(NO) MATERIAL ADVERSE CHANGE CLAUSES
- NORWEGIAN LAW WITH A COMPARATIVE PERSPECTIVE

— DRAFT —

27TH NOVEMBER 2006

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1 DEFINITION OF TOPIC

A common condition to closing in acquisition or merger agreements is the lack of a “material adverse change” in the financial or other condition of the seller or target company between the time of entering into the acquisition agreement and the closing date.¹ The topic of the following article is an analysis of “the (no) Material Adverse Change clause” (hereafter the “MAC clause”) under Norwegian law with a comparative perspective to English and US contract law.

1.1 Presentation of the MAC clause

The purpose of the MAC clause is to provide an opportunity for one of the parties to withdraw from a transaction that has, for unexpected reasons, become far less profitable than originally intended. In short, the MAC clause is meant to assure against the materialisation of unexpected and unknown risks that will or are likely to have significant impact on that party's evaluation of the transaction.

1.2 In what kind of contracts is it used?

MAC clauses frequently appear in both loan agreements and agreements for the acquisition of companies.² In loan agreements, MAC clauses aim to give the lender a right to accelerate or cancel the loan if events occur that are detrimental to the borrower’s financial or other conditions relevant for borrowers ability to meet the loan obligations. In acquisition agreements, the MAC clause aims at giving the buyer a right to withdraw from the transaction before closing if an event happens that is detrimental to the target company.

1.3 The purpose of MAC clauses

As mentioned above, the main purpose of the MAC clause is to provide an exit-opportunity in a transaction, which for some reason has become far less profitable than originally expected. A secondary purpose (which may be just as important to the relevant party) is to provide leverage for re-negotiations of the terms of the agreement.

The MAC clause is not the only clause to provide an exit-opportunity upon the materialisation of particular risks. Agreements for the purchase of businesses or shares typically include lists of conditions and warranties allocating all kinds of risks.

What is special about MAC clauses is the kind of risk these clauses allocate. Typically, a MAC clause aims at allocating supervening, extraneous, unknown and unforeseeable risks. One might say that the MAC clause aims at allocating whatever risks are left after all the more specific conditions and warranties are written.

² But it may also be found in other types of contracts, see for example the General Agreement Concerning the Delivery and Acceptance of Natural Gas, Version 2.0, January 2003, published by the European Federation of Energy Traders.
Examples of risks covered by MAC clauses are non-fulfilment of financial targets, loss of a major customer, general downturns in a relevant market, previously unknown circumstances leading to a loss in a company’s assets and dramatic loss of a company’s market shares.

This is also what makes the MAC clause different from “any other clause”. The task of covering risks that are unseen is a difficult task as it requires extremely open and wide-ranging clauses. The problem with this, besides the obvious problem of getting it through in the negotiations with the other party, is that it creates uncertainty with respect to how the clause is to be understood. Uncertainty is exactly what the clause aims at reducing, but it may nevertheless end up adding uncertainty to the deal.

In order to reduce uncertainty, clauses should be made more specific. But this raises another problem as the unseen risks that the MAC clause is intended to cover cannot be specified. Thus, the more specific the MAC clause is, the less risk will it cover and in turn the less “effective” will it turn out to be.

Because the risks are unseen, the MAC clause aims at the effects of the materialisation of those risks rather than the risks themselves. These effects may well be specified and in turn make the MAC clause more effective. A “material adverse change” may for example be defined as a certain defined fall in the company’s stock price or in some other financial indicator. This, however, increases the resistance from the other party to the contract and if the other party allows it at all, the price paid for such “assurance” will certainly be considerable.

Because of these inherent difficulties, MAC clauses tend to end up with a basic formula with infinite variations in carve outs etc.

1.4 Different types of MAC clauses

MAC clauses are not typical boilerplate clauses. Their wording is individually negotiated (even though they tend to end up with a basic formula) and the clause regulates the material rights and obligations of the agreement (and not only the procedural rights and obligations, as do boilerplate clauses).

The MAC clause may be drafted as either a warranty or as a condition precedent. If drafted as a warranty that no MAC event have (or will) occur, a MAC event will allow the other party to terminate the agreement. If, in the opinion of the other party, a MAC event in fact occurs,
that party may claim a breach of warranty and terminate the agreement. Termination due to a breach of warranty normally gives rise to liability on behalf of the party in breach.

If drafted as a condition precedent, the duty to perform under the agreement is postponed until the time period defined in the clause has elapsed without a MAC event occurring. Consequently, the conditioned obligation does not become effective until the condition precedent is satisfied. If the condition is not satisfied, the obligation to perform under the agreement does not arise.

1.5 Example of a typical MAC clause

MAC clauses typically consist of an operative clause (the MAC clause itself) and a definition of the MAC event. The definition is sometimes included in the operative clause. Due to the impossibility of defining unexpected (and often unknown) risks, definitions typically include situations or occurrences which are not to be understood as “material adverse changes”. The process of defining these “carve-outs” may often result in particularly intense and long-lasting negotiations between the parties.11

A common example of the operative part of a MAC clause is as follows:

"Conditions precedent to Closing

Since the date of [the Agreement], there has not been any Material Adverse Change in the condition (financial or otherwise), business, assets, liabilities or results of operations of [the Party and its Subsidiaries taken as a whole…]"

In this agreement, what was to be regarded as a “material adverse change” (a MAC event) was defined as follows:

"“Material Adverse Change” means any result, occurrence, condition, fact, change, violation, event or effect that, individually or in the aggregate with any such other results, occurrences, conditions, facts, changes, violations, events or effects, is materially adverse to:

(A) the financial condition, business, assets, liabilities or results of operations of the Company and its Subsidiaries, taken as a whole,
(B) the ability of the Company to perform its obligations under this Agreement or
(C) the ability of the Company to consummate the Merger; provided, however, that in no event shall any of the following constitute a Company Material Adverse Change:

(1) any change or effect resulting from changes in general economic, regulatory or political conditions, conditions in the United States or worldwide capital markets;"

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(2) any change or effect that affects the oil and gas exploration and development industry generally (including changes in commodity prices, general market prices and regulatory changes affecting the oil and gas industry generally);
(3) any effect, change, event, occurrence or circumstance relating to fluctuations in the value of currencies;
(4) the outbreak or escalation of hostilities involving the United States, the declaration by the United States of a national emergency or war or the occurrence of any other calamity or crisis, including acts of terrorism;
[...]
(14) any of the matters referred to in Schedule 3.1(a)...

1.6 The following presentation

The main object of this article is to present the MAC clause and its expected legal effects under Norwegian law. However, due to its foreign origin, it is interesting to compare its operation under Norwegian (civil) law with that of its “original” jurisdictions, namely English and US law.

In order to better understand the need for and the applicability of the MAC clause, this article will focus on the MAC clause as a condition precedent in agreements for the acquisition of companies. In the following, “MAC clause” is therefore to be understood as MAC condition precedent.

MAC clauses in English and US law will be presented briefly in chapter 2 below. For more details on MAC clauses' operation under English law, see the article by Ed Peel earlier in this book. MAC clauses in Norwegian law will be presented in chapters 3 and 4 below.
2 THE INTENDED MEANING OF MAC CLAUSES IN ENGLISH AND US LAW

2.1 Intended legal effect of MAC clauses
The intended legal effect of MAC clauses in English and US law is to assure a contracting party towards unknown risk by allowing that party to walk away from the transaction in case of a MAC event.

2.2 English and US legal regime that permits or requires MAC clauses
Both English and US contract law are founded on the principles of freedom of contract and sanctity of contract. The first principle give parties the right to freely make agreements according to their common intentions. The second principle provides that agreements shall be held between the parties according to their agreed content.

There is no conflict between the principle of freedom of contract and MAC clauses. The parties are therefore free to include such clauses at their wish.

With regards to the principle of sanctity of contract, however, two questions arise in relation to MAC clauses. Firstly, there is a practical question of deciding exactly what is agreed (and consequently what is to be performed). This is the question of the interpretation of the MAC clause. Secondly, there is a question of whether or not agreements should always be upheld no matter what their content and their legal effects. This is the question of absolute contracts.

2.2.1 Interpretation – can MAC clauses be relied upon in English and US law?
Generally, English and US contract law have a reputation for giving full effect to the words of commercial contracts, and this has traditionally been expressed through the “plain meaning rule”.12 This rule states that the courts will

“construe a written document [...] according to the ordinary grammatical meaning of the words used therein, and without reference to anything which has previously passed between the parties to it”.

By interpreting contracts according to the plain meaning rule, English and US courts have promoted certainty “by holding that parties who have reduced a contract to writing should be bound by the writing and by the writing alone”.14

This should indicate that parties can trust English and US courts to uphold a MAC clause according to its objective wording without reading the clause in light of the parties’ purpose with it, their previous negotiation history, what is reasonable and fair etc. In short, the points of departure in both English and US contract law seem to indicate that contracting parties in these jurisdictions can safely rely on MAC clauses.

However, this is not necessarily true. Particularly English contract law has during the past decades slowly shifted away from the traditional rules of interpretation towards a more

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12 For an expression of this rule in English case law, see Lovell and Christmas Ltd v Wall (1911) 104 LT 85. An expression of this rule in US law is found in [...].
13 Lovell and Christmas Ltd at 88.
14 Treitel, The Law of Contract, at 192
moderate interpretive theory. This modern approach to interpretation includes subjective elements to a larger extent than was traditionally accepted.\textsuperscript{15}

As for US contract law, subjective elements have traditionally been admitted to a larger extent than in traditional English contract law, and one can say that English and US contract law have moved closer to each other during the past decades.

\textit{Case law}

There have been some instances where MAC clauses have been interpreted and applied by US courts. In the landmark decision of IBP Inc. v Tyson Foods Inc.\textsuperscript{16} in 2001, the Delaware Court of Chancery placed a high burden on a buyer wishing to rely on a broadly drafted MAC clause to get out of a forthcoming transaction. The buying company, Tyson Foods Inc., claimed a considerable loss due to several events affecting the target company, IBP Inc. In deciding whether these events constituted a “material adverse effect” on the target company, the court interpreted the MAC clause in the light of all available evidence. On this basis, it held that the MAC clause was

\begin{quote}
“\textit{best read as 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.}”\textsuperscript{17}
\end{quote}

As a result Tyson Inc., who had relied on the MAC clause to get out of what was perceived as a bad bargain, was instead forced to perform the acquisition.

Although the decision is based on the individual circumstances of that particular case, the IBP v Tyson decision is generally seen as a sign that US courts will hesitate to apply a broadly written MAC clause simply according to its face meaning.\textsuperscript{18} To the contrary, courts are likely to consider all relevant facts of the case, including subjective elements, in order to decide whether a “material adverse change” has, in light of the individual circumstances, occurred. This signifies less certainty for parties including MAC clauses in their contracts, and will probably lead to attempts of greater precision in the future drafting of MAC clauses.\textsuperscript{19}

From English courts, there is little case law on MAC clauses. Partly because of this, and partly because of the fact that MAC clauses originated in the US, English courts are expected to draw on US examples when interpreting MAC clauses.\textsuperscript{20} The development in the interpretation of contracts under English law has also made it possible for courts to take into consideration many of the same arguments that were considered by the Delaware court in the Tyson case.

\textsuperscript{15} The shift is perhaps most clearly seen in the English judgment of Investors Compensation Scheme Ltd v West Bromwich Building Society [1998] 1 WLR 896.
\textsuperscript{16} In re IBP, Inc. v Tyson Foods, Inc., Del. Ch., 789 A.2d 14 (2001)
\textsuperscript{17} In re IBP at 68
\textsuperscript{18} Greater precision may enhance the chances of relying on the MAC clause, but it takes away some of the clause’s advantage, namely its ability to cover unforeseen and unexpected occurrences.
\textsuperscript{20} Kirsten Birkett, \textit{Untying the knot – Material adverse change clauses}, PLC March 2002 pages 17 – 28, at 25.
2.2.2 Sanctity of contract and the doctrines of “frustration” and “impracticability”

Another issue relevant to MAC clauses is whether there is an alternative regulation in English or US law which covers the same need as the MAC clause is intended to cover. In short, which consequences would a MAC event have on a contract if the parties had not included in it a MAC clause?

As mentioned above, typical MAC events are situations of supervening circumstances (that the parties did not or could not anticipate in advance) with detrimental effects on the object of the transaction. Similar situations are regulated by the English and US contract law doctrines of “frustration” and “impracticability”.

The doctrine of frustration

The doctrine of frustration developed in English contract law “[to] mitigate the rigour of the common law’s insistence on literal performance of absolute promises”. Briefly put, “frustration” leads to the discharge of an agreement if fulfilment of the promised performance is hindered in such a way that the purpose of the original contract is frustrated. According to a House of Lords decision, the principle of frustration applies only where “the thing undertaken would, if performed, be a different thing from that contracted for”. Exactly which factual situations that will be regarded as “frustrating” circumstances may be difficult to judge, but the question has been quite extensively developed in case law.

In relation to MAC clauses, it is worth noting that the mere shift in the commercial balance of a contract does not in itself satisfy the conditions for use of the doctrine of frustration. According to an early decision from the House of Lords,

“[t]he argument that a man can be excused from performance of his contract when it becomes ‘commercially’ impossible seems to me a dangerous contention which ought not to be admitted unless the parties have plainly contracted to that effect.”

This contention finds support in later case law from the House of Lords:

“[A] turn of events which [the parties] did not at all anticipate – a wholly abnormal rise or fall in prices, a sudden depreciation of currency, an unexpected obstacle to the execution, or the like [...] does not in itself affect the bargain which they have made [and therefore does not invoke the doctrine of frustration, (author’s comment)].”

On the basis of the above, it is likely that most MAC events would not be covered by the doctrine of frustration.

The US doctrine of frustration goes no further than that of English law, and it will not be examined any closer in this article.

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22 Davis Contractors Ltd v Fareham Urban DC [1956] AC 696 at 729.
24 Cf. British British Movietoneneews v London and District Cinemas [1952] A.C. 166. See also Multiservice Bookbinding Ltd v Marden [1979] Ch. 84 and Pioneer Shipping Ltd v BTP Tioxide Ltd (The Nema) (No. 2) [1982] A.C. 724 s. 752 where the House of Lords expressed that the doctrine of frustration “‘[i]s not lightly to be invoked to relieve contracting parties of the normal consequences of imprudent commercial bargains.”
The doctrine of impracticability

More interesting from a US perspective is the doctrine of impracticability. This doctrine has developed from the doctrine of frustration, and it leads to the discharge of an agreement which performance is hindered by “commercial impracticability”. The test for the application of the doctrine of impracticability is whether, “in the light of exceptional circumstances, justice requires a departure from the general rule that a promisor bears the risk of increased difficulty of performance.” In relation to MAC clauses, it is interesting to examine to what degree the doctrine of impracticability covers instances of commercial occurrences detrimental to an agreement.

Normally, typical MAC events will not be covered by the doctrine of impracticability. According to the Restatement on Contracts 2d § 261 (b), “The continuation of existing market condition and of the financial situation of the parties are ordinarily not such assumptions, so that market shifts or financial inability do not usually effect discharge under the rule [...]”. However, the official commentary included in the Restatement does open up a possibility that the doctrine of impracticability may be “sufficiently flexible to take account of factors that bear on a just allocation of risk”. This might indicate that a severe shift in the commercial balance in an agreement may, under the circumstances, be sufficient to invoke the doctrine.

In practice, it has proved extremely difficult to rely on impracticability to get out of commercially (really) bad bargains. One example is the so called Westinghouse-cases where a producer of radioactive power plants made several concurrent contracts for the delivery of uranium in the 1960’s. As a consequence of the oil crisis of the early 1970’s, the price of uranium rose sharply and the Westinghouse Corporation took huge losses. In order to get out of its many long-term delivery contracts, Westinghouse Corporation relied in a series of lawsuits on the doctrine of impracticability. However, in none of the cases did the courts find for Westinghouse.

As a conclusion, it is not likely that the same result would be reached if the contract did not include a MAC clause. There is thus no significant overlap between the doctrine of impracticability and MAC clauses.

2.2.3 UK City of London Takeover Panel

Acquisitions of public companies in the UK are regulated by the City Code of Takeovers. This is a set of rules that have been created in order to bring predictability and stability in the UK takeover market, and the rules are administered by the Takeover Panel. Although the code is not sanctioned by law, and as such is not legally binding, practice has proved that the rules are followed to a large extent.

In relation to MAC clauses, the Takeover Code is relevant because it regulates, among other things, the making of conditional offers and lays down limits on, among other things, the operability of MAC clauses.

26Farnsworth II s. 634.
27Ibid
28 See Murray on Contracts at 644 with further [references].
29The Takeover Panel regulates the acquisition and merger of listed and public companies in the UK. As such, the regulation is not relevant to private transactions.
30 http://www.thetakeoverpanel.org.uk
In the much publicised decision of WPP v Tempus, the Takeover Panel ruled on the relationship between the regulation of conditioned bids in the Takeover Code and a MAC condition precedent to an acquisition. To cut a long story short, the Takeover Panel concluded that calling off a published acquisition would require

“an adverse change of very considerable significance striking at the heart of the purpose of the transaction in question, analogous [...] to something that would justify frustration of a legal contract.”

This was understood by many as a strict limitation on the ability of acquirers to use MAC clauses to condition their bid, but the Panel has in a later practice statement expressed that the threshold for relying on MAC clauses is not as high as that of “frustration”.

2.3 Discrepancies between perceived need or advisability of MAC clauses

As mentioned in the above, the purpose of the MAC clause is to bring security against the materialisation of unknown risks. In order to cover what is yet unknown to the parties at the time of contracting, the MAC clause is normally drafted broadly.

This was also the case in the matter of Tyson Foods Inc. v IBP Inc. However, in that case the wide scope of the clause caused the court to interpret it as having a very high threshold, thus making it less effective seen from a buyer’s standpoint.

The alternative is to make the MAC clause more precise. That, however, will probably limit the scope of the clause so that events (which would otherwise represent a material adverse change) might not be covered by the parties’ definitions. Confronted with a detailed MAC clause, the courts will be very reluctant to override such a definition of MAC events.

This gives the draftsmen (and women) an obvious dilemma: Drafting a wide clause may cover the necessary risks, but may lead to a higher threshold than that party is seeking. On the other hand, drafting a narrow clause enables the parties to specify the threshold at their wish, but leaves possible material adverse changes uncovered.

As a result of this, the application of MAC clauses is clouded in uncertainty. This does not mean that the clause is useless, however. In many instances, the party claiming a material adverse change will rely on this uncertainty in seeking to re-negotiate the deal or reach a settlement in a lawsuit. Thus, the MAC clause fulfils its function as assurance from unknown risk, but it does not necessarily allow the aggrieved party to simply walk away from the transaction.

3 EVALUATION UNDER NORWEGIAN LAW

Although the MAC clause is frequently included in agreements to be regulated under Norwegian law, I am not aware of any case law in which the interpretation or application of a MAC clause has been in dispute. This part of the article is consequently based on general principles of contract law.

In the following, I will examine the legal effects that MAC clauses may be expected to have under Norwegian law. I will further examine whether the MAC clause is necessary to achieve these legal effects. Lastly, I will make a few comments on the advisability of using MAC clauses to achieve the intended legal effects set out in chapter 1 above.

3.1 Is the MAC clause unnecessary due to default rules in Norwegian law?

The first question is whether the MAC clause is necessary to achieve its intended legal effect, which is to enable a party to get out of an agreement that has turned out to be commercially unsound due to an unforeseen or unexpected supervening change.

In looking at whether the MAC clause is necessary to provide for a way out in case of a (really) bad bargain, we must first look at how the materialisation of risks are handled under Norwegian law before turning to the MAC clause.

3.1.1 Termination due to material breach

Specific and foreseeable risks are generally best regulated through specific contract provisions coupled with a right of termination in cases of material breach. Even if there is no termination clause in the contract, such a right will in many cases follow from general principles of contract law. Thus, if the parties have included a warranty regarding financial strength of a target company, and there is a material adverse change in the financial strength of target, the purchaser could terminate the agreement due to material breach according to general principles (or, if it is included, a specific termination clause in the agreement). In such cases there may not be a need for a MAC clause.

In other cases, a right of termination (whether this follows from general principles or the contract itself) may not be of much value to the purchaser. Firstly, this is the case where there is no warranty covering the particular adverse change. In that case, the negative change does not result in a breach of an obligation and therefore does not give rise to a right of termination. Secondly, a right of termination may not be of much help if there occurs both negative and positive changes to target. In these cases, the courts will weigh the negative changes against the positive in order to make an overall assessment of whether a party may terminate the agreement.

In these cases, a right of termination is clearly not an adequate alternative to a MAC clause, and considering the type of risks MAC clauses typically are meant to cover, a right of termination will not normally be an alternative to the MAC clause.

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33 I will, however, not address the issue of interpretation of contracts drafted in the English language or between foreign parties as this is addressed in several other publications.

34 In contrast with English / US general principles of contract law.
3.1.2 Discharge due to supervening events

The starting point in Norwegian contract law, as in English and US contract law, is that each party must carry his or her own risk as to how the contracted obligations will develop. This follows from a consideration of predictability which is essential for parties' confidence in contracts and contractual obligations. In spite of this, if supervening events lead to totally unreasonable and unfair results, predictability may, under Norwegian law, be outweighed by reasonableness.

There are two sets of principles that may apply in situations of supervening circumstances affecting the balance in the parties’ agreement. Firstly, there is the doctrine of failed assumptions. Secondly, there is the mandatory rule prescribed by the 1918 Contracts Act § 36 saying that an agreement may be declared void or may be amended by the courts if its effects on one of the parties are “unfair”.

The seriousness of the supervening event required for these “safety-valves” to apply varies according to several factors including the level of equality in the relationship between the parties’ bargaining power, the type of contract considered and its specific regulations, the “area of life” involved and, of course, the relative and absolute loss on the one part compared to the possible gain of the other.

The conditions for setting aside a contract according to the doctrine of failed assumptions are that the failed assumption must be significant (i.e. causal), relevant (i.e. it must be fair and reasonable to put the contract aside in light of the supervening circumstances) and recognisable to the other party. The condition for setting aside a contract, or amending it, under the law of contracts § 36 is simply that its effectuation is “unfair”.

Despite the differences in conditions (§ 36 being much “wider” than the doctrine of failed assumptions), the level of “unfairness” or the seriousness of the supervening change is understood to be quite similar.

The question is then what it takes for a contract (or a contractual obligation) to be set aside or revised according to the doctrine of failed assumptions or the law of contract § 36. In the following, I will briefly refer some of the relevant case law on this matter beginning with the doctrine of failed assumptions.

3.1.2.1 Setting aside a contract under the doctrine of failed assumptions

According to established legal doctrine, the failure of fundamental assumptions due to supervening circumstances may lead to discharge of contractual obligations. Exactly how much it takes for the doctrine of failed assumptions to apply depends on the circumstances of the case.

In commercial contracts, the threshold for its application will normally be very high, particularly where the parties to the contract are professional and the relevant contract entails a considerable amount of risk known to the parties in advance. If the court (or arbitrator) finds that the effect of the supervening circumstance really is a result of a deliberate sharing of risk

35 “Synbar” cf. Rt 1999 p. 922 at 931
36 Cf. Rt 1999 p. 922 at 931
37 Cf. Hagstrøm, Obligasjonsretten and Woxholt, Avtalerett
within the contract, the doctrine will not lead to discharge. In these cases, the consideration of predictability and the general principle that each party carries his or her own risk will not be considered outweighed.

In principle, the doctrine of failed assumptions will cover some of the same types of risk as the MAC clause such as downturns in relevant markets or prices. In reality, however, a claim for discharge according to the principle of failed assumptions in the face of supervening circumstances will rarely succeed.

3.1.2.2 Avoidance of unfair agreements – 1918 Contract act § 36

The § 36 of the Contract Act was inserted in 1983 and allows for amending or setting aside a contractual obligation which leads to an “unfair” result. In the preparatory works for the clause it is explicitly stated that it should be applied according to current practice under the doctrine of failed assumptions. This means that (in commercial settings, at least) the threshold for setting aside or amending contracts under § 36 will be similar to that discussed above under the doctrine of failed assumptions.

Even though a court finds that the particular risk (which has later materialised) is allocated through the contract, there might still be room for § 36 to apply if the contractual allocation of risk is considered unfair – at least in principle. In reality, however, where the “risk for failed assumptions has been allocated in the agreement, there is little room left for the application of the general clause in the Contract Act § 36”.

Relevant case law where § 36 has been applied to commercial contracts confirms that the threshold for application is very high, even in the face of considerable economic loss. One example is found in Rt 2000 p. 806 where there was a contract for the delivery of power. Due to significant changes in the energy market, the producer claimed a total loss of 46 MNOK in a nine-year period (1994-2003). The court, however, found that the producer, as a professional party, must carry the risk for such developments, as the contract did not expressly allocate it.

In most cases, the courts will find that a risk (that later materialises) in fact has been allocated through the contract between the (professional) parties. This is true even though the risk is “allocated” only through the silence of the contract.

3.1.3 Conclusion

As we have seen above, there may be some overlap between the Contract Act § 36, the doctrine of failed assumptions and the MAC clause with regards to the area of operation. This means that some of the typical MAC events may, depending on the circumstances, have “unjust” effects on the parties to an agreement or to be assumptions the failing of which leads to a discharge of the agreement.

Despite this overlap, the MAC clause is not made superfluous. Firstly, its area of operation is much more predictable than the default rules in that the MAC clause to a larger degree enables the parties to evaluate their risk in advance. Secondly, the MAC clause can be made

38 Ot.prp. nr. 5 (1982–83) s. 35.
40 due to the conditions of the concession
much more precise, and the standard of materiality required for its operation, will generally be lower than that of § 36. Thirdly, the area of operation for the MAC clause can be made much wider than the doctrine of failed assumptions (in particular) and § 36. Fourthly, § 36 does not automatically entail discharge of the whole agreement if a supervening event makes it unjust. To the contrary, the provision only results in discharge in so far as it is necessary to avoid the unjust effects of the change. Significantly, it enables the judge to amend the agreement so that its totality is not found to be “unjust” rather than to declare it null and void.

In short, the doctrine of failed assumptions or the Contract Act § 36 allocates far less risk than a typical MAC clause. Additionally, relying on these default rules will generally be far less predictable than relying on a MAC clause. Consequently, MAC clauses are not made superfluous by default rules in Norwegian contract law.

3.2 Can the MAC clause be expected to achieve its intended legal effect under Norwegian law? (Hereunder whether the intended legal effect is possible under Norwegian law)

It was pointed out above that there is in fact a need for MAC clauses in contracts under Norwegian law. The next question is whether the MAC clause can be expected to achieve its intended legal effects. In other words, can the MAC clause be relied upon to give the required assurance against unknown risk so that it gives a party an opportunity to walk away from the agreement under Norwegian contract law?

It is somewhat difficult to answer this question as no MAC clause to my knowledge has ever been tried by a Norwegian court. However, I will in the following examine some reasons why MAC clauses may not be relied upon under Norwegian law. Firstly, the intended legal effect of MAC clauses may be hindered due to interpretation by the courts. Secondly, the MAC clause may be directly controlled through the above mentioned § 36 of the contracts act. Thirdly, there are specific rules regulating MAC clauses in certain transactions – in this case with relation to takeovers of publicly listed companies.

3.2.1 Interpretation of MAC clauses under Norwegian law

The goal for the interpretation of contracts under Norwegian law is to achieve a “fair and reasonable expression of the parties’ common understanding of the content of the agreement as this is objectively expressed in the agreement”. Most of the interpretative principles of English and US contract law are of relevance also in Norwegian contract interpretation, but there is one important difference. Under Norwegian law, the interpreter can and will take into consideration all relevant evidence - there is no limit in principle on the evidence that can be considered. The question which may decide the outcome of the interpretation process is how much each piece of evidence shall weigh in relation to the other evidence presented.

There is a tradition in Norwegian contract interpretation for taking into consideration the fairness of the result. In other words, if one alternative interpretation leads to a fairer result than another does, this in itself is an argument for choosing the “fairest” interpretation as the correct interpretation.

41 Woxholt, Avtalerett at 436-437 and Hov, Kontraktsrett I at 148.
As with the application of the doctrine of failed assumptions and § 36 of the contract act (above), the interpretation of MAC clauses under Norwegian contract law will depend on a balancing of interests. Typical interests for agreements that include MAC clauses, however, are the needs for predictability and objectivity. These are the needs of commercial parties who make business and strategic decisions based on an assessment of risk contained in their contracts. Additionally, commercial parties typically have access to highly qualified personnel who are able to take care of each party’s interests. This means the consideration for protection of the “weak” contracting party is less relevant – there are (typically) no weak contracting parties in these types of contracts.

An objective and literal interpretation of MAC clauses in commercial contracts is supported by the ruling of the Supreme Court in Rt 2002 p. 1155. Here, the court expresses that

“such contracts, as a starting point, should be interpreted objectively, and that the wording of the contract must be given great weight. [...] That the principle of objective interpretation carries extra weight in contracts between commercial parties, is underlined by commercial parties’ need for safety and predictability, something which is obviously encouraged best by an interpretation based on objective and accessible elements.”\(^{42}\) (my translation)

If the wording of a MAC clause is clear and unequivocal, it is to be expected that the MAC clause is applied according to its letter. This follows from consistent case law such as Rt 1994 p. 581.\(^{43}\) In that case, the Supreme Court expressed that it's clear starting point is that the unequivocal wording of an agreement determines the rights and obligations of the parties. Based on this, it is likely that a clearly and unequivocally defined MAC clause, with objectively defined indicators, for example where the MAC clause is normally linked directly to a defined set of financial or other objective indicators, will be upheld “as they are” by the courts.

In practice, the question of ambiguity and clearness is often difficult to decide. If any subjective assessment is involved, the clause has to be interpreted. This gives room for many different considerations, some of which may be difficult to predict in advance. If the wording of a MAC clause is ambiguous or vague, its interpretation and application will depend on the particular circumstances of that case. It will come as no surprise if the materiality requirement will be subjected to such interpretation as “material” very often is not sufficiently defined or not defined at all. The question is then how the Norwegian courts will interpret such contractual obligations.

3.2.1.1 Interpretation of ambiguous and vague contractual obligations

Despite the principle of objective interpretation of commercial contracts, where the contract leaves equal room for alternative interpretations a court is likely to choose the alternative that is seen as the most “fair and reasonable”. This is supported by the general duty of loyalty in contracts under Norwegian law and the standard for fairness in § 36 of the contracts act.

It is likely that the considerations of fairness and reasonableness will depend on the specific circumstances of the case. As an example, in cases where the seller risks huge losses if the


\(^{43}\) Also, Hagstrøm, Obligasjonsretten, at 44.
buyer is allowed to withdraw from the agreement, the threshold will probably be somewhat raised for the courts to find “material” adverse change. Here, the type of contractual relationship may be of relevance for the assessment of materiality. The potential for great losses may be greater in particularly long lasting delivery contracts (or loan agreements) than in acquisition or merger agreements. A relevant consideration may also be the degree of arrangements made by the parties in relation to the contract.

Another consideration in line with the previously mentioned is the scope of the MAC clause. The Delaware court in the Tyson case found that a MAC clause with as wide a scope as the one included in that particular agreement was best read as a «backstop». In other words, the court took into account the wide scope of the clause when laying down the threshold for its application. The same result is likely from a Norwegian perspective as the MAC clause in Tyson gave much room for interpretation by the court. The bigger the transfer of risk caused by the MAC clause the likelier it is to be interpreted narrowly so as to balance its effect between the parties.

Even in the interpretation of commercial contracts containing ambiguous or vague clauses, such as the MAC clause, it is not likely that “fairness” and “reasonableness” will have a prominent place. However, it may be expected that these considerations may, all else equal, alone or in combination with other considerations “tip the weights” in one way or another.

3.2.1.2 What is “material”?
A particular question with regards to MAC clauses is how to apply the materiality requirement – i.e. what exactly is to be regarded as a “material” adverse change? Although it is impossible to state a certain percentage or fixed sum to indicate exactly what is “material”, it is possible to point out some general factors that will have relevance in the assessment. 44

Firstly, it may be expected that the courts will interpret “material” according to the specific circumstances of the case. This means that the courts will look at all sides of the matter: how big is the claimed loss in absolute and relative terms and how significant is that loss to the party relying on the MAC clause. Furthermore, the courts are likely to look at the contract in question and compare the actual loss to the risks taken in the contract. The higher risk-level accepted through the contract, the more will it probably take for a court to find a “material” adverse change. This is because the level of risk indicates what the parties have accounted for when entering into that contract.

Secondly, especially for clauses involving a subjective element such as the materiality requirement in MAC clauses, the courts will as parts of its interpretation look for similar cases for guidance. Faced with no previous case law dealing with MAC clauses as such, it is likely that the courts will look at case law dealing with similar criteria in similar circumstances (in different clauses). In this relation, it may be interesting to compare the MAC clause with another rule incorporating an assessment of materiality, namely the general rule of termination in cases of material breach.

44 Egholm Hansen & Lundgren, Køb og salg at 243 reach the same conclusion.
An assessment of material breach and material adverse change will rely on many of the same set of facts. Due to this, the assessment of a material adverse change may resemble the assessment of a material breach. Although the comparison of materiality with regards to MAC clauses and termination in the event of material breach probably is fruitful, it does not mean that materiality in every case must be the same under both provisions. There may be several reasons why the actual assessment may turn out to be different.

Firstly, the requirement of materiality in the question of breach of contract is, at least to some extent, based on a balancing of interests between both parties to the agreement. This may not be relevant under a MAC clause. The assessment of the MAC clause will, e.g., not take into consideration the other party’s fault or what the consequences of termination will be for the other party.

Secondly, the two clauses serve different functions to some degree. The intention behind a provision for material breach is, at least partly, to be a sanction for a party who does not fulfil his/her obligations under the contract. This element of sanction is not relevant under the MAC clause because none of the parties have taken on an obligation to fulfil the condition. As an expression of an objective sharing of risk, the assessment under the MAC clause will to a larger extent focus on the isolated facts of the invoked negative change rather than focusing on an overall assessment.45

Although it is somewhat difficult to foresee, there may also be other differences between the assessment under a MAC clause and a provision for discharge in case of material breach. Under the MAC clause, materiality may be linked to specific indicators such as e.g. financial strength. If there is indeed a material adverse change in this indicator, but at the same time an equally material positive change to another indicator, a MAC event may still be found to have occurred according to the agreed share of risks between the parties. In an assessment of potential material breach, this is likely to be different as the rule is that it is the totality of the effects of the breach agreement which shall be assessed, not the individual indicators.

Based on the above, and despite their resemblance, it is possible that the assessment of materiality under a MAC clause and provisions for material breach will be somewhat different from each other. This is due both to the different considerations upon which they are built and the fact that some elements of the material breach evaluation are not relevant for the evaluation under the MAC clause.

3.2.2 Judicial control under Contracts Act § 36
Another relation that may limit the use of MAC clauses under Norwegian law is that the courts find that these clauses lead to unfair results. As discussed above, however, the threshold for applying § 36 in commercial contracts between professional parties is very high, and it is not likely that a court will find that a MAC clause leads to unfair results.

3.2.3 Conditions precedent in Norwegian law
The term “condition” is generally used in the meaning of “a term in the contract” or similar. Used in this way, the term has in and of itself no particular legal effect. In contract law however, conditions (precedent) do have particular legal effects.

45 However, see section 3.2.1.1 above.
A condition precedent is a condition that must be performed before the agreement of the parties becomes a binding contract or that must be fulfilled before the duty to perform a specific obligation arises. Conditions precedent thus postpone the effectuation of legal obligations by making them dependent on future uncertain events or occurrences. If the future event does not occur there is consequently no legal obligation. If the future event does occur, however, the legal obligation does arise.

Even though the legal obligation only arises if X happens at some point in the future, the promisor is still bound to his conditional promise from the time of making it. This means that the promisor cannot withdraw from his conditional promise before the condition is decided (unless the condition is waived by the other party). On the other hand, the promisor is under no obligation to (seek to) fulfil the condition, and if it is not fulfilled then no liability can arise on the promise that the condition qualifies.

The legal effects of a condition apply ipso jure, i.e. automatically. If a MAC event occurs, the obligation to close the agreement in question does not arise.

3.2.4 Relevant case law: Rt. 1969 p. 222
There have been a couple of cases in Norwegian courts dealing with conditions in the legal sense of the term. One of them may seem to give rise to concerns for purchasers wanting to rely on a MAC condition.

In Rt. 1969 p. 222 a local public authority, in its capacity as landowner, had given a conditional building permission to a private developer. The agreement between the parties stated three conditions for the permission. It further stated that the property would return to the public authority's ownership without any compensation to the developer if the said conditions were not fulfilled within a specified time limit.

It later turned out that two of the conditions (a financial condition and a condition of continuous activity) were not fulfilled within the time limit of the conditional permission. On that basis, the local government retracted the permission. The developer went to court, and the case was tried in the Supreme Court.

The case proved to be a close call with the votes split five to three. The majority impliedly acknowledged that the conditions were not, objectively, fulfilled. However, despite expressing its doubts about the decision, it was held that the lack of fulfilment of the conditions were due to the developer's misunderstanding and that this meant that the retraction of the building permission by the local authority was void. The minority kept to the letter of the conditions for the building permission, and held that the retraction by the local authorities was perfectly legal.

In one way, the Supreme Court accepted the doctrine of conditions as this has been developed in legal theory. However, the court introduced an additional element in the assessment of the

46 Cf. Rt 1985 p. 1066 at 1071 and Oscar Platou, Privatrettens Almindelige Del, at 327.
47 Ibid at 342 and Rt. 1985 p. 1066 where a local government was free to walk from an agreement whose financial condition had not been fulfilled.
48 In this case, the conditions were such that the conditional right ceased if the condition was not met within a certain time. This type of condition is called condition subsequent, or in Norwegian terms “resolutiv betingelse”.
conditions, i.e. an element of fairness and reasonability. It said that since the developer had thought “in good faith” that the conditions were fulfilled, the authorities could not regard the conditions as unfulfilled. Although the court doesn't explicitly say so, it looks as if it was hesitant to strictly follow the doctrine because it was, for some reason, uncomfortable with the result.

Despite this result, there is reason to believe that the court would have come to a different conclusion regarding the assessment of a MAC clause. Firstly, this is supported by the fact that parties to agreements including MAC clauses will normally be much more professional than the parties involved in this case. This gives different perspective to what is to be regarded as a fair and reasonable result. Secondly, it is supported by a later case in which the Supreme Court found that a local public authority could walk away from a conditional agreement in the face of the non-fulfilment of a financial condition.

3.2.5 Discretion to decide whether a MAC event has occurred

In some MAC clauses the parties include a phrase (such as “in the opinion of...” or ”in the reasonable opinion of...”) giving either party ”discretion” to decide whether a MAC event has occurred or not. The question is then how Norwegian courts will interpret such clauses.

Without going in too much detail on the matter, such discretionary rights must be read in the light of the principles of loyalty and good faith as found, inter alia, in the Contracts Act § 36. In short, this means that even if the word «reasonable» is not included, this is very likely to be implied by the courts.

49 Cf. e.g. Rt 1988 p. 1078, Rt 1995 p. 1460, NOU 1979: 32 Formuerettslig lempingsregel at 52 and Hagstrøm, Obligasjonsretten, p. 74.
CONCLUSION

The purpose of including a MAC clause in an agreement is to provide assurance for unknown and future risk. MAC conditions precedent do this by making the obligation to close an agreement dependent on there not occurring any material adverse changes between the time of signing and the time of closing the deal.

The application of the MAC clause in Norwegian law may (maybe surprisingly) be expected to be similar to its application under US contract law. When interpreting MAC clauses, US courts have to a large extent taken given weight to the same considerations as Norwegian courts can be expected to do. This includes the considerations of fairness and reasonableness. US courts have also been very fact specific in the different cases involving MAC clauses. English courts will maybe not take these considerations into account to the same degree, but with lack of case law it is difficult to make a certain prediction.

When it comes to the practical use of the MAC clause, it must be said that trying to effectively cover what one cannot know is a difficult task. The challenge in drafting MAC clauses is to reach far and wide without losing strength. In other words, giving the MAC clause a wide scope increases the chances of covering the materialisation of an unknown risk. The drawback seems to be that such a wide clause may be difficult to rely on – it loses its “strength”. That problem can be remedied by defining the MAC clause more precisely, but this will in turn result in a narrower clause. A narrower clause brings with it the risk that a particular material adverse change will fall outside the scope of the MAC clause.

Due to these circumstances, MAC clauses rarely end up in court. There is reason to believe, however, that MAC clauses are relied upon to a considerable degree in order to re-negotiate agreements. Thus, even though the MAC clause may not release the party in question of its contractual obligation to close an agreement, it may provide that party (or both) with a mid-way solution.

If a party needs a MAC clause with wide scope without losing its predictability, one solution is to draft a clause which defines a set of (explicitly) non-exhaustive parameters for the assessment of material adverse changes. In reality, whether a party can do this or not, depends on that party’s bargaining power. In most cases, such a clause would not be accepted by the opposite party, or the price to be paid for inserting it would be so high that it wouldn’t be worth it anyway. If a party is concerned about a specific risk, that party will usually be better off allocating that risk through a particular provision rather than through a MAC clause.

Based on the above, trying to include a MAC clause in an agreement can be extremely valuable. However, the party wishing to include it must firstly know what it wants with it (the need), secondly be aware of its limitations and thirdly recognize the possible costs and gains by inserting it. Only then can the MAC clause be of real use.