adverse effects and Material Adverse Effects and leads to a near reversal of the internal logic of the MAE definition. That is, in the situation that the court is considering, an event causing a material adverse effect falls within an exception. What follows from this is that *this event* is not a Material Adverse Effect. What the court *thinks* follows from this is that the *material adverse effect* caused by the event is not a Material Adverse Effect. But this latter conclusion is nonsense, for it is events causing material adverse effects that are Material Adverse Effects (if the event is not excepted) or not Material Adverse Effects (if the event is excepted); material adverse effects themselves cannot be Material Adverse Effects. Thinking they could be is a category mistake. Although confusing Material Adverse Effects and material adverse effects is often harmless, confusing the two concepts in this context leads the court to the erroneous view that *exceptions in the MAE definition apply to material adverse effects* in the sense that, if an excepted event causes a material adverse effect, then not only is that event itself excepted but the material adverse effect it causes is excepted too, and so *any other event* causing that material adverse effect is treated as if it were excepted as well even if it is plainly *not* excepted. That is why, in the court's view, if the lockdown orders (an excepted event) cause a material adverse effect, the pandemic that caused the same material

83. *Id.* at *56-57.

84. Robert T. Miller, *Material Adverse Effect Clauses and the COVID-19 Pandemic* (Univ. Iowa Legal Stud., Rsch. Paper No. 2020-21), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3603055 [<https://perma.cc/NHA6-EXL7>] [hereinafter Miller, *Covid-19 Pandemic*], at 25-26.

85. *AB Stable VIII LLC*, No. 2020-0310, at *55 n. 204.

86. *AB Stable VIII LLC*, No. 2020-0310, at *48 (emphasis added).

adverse effect (via the lockdown orders) is not a Material Adverse Effect: on the court's view, the pandemic is not a Material Adverse Effect because the material adverse effect it causes has been "excepted" since it was also caused by an excepted event (the lockdown orders). This is all quite wrong, of course, because the exceptions in an MAE definition plainly apply to events (i.e., to Underlying Predicate Events) causing material adverse effects and not to material adverse effects themselves, and the fact that one event is not a Material Adverse Effect does not generally imply that some other event is not a Material Adverse Effect.

Now, as I argued above, on the correct reading of the MAE definition, acquirers enjoy a certain natural advantage in MAE disputes. That is, the acquirer prevails if there is even one Material Adverse Effect, that is, even one unexcepted event that would reasonably be expected to have a material adverse effect. The target prevails only if *every event* is *not* a Material Adverse Effect, that is, every event is either excepted or would not reasonably be expected to have a material adverse effect.⁸⁷ The court's reading of the MAE definition negates the acquirer's natural advantage and confers an analogous advantage on the target. Under the court's reading, if there is even one excepted event that would reasonably be expected to have a material adverse effect, then that material adverse effect is excepted, and no event, excepted or unexcepted, causing that effect is a Material Adverse Effect. Hence, for the acquirer to prevail, *every event* having a particular material adverse effect must be unexcepted, and if there is even one excepted event causing that material adverse effect, the target wins. Put another way, if there are some events causing a material adverse effect, under the proper reading of the MAE definition, the acquirer wins if *even one* of them is unexcepted; under the court's reading in *AB Stable*, the acquirer wins only if *every one* of them is unexcepted. By making the MAE exceptions apply to material adverse effects rather than the events causing them, the court's reading has negated the natural advantage of the acquirer and conferred an analogous advantage on the target.

This analogous advantage comes with an analogous ability to make specious arguments separating events from their reasonably-expected consequences and invites an analogous drafting solution to block such arguments. That is, recall that, when the risk of a remote event E_1 (such as a pandemic) was allocated to the acquirer and the risk of a proximate event E_2 (such as lockdown orders) was allocated to the target, the acquirer's natural advantage under the proper reading of the MAE definition (it takes only one unexcepted event having a material adverse effect for there to be a Material Adverse Effect) creates the possibility that the acquirer may ignore the principle that for purposes of the MAE definition an event includes all its reasonably-expected consequences and argue unfairly that, even if the remote event E_1 (the pandemic) was not a Material Adverse Effect, the proximate event E_2 (the lockdown orders) resulting from E_1 was a Material Adverse Effect. Recall, too, that such specious arguments can be blocked by language in the MAE definition introducing the exceptions that provides that events arising from excepted events are excepted. The court in *AB Stable*, by treating exceptions in the MAE definition as if they applied to material adverse effects rather than events causing material adverse effects,

87. The text here skips over the problem that MAE definitions generally include language like "either singularly or in the aggregate," which means that if two or more events, each unexcepted, cause an adverse effect on the target, these effects may be aggregated to determine if, taken together, they are material. This introduces a significant additional level of complexity, which I shall leave for another day.

has not only negated the acquirer's natural advantage under the MAE definition and conferred an analogous advantage on the target but it has also created the possibility of the *target* making analogously specious arguments against the acquirer. That is, when the risk of a pandemic is allocated to the target, but the risk of changes in law is allocated to the acquirer, the target can now argue (in violation of the principle that, for purposes of the MAE definition, an event includes all its reasonably-expected consequences) that, even if the pandemic is not an excepted event, the lockdown orders are, and so the material adverse effect resulting from the lockdown orders is "excepted," which makes the pandemic effectively excepted as well. Of course, the target ought not be permitted to distinguish between the pandemic and lockdown orders reasonably expected to arise from it. To block such a move, there is a drafting solution analogous to the language introducing the exceptions and providing that events arising from excepted events are excepted: such a solution would involve having the MAE definition provide that events arising from non-excepted events are not excepted.

Unsurprisingly, therefore, the court in *AB Stable* pointed out that its interpretation of the MAE exceptions could be blocked if the language in the exceptions included a proviso to the effect that otherwise excepted events would not be excepted after all if they arose from unexcepted causes,⁸⁸ which is exactly the drafting solution suggested above. Of course, such a proviso should be doubly unnecessary. It is unnecessary in the first instance because, in allocating the risk of an event to the target, the MAE definition allocates as well the risk of any event reasonably expected to follow from the event. It is unnecessary a second time because, if exceptions are understood to apply to events causing material adverse effects and not to material adverse effects themselves, even if an event arising from an unexcepted event is excepted and so not a Material Adverse Effect, nevertheless the unexcepted event from which the excepted event arises may be a Material Adverse Effect in its own right, which is all the acquirer needs to prevail. Hence, the fact that the court noted that parties could add a proviso to the MAE definition to make events arising from unexcepted events unexcepted shows again that the court had reversed the basic logical structure of that definition.

In sum, there are two problems with the reasoning in *AB Stable*. The first and less serious is a failure to appreciate that, in allocating the risk that a certain event will occur, the MAE definition also allocates the risk of all events reasonably expected to follow from the event, up to and including any reasonably-expected material adverse effect on the target. The second and more serious is that, by conflating Material Adverse Effects with material adverse effects at a critical point in the argument, the court has made exceptions in MAE definitions apply to material adverse effects rather than Material Adverse Effects,⁸⁹ which reverses the internal logic of the MAE definition.

88. *AB Stable VIII LLC*, No. 2020-0310, at *56.

89. The court in *KCake* makes exactly the same mistake. In that case, the acquirer had pointedly refused to agree that "pandemics" would be excepted events, thus allocating the risk of a pandemic to the target, *KCake Acquisition, Inc.*, No. 2020-0282, at *6-7, but the parties had agreed that general changes in the economy, *id.*, and changes in law would be excepted, *id.* at *35, and thus that the risk of such changes would be allocated to the acquirer. The court held that the target had not suffered a material adverse effect, which suffices to dispose of the case, but it then went to say in dicta that that "revenue declines arising from or related to changes in law fall outside of the definition of an MAE, regardless of whether COVID-19 prompted those changes in the law." *Id.*

Now, as I mentioned above, even the most expert and experienced transactional lawyers sometimes conflate Material Adverse Effects and material adverse effects, which suggests that the *AB Stable* court ought not be judged harshly for falling into this mistake at a critical point in the argument. In fact, however, the particular form of the confusion in *AB Stable*, making exceptions in MAE definitions apply to material adverse effects instead of events causing them, is not the court's fault at all. If anyone is responsible for this mistake, I am. The mistake existed in both scholarly and practitioner literature for years before *AB Stable*, but the earliest example of this mistake that I have found is in one of my own law review articles from 2009.⁹⁰ There, I said, "When ... exceptions are present [in an MAE definition], adverse changes to the company resulting from such causes are not MACs within the meaning of the definition."⁹¹ Replace the word "changes" with "effects" and the abbreviation "MAC" with "MAE," and what I said in 2009 is exactly what the court in *AB Stable* said in 2020: if an event causing a material adverse effect falls into an exception, the material adverse effect is not a Material Adverse Effect, which makes the exceptions apply to material adverse effects rather than the events causing them, and so entails all the erroneous consequences exposed and deprecated above.

The confusion I condemn here is thus one that I myself invented. Whether everyone who has fallen into this mistake has done so under the influence of my writings is doubtful; because of the pervasive confusion of Material Adverse Effects with material adverse effects, this was a mistake waiting to happen. But given the unpleasant choice, I would rather accept the whole blame and be accused of grandiosity in appropriating the responsibility to myself than blame others for making the mistake independently and be accused of shirking the responsibility for the mistake.

IV. CONCLUSION

The aim of this Article has been to understand MAE clauses in the way sophisticated commercial parties entering business combination agreements understand them. Unfortunately, this understanding is only partly articulate; in significant part it is embodied in the unarticulated beliefs, intuitions, and dispositions of individuals who manage such entities and the transactional lawyers who represent them. My approach to getting at this inarticulate—or at least as yet unarticulated—understanding has been essentially economic in the neo-classical sense: I have assumed that sophisticated commercial parties are rational profit-maximizers who may be counted upon to discover what is in their long-term interest and act accordingly. Hence, at least when they are not litigating, such parties will understand a contractual clause in a way that makes it economically efficient. This gives us a method of interpreting their agreements: we construe provisions in a manner that makes them efficient *ex ante*.

Thus, in the court's view, because changes in law were excepted and so not Material Adverse Effects, if a material adverse effect ("revenue declines") arises from a change in law, no other event (including "COVID-19") can be a Material Adverse Effect. In other words, if a material adverse effect arises from an excepted event, then no event causing that material adverse effect can be a Material Adverse Effect. As in *AB Stable*, this is to treat the exception as applying to material adverse effects, not the events causing them.

90. Miller, *Deal Risk*, *supra* note 8.

91. *Id.*, at 2047.

The analysis in Part III was based on this premise, but the idea also came out in Part II when I argued that the canon of *ejusdem generis* notwithstanding, most transactional lawyers would not see a difference between such phrases as “hurricanes, tornados, tsunamis, and other natural disasters” and “natural disasters, including hurricanes, tornados, and tsunamis.”⁹² In drawing a distinction between the phrases, the canon appeals to the economic rationality of contract drafters, and so it may be at first surprising that the canon produces an answer at odds with the understanding of sophisticated commercial parties and their transactional lawyers. The reason for this is that the canon, while assuming contract drafters are economically rational, also assumes that the paramount concern in drafting contracts is economy of expression.⁹³ Perhaps this was a reasonable view in the historical context in which the canon arose (it is not accidental that the canon is expressed in Latin and was undoubtedly first written down with a quill pen), and perhaps it is a reasonable view in certain contexts still today. But in the context of the negotiation of a public company merger agreement, where billions of dollars are typically at stake and where the agreement will be reviewed and edited by teams of lawyers (using word processors, not quill pens) and will inevitably run to about a hundred single-spaced pages (with hundreds of additional pages in the attached disclosure schedule), there is little concern with economy of expression and immense concern about commercial realities. Put another way, in the rarefied context of public company mergers, the transaction costs of drafting a longer agreement are negligible compared to the benefit of added certainty on the commercial issues. In that context, belts and suspenders (note that this expression is in English, not Latin)⁹⁴ will prevail over economy of expression every time.

92. When I presented some related work to members of the Mergers & Acquisitions Committee of the Business Law Section of the American Bar Association, one very experienced senior practitioner remarked that he could not recall a single instance in which anyone had invoked the canon of *ejusdem generis* to interpret a merger agreement. This is consistent with my own experience.

93. See discussion *supra* Part II.

94. In the United Kingdom, the phrase is “belts and braces,” and the oldest recorded use of the phrase in the Oxford English Dictionary dates from 1955. Oxford English Dictionary, s.v., *belt*, P4. *belts and braces*. The entry notes that “belts and suspenders” arose later in North America, and the oldest example in the entry dates from 1995. See also Declercq, *supra* note 29, at 250–51 (recommending that *force majeure* clauses in commercial agreements expressly provide that *ejusdem generis* not control the interpretation of such clauses).