

## M&A Watch

### That's the Way the Cookie Crumbles: Delaware Court Rejects MAE Claim in Commercial Contract Litigation

19 July 2017

The Delaware Court of Chancery recently reaffirmed its approach to Material Adverse Effect jurisprudence in the context of a commercial arrangement.

#### THE CONTEXT

Mrs. Fields and Interbake entered into a **multi-year exclusive licensing agreement** under which Interbake became the sole producer and distributor of pre-packaged Mrs. Fields cookies. The license agreement, in relevant part, included a representation that Mrs. Fields had no knowledge of any fact or occurrence that was or could become “materially adverse” to Mrs. Fields’ business. The term “materially adverse” was undefined.

The arrangement was not successful and Interbake purported to terminate the license agreement, arguing that, among other things, Mrs. Fields had breached its “material adverse effect” representation because it knew its retail cookies were inferior in taste and that the Mrs. Fields brand was in decline. There was evidence that consumers were facing “cookie confusion” — the prepackaged product wasn’t the same as the fresh-baked variety — and that both parties were aware of this fact at the time they entered into the license agreement. Mrs. Fields sued, challenging the purported termination.

#### DELAWARE COURT RULING

Even though the license agreement did not involve a merger or acquisition, in analyzing the undefined term “material adverse effect,” Chancellor Bouchard applied the Court’s three-prong MAE test from *In re IBP Shareholder Litigation*, which construed an MAE condition as a backstop protecting the acquirer from:

- 1) the occurrence of unknown events,
- 2) that substantially threaten the overall earnings potential of the target,
- 3) in a durationally significant manner.

The Court found that none of the test's three prongs had been satisfied. Particularly important was the fact that Interbake knew about the "cookie confusion" issue at the time of entering into the license agreement. Chancellor Bouchard did concede, however, that the durational element of the third prong "presumably would be shorter than the period of time relevant to the acquisition of a business."

## OUR VIEW

The Delaware Courts have been consistent in their view that contracting parties will be held to a high standard if they try to use a "Material Adverse Effect" provision to avoid performing their contractual obligations. At this point, principals and advisers should basically view the term "Material Adverse Effect" — whether defined or not, and whether in the M&A context or not — as a term of art that is an ultimate backstop for a party to a contractual arrangement that needs to meet specific criteria with a high threshold and is very difficult to invoke under Delaware law.

If you are interested, we would welcome the opportunity to discuss this topic with you directly.



**George Casey**

Head of Global M&A

+1 212 848 8787

[george.casey@shearman.com](mailto:george.casey@shearman.com)



**Scott Petepiece**

Head of Americas M&A

+1 212 848 8576

[spetepiece@shearman.com](mailto:spetepiece@shearman.com)



**Alan Goudiss**

Partner, M&A Litigation

+1 212 848 4906

[agoudiss@shearman.com](mailto:agoudiss@shearman.com)

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This memorandum is intended only as a general discussion of these issues. It should not be regarded as legal advice. We would be pleased to provide additional details or advice about specific situations if desired.

599 LEXINGTON AVENUE | NEW YORK | NY | 10022-6069

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