



BY DAVID MARCUS

UNDER THE MICROSCOPE

IN DELAWARE, LAMB TAKES A CLOSER LOOK AT MAES, WHILE STRINE EXAMINES MHR'S INVESTMENT IN LORAL

URNS OUT TOKYO'S RICOH CO. LTD. may have been right to give up a so-called material adverse effect clause in its agreement with Ikon Office Solutions Inc. In *Hexion Specialty Chemicals Inc. v. Huntsman Corp.*, Delaware Vice Chancellor Stephen Lamb offered perhaps the most thorough analysis of an MAE clause under Delaware law since Judge Leo E. Strine Jr.'s 2001 opinion in *IBP Inc.'s* suit to force Tyson Foods Inc. to complete its acquisition of IBP.

Lamb leaned heavily on IBP in finding that Huntsman Corp. had not suffered an MAE as defined in its merger agreement with Hexion Specialty Chemicals Inc., which was typical of such clauses. "Many commentators have noted that Delaware courts have never found an MAE to have occurred in the context of a merger agreement," Lamb wrote. "This is not a coincidence. The ubiquitous MAE clause should be seen as providing a 'backstop protecting the acquirer from the occurrence of unknown events that substantially threaten the overall earnings potential of the target in a durationally significant manner. A short-term hiccup in earnings should not suffice; rather [an adverse change] should be material when viewed from the longer-term perspective of a reasonable acquirer.'"

The judge also noted "that absent clear language to the contrary, the burden of proof with respect to an MAE rests on the party seeking to excuse its performance under the contract."

Lamb's statement that no Delaware court has found an MAE, though accurate, overlooked that he himself heard a case where such a result seemed likely—*Monolithic Systems Technology Inc.'s* 2004 lawsuit seeking to force Synopsys Inc. to close its \$432 million acquisition of Monolithic. But Synopsys' lead lawyer on the deal, Richard Climan of Cooley Godward Kronish LLP in Palo Alto, Calif., wrested an exceptionally buyer-favorable MAE definition from Alan Kalin, Monolithic's lawyer at Bingham McCutchen LLP in East Palo Alto. With his ruling in *Hexion*, Lamb gives a seller with a typical MAE definition more security in resisting a buyer that claims an MAE.



Lamb no coincidence

LEO E. STRINE JR. has never shied from bold rulings, and he offered another one on Sept. 19 in a case involving Loral Space & Communications Inc. The Delaware vice chancellor relied on the broad power of a court of equity to change the terms of preferred stock that MHR Fund Management LLC extracted from Loral, which emerged from bankruptcy in 2005 with MHR as its largest stockholder.

"This decision comes when there are all sorts of companies who face this issue," says Ethan Klingsberg, a partner at Cleary Gottlieb Steen & Hamilton LLP in New York. "They will need their largest shareholder to come in and give them money."

Such companies will need to do a better job of negotiating than Loral did. Its board was conflicted by its ties to MHR, which installed its adviser, Michael Targoff, as Loral's CEO "with the goal of having MHR make a substantial equity investment in Loral," Strine wrote. Targoff proposed that Loral raise \$300 million in equity from MHR, and Loral established a special committee to do so. The committee's chair, John Harkey Jr., was a close friend of MHR founder Mark Rachesky, and its other member, Arthur Simon, was so clueless that he sent one e-mail asking, "What is happening???"



Strine not shy

The committee struck a deal with MHR "after less than two weeks and after conducting no market check," Strine wrote. MHR extracted convertible preferred stock "with a high dividend rate and low conversion rate [and] extraordinary class voting rights" as well as several other terms highly favorable to MHR. The preferred limited MHR's voting power at 39.99% but gave it veto power "over any strategic initiative Loral undertook."

The judge found that the special committee ran a seriously flawed process that resulted in terms "unfairly advantageous" to MHR. He reformed the financing by converting the convertible preferred into nonvoting common stock and adjusted the price to account for "MHR's access to inside information, its insulation of itself from market pressures, and its attainment of a \$6.75 million [placement fee]." By doing so, Strine wrote, he "took MHR and the special committee up on their desire to avoid a Revlon deal," one that would result in a change of control at Loral, and crafted a remedy "not punitive to MHR." ■

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