

Contractual Takeaways From Payment Providers Ruling

By Marcus Young and Layla D'Monte (November 10, 2020, 5:46 PM EST)

In March, there was a slew of thought leadership on whether the COVID-19 pandemic provided sufficient legal grounds for parties to terminate existing commercial contracts for force majeure. To date, precious little actual guidance has been provided by the English courts on an adjacent topic — the interpretation and enforcement of material adverse effect and material adverse change clauses.

Accordingly, a recent landmark preliminary ruling on the interpretation of a material adverse effect clause is worth reviewing in more detail, as it provides practical drafting pointers for mergers and acquisitions lawyers on both sides of the Atlantic, and is the first case where the English courts have considered whether the COVID-19 pandemic has resulted in a material adverse effect.

In *Travelport Ltd. v. WEX Inc.*,^[1] Judge Sara Cockerill dissected the construction of a material adverse effect clause, of the kind which typically appears in both U.S. and U.K. M&A purchase agreements. In her ruling, Judge Cockerill considered the leading English case law authorities on material adverse effect clauses as well as the more developed case law of the Delaware Chancery Court and U.S. academic legal writing.

Judge Cockerill predicted that M&A lawyers will tighten their drafting following her judgment, saying that:

The parties could have but did not specify what industries they meant. It may well be that one result of this case is that future drafters will do differently.

The case is a preliminary ruling on questions of contractual interpretation, and a full trial is expected in 2021.

Background

Travelport Ltd. agreed, along with other minority shareholders, to sell Optal Ltd. and eNett International Ltd., providers of payment services in the travel industry, to U.S. corporation Wex for \$1.7 billion. The English law share purchase agreement was signed on Jan. 24 and completion was subject to various conditions.

The onset of the pandemic had an adverse effect on eNett and Optal — the adverse effect was broadly



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agreed by both Wex and the sellers — and Wex sought to terminate the share purchase agreement by serving notice on the sellers that a material adverse effect had taken place.

The sellers disputed that a material adverse effect had occurred under the share purchase agreement and brought an action in the English courts in May seeking a declaration that Wex should be required to complete the transaction.

Material Adverse Effect Clause

The material adverse effect definition adopted a three part structure:

- A base definition of the material adverse effect (i.e., any event, change, development, state of facts has had and continues to have a material adverse effect on the business, condition (financial or otherwise) or results of operations of the targets);
- The exceptions to that definition (i.e., not a material adverse effect if inter alia there is a general change in economic conditions, pandemic, natural disaster); and
- The exclusion from the exceptions (i.e., that if a target was disproportionately affected by an excluded event compared with the industry in which it operates, this would no longer be an exception and would be capable of amounting to a material adverse effect).

The base definition was not controversial. The carveouts included changes in law and, pertinently, pandemics but, crucially in this case, due to the carveout exceptions, a material adverse effect could be established if either eNett or Optal was disproportionately affected by an otherwise excepted circumstance in comparison with the industries in which either company operated.

Therefore, notwithstanding the financial impact of the pandemic, if it could be shown that neither company was disproportionately affected when compared to the rest of the industry, there would be no material adverse effect, and Wex could not terminate the share purchase agreement.

The Relevant Industry

The sellers, in trying to save the deal, argued that neither target was disproportionately affected by the pandemic in comparison to the travel payment industry. Wex argued that the relevant industry was the broader payment industry, that the targets had been disproportionately affected by reference to this broader industry, and it was therefore entitled to terminate the deal.

In rendering her decision, Judge Cockerill considered, inter alia, what was the natural and ordinary meaning of the clause. Wex argued the natural and ordinary meaning of the clause was revealed by the use of the word "industries," rather than any other term.

The sellers pointed to issues with the use of the word "industries" in the plural, and argued that given the need for a pool of like comparators for the clause to work — relevant to which was eNett and

Optal's specific business operations and Wex' rationale for acquiring the companies — the correct interpretation was the travel payments industry. Judge Cockerill preferred Wex's arguments on the use of language.

The sellers relied heavily on the contention that it was clear, from extraneous evidence including press releases and Wex's board minutes, that the purpose of the transaction was to acquire a travel payments business. Although the judge agreed that the travel element was a critical part of the deal thesis, contrary to Wex's evidence, which sought to minimize this aspect, she concluded that it was an oversimplification to characterize the deal as "just a purchase of a travel payments business."

In her ruling Judge Cockerill determined that, in considering whether eNett and Optal had been subject to a material adverse effect, their financial position should be measured against the broader payments industry rather than the travel payments industry, thus supporting Wex's position. The court, having considered extensive expert evidence, also determined there was not in fact a travel payments industry as the term was defined by the sellers.

Note that no determination was made as to whether there had in fact been a disproportionate effect on eNett or Optal as compared to the broader payments industry, as this will be a matter for the full trial.

The Effect of Multiple Carveouts

Another key issue for the judge to unravel was the effect of overlapping carve outs in the material adverse effect clause. Certain events, including pandemics, were subject to the carveout exception whereas others, like legal and political changes, were not. Arguably, the pandemic and the legislative and policy responses fell under both the carveout for pandemics and the one for legal and political changes.

The sellers argued any legal and political changes would fall outside of the disproportionate effect carveout exception, even though such legal and political changes might be said to have resulted from the pandemic. Wex argued that the pandemic was the primary cause behind the engagement of each carveout, and as such the carveout effect exception should apply across the board, and regardless of whether another carveout was also triggered.

The court supported the sellers' construction, stating that Wex sought to "cherry-pick among various overlapping matters in connection with which an event may be said to have arisen." The clear wording of the share purchase agreement provided that the carve-out exception did not apply to the legal and political changes exception in determining whether there had been a material adverse effect.

Whether in fact the legal and political changes were caused by the pandemic was, for these purposes, irrelevant — the court holding that "there is no basis in the wording of the clause to conclude that the parties objectively intended that if two Carve-Outs were engaged they would have to work out which should prevail to the exclusion of the others."

Burden of Proof

Among other issues of construction and interpretation, the court also held the burden of proof in relation to establishing the scope of a carveout rested on the sellers, but the burden of proof in establishing whether the scope of the material adverse effect carve out relating to the pandemic fell within the carve out exceptions rested on Wex.

English and U.S. Case Law and Academic Writing

Judge Cockerill confirmed that there is a dearth of relevant English authority. The leading English cases in which material adverse effect clauses were considered relate to finance transactions, rather than M&A transactions, i.e., *BNP Paribas SA v. Yukos Oil Co.*[2] and *Grupo Hotelero Urvasco SA v. Carey Value Added SL*.^[3]

There is one other case in which the issue was considered as it related to a share purchase agreement, *Ipsos SA v. Dentsu Aegis Network Ltd.*,^[4] but this was not considered by the parties to offer any relevant principles in this case.

Judge William Blair noted in *Urvasco* that the Delaware Chancery Court is the leading forum for corporate merger litigation. Having heard submissions on the point as to whether it was appropriate to consider foreign authority, which *Wex* opposed, Judge Cockerill concluded that: this is just the kind of situation where a review of the authorities from a foreign court is called for. Those authorities will obviously not be binding or formally persuasive, but to ignore the thinking of the leading forum for the consideration of these clauses, a forum which is both sophisticated and a common law jurisdiction, would plainly be imprudent.

The principal case from the Delaware Chancery Court referred to was *Akorn Inc. v. Fresenius Kabi AG*,^[5] in which the court considered a material adverse effect clause with a similar structure to the one in this case, in that it had a base definition, exceptions and an exclusion to the exceptions.

The *Akorn* judgment and academic writing referred to was considered helpful by Judge Cockerill principally for elucidating four categories identified on the risk spectrum that material adverse effect clauses seek to cover and how these are typically allocated between the buyer and seller in an M&A transaction.

The four categories are, at one end systemic risks beyond the control of the parties (and which would usually be borne by the buyer on the basis that it takes the contingent risks of the industry in which the target operates), and at the other end of the spectrum, business risks over which one or both parties have direct control (and which would be borne by the seller on the basis of its control). indicator risks and agreement risks (irrelevant for present purposes) sit in between.

While helpful to the court, neither the U.S. authorities nor the academic writing were instrumental in its determinations, which primarily rested on ordinary questions of construction and interpretation of the precise wording of the share purchase agreement, in which neither party sought to argue for any special or esoteric principle, and Judge Cockerill was careful in this respect to note that "the similarities between *Akorn* and this case must not be overstated."

Comment

The key point for M&A practitioners is the need for careful drafting and precise language, and affirms, notwithstanding the English and U.S. case law and academic writing, that English courts will generally interpret clauses within contracts according to their natural meaning and the clearer the natural meaning of the clause, the more difficult it is to justify departing from it.

While the share purchase agreement was heavily negotiated by sophisticated M&A counsel, who likely

spent hours negotiating the carveouts and the carveout exceptions, a holistic analysis of how the different limbs of the material adverse effect clause worked together, and the precise language utilized, would have revealed significant ambiguity, as revealed by the court's analysis, particularly in relation to the industry comparator point.

This case also highlights how the drafting of U.S. and U.K. English law governed M&A documents has converged over the last decade, with material adverse effect clauses being much less common in English law deals prior.

Given the ongoing pandemic, it is probable that courts in both jurisdictions will be asked to consider material adverse effect and material adverse change clauses in the future. Developments will be watched closely.

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[1] EWHC 2670.

[2] [2005] EWHC 1321 (Ch).

[3] [2013] EWHC 1039 (Comm).

[4] [2015] EWHC 1726 (Comm).

[5] No. 2018-0300-JTL, 2018 WL 4719347 (Del. Ch. October 1, 2018).