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Original Research

How M&A Contracts Can Prevent Corporate Collapse

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Abstract

Buying a company is not instant. After a merger agreement is signed, it can take months before the deal closes and ownership changes hands. During that time, markets can fall, buyers can lose their nerve, and money can disappear. This paper asks how the protective clauses in buyout contracts insulate transactions from severe operational disruptions during this waiting period.

It studies three real cases: Elon Musk's 2022 deal to buy Twitter, Bank of America's purchase of Merrill Lynch during the 2008 financial crisis, and the fight between Dow Chemical and Rohm and Haas in 2008 and 2009. Across these cases, the paper looks at three contract tools. The first is the material adverse effect (MAE) clause, an escape hatch that buyers can use only after a severe, lasting blow to the target company. The second is the ordinary course requirement, which obliges the target company to keep running its business normally until closing. The third is specific performance, a court order that forces a party to complete the deal.

The paper finds that in these high-profile deals, these rules often worked as safety guardrails. They tend to discourage buyers from backing out simply because the market turns bad, offer paths to manage risk under serious losses, and frequently protect sellers if a buyer's cash suddenly vanishes.

Keywords: Corporate Law; Mergers and Acquisitions; Delaware Court of Chancery; Material Adverse Effect; Specific Performance; Contractual Risk; Sign-to-Close Period

Introduction

Imagine you sign a contract to buy a house, but you will not receive the keys for six months. In that time, the roof could leak, the neighborhood could flood, or the seller could stop paying the bills. Now imagine the "house" is a company worth billions of dollars. In mergers and acquisitions (M&A), where one company buys or combines with another, the gap between *signing* the agreement and *closing* the deal (the moment ownership transfers and payment is made) can last many months. Regulators must approve the deal, and shareholders must vote on it. During this period, markets can crash, key managers can leave, and a buyer can decide the price was a mistake.[1]

Contracts are the main protection in this risky waiting period. This essay focuses on three tools. First is the "material adverse effect" (MAE) clause, a safety escape hatch that lets a buyer walk away if the target company suffers a severe and lasting decline. Delaware courts set a very high bar for using it,

[1] General treatment of the sign-to-close period: see a standard M&A treatise, e.g., Ronald J. Gilson & Bernard S. Black, The Law and Finance of Corporate Acquisitions (2d ed.), and SEC merger filings (Form 8-K, proxy statements).

and a Delaware court first found an MAE in 2018.[2,3] Second are "ordinary course covenants," promises that the company being bought will keep running its business normally until closing. Third is "specific performance," a court order that forces a party to complete a deal instead of only paying money damages.[4]

The paper will test these tools against three real crises. In April 2022, Elon Musk agreed to buy Twitter for about $44 billion, then tried to cancel the deal. Twitter sued in the Delaware Court of Chancery, and the deal closed in October 2022, before trial.[5] In September 2008, Bank of America agreed to buy Merrill Lynch as the financial crisis intensified. The deal closed on January 1, 2009, after Merrill's losses grew and the U.S. government stepped in with additional support.[6] Finally, the paper examines Dow Chemical's 2008 agreement to buy Rohm and Haas for about $15 billion. When Dow's financing plans fell apart during the crisis, Rohm and Haas sued to force the deal through, and it closed in April 2009.[7] This raises an important question: **How do the protective clauses built into buyout contracts keep companies from collapsing during the waiting period before a deal is officially finished?** M&A contracts keep companies from collapsing by using special rules—like safety escape hatches, normal everyday business requirements, and court orders—to protect buyers from massive losses and keep businesses stable during risky deal periods.

1. The Safety Escape Hatch: MAE Clauses and the Battle for Twitter

Think of a "material adverse effect" clause, or MAE, as the emergency exit in a theater. It is there for real disasters, not for people who simply dislike the movie. In a merger agreement, an MAE clause lets the buyer walk away if the target company is hit by a truly serious blow between signing and closing. A fire in the factory would qualify. A bad quarter would not.[8]

Elon Musk learned how narrow that exit is. On April 25, 2022, Twitter agreed to be bought by Musk for $54.20 per share, about $44 billion in total.[9] Then the market turned. Technology stocks fell through the spring, and the price Musk had promised began to look generous. In May he announced that the deal was "on hold" until Twitter proved how many of its accounts were fake or spam. Twitter had said in its public filings that these accounts made up fewer than 5 percent of its users. Musk doubted that number.[10]

On July 8, 2022, Musk's lawyers sent a notice saying he was ending the deal. They argued that Twitter had broken the contract by withholding data about bots and had misled investors, and they pointed to the harm this caused as grounds for cancellation.[10] Furthermore, Musk asserted that by firing key executives and changing its hiring practices during the waiting period, Twitter had explicitly violated its ordinary course covenants—the structural promise to manage daily operations normally until closing.

Musk's notice leaned on a second tool as well: the "ordinary course covenant." This is a promise that the target company will run its day-to-day business in line with its past practices until closing. Musk argued that Twitter broke this promise by firing executives and freezing hiring.[10] Twitter countered that managing workforce changes during a pending merger falls well within routine corporate adjustments, not a break from normal practice.[11] Four days later, Twitter sued him in the Delaware Court of Chancery and asked the judge to order him to close.[11]

[2] *In re IBP, Inc. Shareholders Litigation*, 789 A.2d 14 (Del. Ch. 2001).

[3] *Akorn, Inc. v. Fresenius Kabi AG*, C.A. No. 2018-0300-JTL (Del. Ch. Oct. 1, 2018), *aff'd*, 198 A.3d 724 (Del. 2018).

[4] *Hexion Specialty Chemicals, Inc. v. Huntsman Corp.*, 965 A.2d 715 (Del. Ch. 2008) (discussing MAE and specific performance).

[5] *Twitter, Inc. v. Musk*, C.A. No. 2022-0613-KSJM (Del. Ch.); Twitter Form 8-K (Apr. 25, 2022).

[6] Bank of America and Merrill Lynch SEC filings (Sept. 2008–Jan. 2009); U.S. Treasury and Federal Reserve announcements (Jan. 16, 2009).

[7] Dow Chemical and Rohm and Haas SEC filings and press releases (July 2008–Apr. 2009); *Rohm & Haas Co. v. Dow Chemical Co.* (Del. Ch. 2009).

[8] *In re IBP, Inc. S'holders Litig.*, 789 A.2d 14 (Del. Ch. 2001) (MAE as protection against unforeseen events that substantially threaten overall earnings potential).

[9] Agreement and Plan of Merger among Twitter, Inc., X Holdings I, Inc., and X Holdings II, Inc. (Apr. 25, 2022), Exhibit 2.1 to Twitter's Form 8-K filed Apr. 25, 2022 (price, MAE definition, specific performance provision).

[10] Musk's termination notice (July 8, 2022), publicly filed with the SEC; see also Twitter's Form 10-K for fiscal 2021 (describing the spam-account estimate of under 5 percent).

[11] *Twitter, Inc. v. Musk*, C.A. No. 2022-0613-KSJM (Del. Ch.), Verified Complaint (filed July 12, 2022).

Here Delaware law mattered a great deal. For decades, its courts have treated MAE claims with deep suspicion. The buyer carries the burden of proof. The damage must be large, and it must be tied to the company itself, not to a falling market that hits everyone. Most importantly, it must last. Courts look for a decline that threatens the business over years, not months.[12] A buyer who feels regret does not meet this test. Only one Delaware court, in *Akorn* in 2018, had ever found an MAE.[13]

Twitter's lawyers leaned on exactly this wall. They argued that Musk was not reacting to a disaster. He was a buyer with second thoughts, using bots as an excuse after the stock market made his price look expensive. Twitter's user numbers had not collapsed, and nothing suggested a multi-year crisis. The merger agreement also contained a specific performance clause, which let Twitter ask a court to force the closing.[9,11]

Chancellor Kathaleen McCormick fast-tracked the case, with a five-day trial set for October 2022. It never happened. In early October, Musk offered to close at the original price, the court paused the case, and the deal was completed on October 27, 2022.[14]

Notice what this means. No judge ever ruled on Musk's MAE theory. The clause worked as a deterrent. The tough Delaware standard, combined with the threat of a forced closing, made walking away look more dangerous than staying. That is as far as the evidence goes in answering our research question: The contract may have discouraged Musk from walking away, although no court tested this.

2. Systemic Risk and the 2008 Crash: Bank of America and Merrill Lynch

Sunday, September 14, 2008. Wall Street was in panic. Lehman Brothers was out of time, and Merrill Lynch, one of the world's best-known investment banks, knew it might be next. In a few frantic hours, Bank of America (BofA) agreed to buy Merrill for about $50 billion in stock, or $29 per share, a premium of roughly 70 percent over Friday's closing price. Early the next morning, Lehman filed for bankruptcy, the largest in American history.[15]

Then Merrill got worse. Over the following weeks, its losses grew far beyond anything BofA had expected when it signed. By mid-December, BofA's CEO, Ken Lewis, was alarmed. Merrill was heading toward a fourth-quarter loss of roughly $15 billion. On December 17, Lewis told Treasury Secretary Henry Paulson that BofA was thinking about using the contract's MAE clause to back out.[16]

Here the contract worked like a trap. Remember the emergency exit from Section 1? Most MAE clauses exclude damage caused by the economy or the financial markets as a whole. The logic is simple. If you buy a boat in hurricane season, you cannot cancel because a storm arrives. BofA signed during a crisis, so a deeper crisis was a risk it had accepted. Proving that Merrill's problems were unique to Merrill, and not just the general crash, would have been very hard.[16]

The ordinary course covenant, the promise to keep running the business normally until closing, was not the main fight here. Merrill's huge fourth-quarter losses came largely from write-downs on mortgage-related and other assets as markets collapsed, not from Merrill running its business badly. Since the losses did not come from a failure to operate in the ordinary way, this covenant gave BofA little to argue.[16]

Washington saw the danger at once. The Federal Reserve and the Treasury feared that if BofA walked away, Merrill might fail, just after Lehman had, and panic could spread through the global banking system. Paulson and Fed Chairman Ben Bernanke told Lewis that an MAE claim was legally weak and that abandoning the deal could do enormous damage. Accounts differ on how hard they pushed. Paulson

[12] *Hexion Specialty Chems., Inc. v. Huntsman Corp.*, 965 A.2d 715 (Del. Ch. 2008) (buyer's burden; durational significance measured in years).

[13] *Akorn, Inc. v. Fresenius Kabi AG*, 2018 WL 4719347 (Del. Ch. Oct. 1, 2018), *aff'd*, 198 A.3d 724 (Del. 2018).

[14] Order staying proceedings, *Twitter v. Musk* (Del. Ch. Oct. 2022); Twitter and Musk SEC filings (Oct. 2022) reporting the closing.

[15] Bank of America Corp., Form 8-K (Sept. 2008) and press release announcing the Merrill Lynch acquisition (Sept. 15, 2008); Agreement and Plan of Merger, dated as of Sept. 15, 2008, filed as an exhibit.

[16] Merrill Lynch and Bank of America Q4 2008 earnings disclosures (Jan. 2009); Hearings before the House Committee on Oversight and Government Reform (June 2009) (testimony of Lewis, Paulson, and Bernanke); Letter from N.Y. Att'y Gen. Andrew Cuomo to Congressional leaders (Apr. 23, 2009).

later testified that he told Lewis the government could remove BofA's management if it tried to walk away. Lewis felt real pressure.[17]

He backed down. Shareholders had already approved the merger on December 5, and the deal closed on January 1, 2009.[17]

The government then cushioned the blow. On January 16, 2009, the Treasury, the Federal Reserve, and the FDIC announced a rescue package: $20 billion in new capital for BofA, plus a guarantee against losses on a pool of about $118 billion of risky assets. BofA had already received $25 billion from the Treasury's bailout program.[18]

This is where the answer to our research question gets uncomfortable. The contract did its job. Because the clause placed the risk of a market-wide crash on the buyer, BofA could not easily escape, and Merrill did not fall alone. Yet the rescue came at a steep price. The contract held the deal together, but taxpayers helped pay for it. The protective clause worked as intended, and it still needed government support to prevent a domino-style collapse.

3. The Power of Specific Performance: Dow Chemical and Rohm & Haas

Some deals fail because the target falls apart. This one nearly failed because the buyer ran out of money.

On July 10, 2008, Dow Chemical agreed to buy Rohm and Haas, a Philadelphia specialty chemicals maker, for $78 per share in cash, about $15 billion in total.[19] Dow planned to pay for much of it with a $9 billion cash payment from a joint venture with Petrochemical Industries Company, a subsidiary of Kuwait's state-owned oil group. The venture was called K-Dow, and the payment was due around the end of the year.[20]

Then the financial crisis arrived. On December 28, 2008, Kuwait pulled out of K-Dow. The $9 billion Dow was counting on disappeared, and the closing was only weeks away.[20] Dow's CEO, Andrew Liveris, needed time. Dow publicly said it still wanted the deal, but it had no clear way to pay for it, and it sought to delay the closing.[21]

Rohm and Haas refused to wait. Its lawyers pointed to a detail in the contract that made Dow's position very weak. The agreement had no "financing condition," meaning no clause that lets a buyer walk away if its loans or cash sources fall through. Dow had carried the funding risk. Imagine buying a car and telling the seller afterward that your bank turned you down. The seller will say that was your problem to solve.

As far as the public record shows, Dow never claimed that Rohm and Haas broke its promise to run its business normally between signing and closing. Dow's trouble was money, not operations, so it had no operational breach to point to.[19]

Rohm and Haas also had a second tool, a specific performance clause. As we saw in the introduction, this is a promise that a court can order a party to complete the deal rather than just pay damages. In January 2009, Rohm and Haas sued Dow in the Delaware Court of Chancery and asked the judge to force the closing.[22] Money damages would have been a poor remedy for Rohm and Haas. Its own value as a company was tied to the deal's success, and a collapse would have left it exposed in the worst credit market in decades.

Dow's position was not hopeless, but it was unattractive. Delaware courts enforce clearly written contracts strictly, and Dow had no financing escape to point to. Rather than risk an order requiring it to pay $15 billion it did not have, Dow went looking for money. It raised $3 billion from Berkshire

[17] Same House hearings; Bank of America Form 8-K reporting the Dec. 5, 2008 shareholder vote and the Jan. 1, 2009 closing.

[18] Joint Statement by Treasury, the Federal Reserve, and the FDIC on Bank of America (Jan. 16, 2009), available on the Federal Reserve and Treasury websites.

[19] Dow Chemical Co., Form 8-K and press release (July 10, 2008); Agreement and Plan of Merger among Rohm and Haas Co., Dow Chemical Co., and Ramses Acquisition Corp. (July 10, 2008), filed as an exhibit.

[20] Dow Chemical Co., Form 8-K (Dec. 2008 and Jan. 2009) on the K-Dow joint venture and its termination.

[21] Dow Chemical Co. and Rohm and Haas Co. public statements and SEC filings (Jan. 2009).

[22] *Rohm & Haas Co. v. Dow Chemical Co.*, Del. Ch. (filed Jan. 2009), Verified Complaint.

Hathaway, sold new debt, cut its dividend, cut jobs, and offered Haas family shareholders part of their payment in Dow preferred stock.[23] The deal closed on April 1, 2009.[23] Years later, in 2013, an arbitration panel ordered Kuwait's company to pay Dow about $2.2 billion for walking away from K-Dow.[24]

Here the answer to our research question is clearest. The specific performance clause did not just give Rohm and Haas a right to sue. It kept the deal bound together while the buyer's financing collapsed. Rohm and Haas stayed whole, and its employees and operations avoided a messy break. Dow, not the target, absorbed the cost of its own funding failure. In this case, the contract protected the company that did nothing wrong.

Conclusion

A merger agreement is a promise made at one moment and kept at another, and the months in between are dangerous. This essay asked how the protective clauses in buyout contracts keep companies from collapsing during that wait. The three cases suggest a clear pattern in these instances. The clauses work by deciding in advance who carries which risk.

In the Twitter case, the strict material adverse effect (MAE) standard may have acted as a deterrent. Musk never got a ruling on his theory, because the high bar and the threat of a forced closing made walking away look too costly. At Bank of America, the contract placed the risk of a market-wide crash largely on the buyer. Even in the worst financial crisis in generations, that allocation kept Merrill Lynch tied to a buyer that wanted out. At Dow Chemical, the missing financing condition and the specific performance clause made the buyer responsible for its own funding failure. The seller was protected from a collapse it did not cause.

Together with ordinary course covenants, the promise to keep a business running normally until closing, these tools make up a simple system. The MAE clause limits the buyer's exits. Ordinary course covenants keep the target stable while it waits. Specific performance gives the seller a court-backed way to hold the buyer to its word. In these cases, each one lowers the chance that a shaky moment becomes a collapse.

None of this makes deals risk-free, and the 2008 rescue showed that contracts sometimes need help. But when markets panic and buyers lose their nerve, these clauses often keep the transactions bound together. They rarely make headlines, yet they are the guardrails of the corporate world.

Conflicts of Interest

The author declares that there are no conflicts of interest related to this work.

[23] Dow Chemical Co., Form 8-K (Mar.–Apr. 2009) on the Berkshire Hathaway investment, financing, and the Apr. 1, 2009 closing; Rohm and Haas Form 8-K reporting completion of the merger.

[24] International Chamber of Commerce arbitration award, *Dow Chemical Co. v. Petrochemical Industries Co.* (2013); see Dow's SEC filings reporting the award.

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