COMMERCIAL BRIEFING

Drafting MAC clauses in SPAs: a transatlantic perspective

Material adverse change (MAC) clauses are common in transactional documents, such as share purchase agreements (SPAs), on both sides of the Atlantic. However, they often present challenges in interpretation as judicial guidance on them is scarce, particularly in the UK. The High Court's recent decision in *BM Brazil 1 Fundo De Investimento Em Participacoes Multistrategia and others v Sibanye BM Brazil (Pty) Ltd and another* offers a helpful review of MAC clauses, drawing on jurisprudence from both the UK and the US (*[2024] EWHC 2566 (Comm); www.practicallaw.com/w-045-0982*) (*see box "The dispute in Sibanye"*).

The court discussed the extent to which a target company's value must decrease to constitute a MAC, while reiterating that there is no definitive test. It held that a quantifiable decrease in value is the necessary factor in determining a MAC and that qualitative factors on their own are unlikely to be sufficient. In addition, the court found that revelatory events are insufficient to constitute a MAC and stressed the importance of careful due diligence. *Sibanye* also provides a reminder to parties that environmental, social and governance (ESG) factors will only trigger a MAC clause if they reduce a target company's value and highlights the need for other contractual tools for redress.

The dispute in *Sibanye*

Sibanye BM Brazil (Pty) Ltd and Sibanye Stillwater Limited (together, Sibanye) signed share purchase agreements (SPAs) to buy the shares in two companies that owned mines in Brazil. The SPAs contained material adverse change (MAC) clauses stating that Sibanye did not have to complete the transaction if a MAC occurred between the signing and the completion date. A geotechnical event occurred at one of the mines before the completion date. Sibanye claimed that this constituted a MAC and purported to terminate the SPAs. When Sibanye failed to complete the SPAs on the completion date, the sellers claimed that this was a wrongful repudiation of contract and stated that they were terminating the SPAs.

The High Court held that the geotechnical event was not a MAC and therefore Sibanye had wrongfully terminated the SPAs (*BM Brazil 1 Fundo De Investimento Em Participacoes Multistrategia v Sibanye BM Brazil (Pty) Ltd [2024] EWHC 2566 (Comm); www.practicallaw.com/w-045-0982*). It concluded that:

- The wording of the MAC clause dictated that a matter would only be a MAC if the change, event or effect was material and adverse. This did not include a revelatory event; that is, an event that reveals something adverse which already existed but of which the buyer was not previously aware.

- An objective assessment is necessary to decide whether a MAC is reasonably expected to be both material and adverse. The test here was whether a reasonable person would have considered it more likely than not that the matter would turn out to be material.

- While there is no universally applicable test as to what constitutes materiality, it is intended to mean something that is significant and substantial. On the facts of the case, the geotechnical event was not material.

Contractual interpretation

Practitioners will be familiar with the inherent ambiguity of MAC clauses and the difficulties around defining a material adverse change, effect or event (*see box "Material adverse change, event or effect?"*). On the one hand, this can be constructive during negotiations as parties avoid debating various events of termination, thereby increasing the chances of a signing. On the other hand, the ambiguity can create uncertainty around termination rights and, as the High Court observed in *Travelport Ltd v Wex Inc*, may lead to the unwanted consequence of a court finding an objective intention that, in reality, the parties had never subjectively shared (*[2020] EWHC 2670 (Comm)*).

This uncertainty is exacerbated by the fact that judicial guidance on MAC clauses is rare. This is the case even in the US and, more specifically, the Delaware Court of Chancery, which has been praised by English judges for being the leading forum for litigating MAC clauses owing to its commercial sophistication. The first major case on MAC clauses in Delaware was in 2001 and, even more surprisingly, the first time that the court found that a MAC had occurred was in 2018 (*In re IBP Inc Shareholders Litigation v Tyson Foods Inc 789 A 2d 14 (Del Ch June 18, 2001); Akorn Inc v Fresenius Kabi AG 2018 WL 4719347 (Del Ch Oct 1 2018)*).

The principles of contractual interpretation in the US and the UK differ slightly in relation to agreements between well-advised parties. US courts are generally more willing to take a contextual approach to contract interpretation; for example, the Delaware Court of Chancery routinely takes into account the context in which the parties were dealing and negotiating (*In re IBP Inc Shareholders Litigation*). In many circumstances, English courts do recognise the relevance of the factual background that was known to the parties at the time of entering into a contract (*Wood v Capita Insurance Services [2017] UKSC 24; see News brief "Contract interpretation: the Supreme Court's last word (for now)?", www.practicallaw.com/1-641-0887*). However, English courts are less likely to adopt a contextual approach when interpreting detailed and professionally drafted contracts, such as SPAs.

For example, in *Travelport*, the court found that a long, highly detailed SPA prepared by experienced solicitors of sophisticated commercial parties carried the most weight

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in the interpretative process. The court in *Sibanye* confirmed this approach, noting that complex and sophisticated agreements that have been drafted by skilled legal advisers can be successfully interpreted by textual analysis. However, it also recognised that even in professionally drafted and complex contracts, there may still be a lack of clarity that can benefit from considering the surrounding facts and the purpose of similar provisions in contracts of the same type.

Despite these jurisdictional differences, the High Court in both *Travelport* and *Sibanye* acknowledged that, due to the dearth of English authority on MAC clauses, it was helpful to consider US authorities, and the academic commentary cited in them, when interpreting MAC clauses governed by English law.

No definitive test

In *Sibanye*, the court comprehensively went through the leading authorities on what constitutes a MAC. It referred to the US case of *Snow Phipps Group LLC v KCake Acquisition Inc* in which the Delaware Court of Chancery observed that there is no "bright-line test" for determining whether a MAC has occurred (*2021 WL 1714202 (Del Ch Apr 30 2021)*). This is in line with academic commentary from Professor Robert T Miller that deciding on a particular percentage of decline in a business's financial condition as a MAC would be arbitrary and so courts have generally been reluctant to pinpoint one (*Robert T Miller, "A New Theory of Material Adverse Effects", The Business Lawyer, volume 76, 2021*).

Surprisingly, the court in *Sibanye* said that a 20% decrease in a target company's equity value would likely be a MAC, a 15% reduction could also be material, but 10% would not be material, seemingly contradicting the academic position. While there is merit to the argument that drawing a line at a particular value would be arbitrary, any judicial guidance should be welcomed as it helps practitioners to understand when an adverse change becomes so adverse that it is material. The court in *Sibanye* also pre-empted allegations of inconsistency in relation to *Finsbury Food Group PLC v Axis Corporate Capital UK Ltd* in which the High Court found that a 10% reduction was material as, in that case, the reduction referred to the value of the company group as opposed to only the company concerned (*[2023] EWHC 1559 (Comm); www.practicallaw.com/w-040-1813*).

MAC objects

In *Sibanye*, the court referred to Professor Miller's commentary where he stated that MAC clauses typically require a material adverse effect either on a company, its financial condition, or any other of a long list of objects. The term "objects" was initially adopted by the Delaware Court of Chancery in *AB Stable VIII LLC v Maps Hotels & Resorts One LLC* to refer to drafting that defines a MAC as an adverse change to the list of dimensions of the company's business that could suffer a MAC (*268 A 3d 198 (Del Dec 8 2021)*). The court relied on the analysis of Professor Miller that the Delaware Court of Chancery has consistently ignored wordy lists of objects in a line of cases, including *Akorn* and *IBP*, and has instead assessed whether the company's financial position has suffered a MAC.

Practitioners should welcome this view as it advocates for clear and concise drafting, and avoiding superfluous wording in what are usually already long acquisition agreements. The court stated that parties should assume an objective assessment of whether a change is reasonably expected to be material and adverse, but nonetheless noted that this ultimately remains a determination to be made by the courts in the event of a dispute. This is reminiscent of the US position in *Akorn*, which makes the court's comments as to specific percentages in *Sibanye* even more extraordinary.

Quantitative vs qualitative tests

Another interesting aspect of *Sibanye* is the treatment of the quantitative and qualitative tests for a MAC, distinguishing between matters that can be measured in financial terms and those that cannot. There is a line of authority in the US that both should form part of the analysis when deciding whether a MAC has occurred. For example, in *Frontier Oil Corp v Holly Corp*, the Delaware Court of Chancery found that a MAC has both quantitative and qualitative aspects and, following *Akorn*, both should be considered (*2005 WL 1039027 (Del Ch Apr 29, 2005)*).

However, the court in *Sibanye* rejected this view and agreed with Professor Miller's observation that it is hard to imagine a situation where the quality of the target company deteriorates but its value does not decrease as a consequence. The court emphasised that if there is no significant quantitative effect of a MAC then it is difficult to see how a qualitative matter on its own could make a change, event or effect material and adverse.

Therefore, English courts are likely to look only at the quantitative effects of a particular event to determine whether it constitutes a MAC. This position should be welcomed as it is in line with the contract law principle that damages must be quantifiable in some way and actual loss needs to have been suffered in order for a claimant to succeed.

Revelatory events

In *Sibanye*, one of the issues for the court was whether a revelatory event could constitute a MAC. A revelatory event is an event that is not of a magnitude to qualify as a MAC on its own but reveals other faults or issues with the target company that amount to a MAC. While the claimant mine owners denied that the geotechnical event affecting the mine was a revelatory event that revealed other pre-existing issues, they argued that, even if it was, it would not be a MAC.

The court agreed, stating that it would be contrary to the natural meaning of the MAC clause to say that a change, event or effect that occurs between signing and completion can be material and adverse because it reveals another problem or issue with the target company. Therefore, an event must be a MAC on its own right and merely being a revelatory event is insufficient. To hold otherwise would circumvent the temporal aspect of MAC clauses, which serve to address issues arising in the timeframe between signing and completion. If a contrary interpretation were to be adopted, a buyer could abuse a MAC clause to be released

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from an agreement on the basis of issues that predated it.

The court also reiterated the importance of performing extensive due diligence and negotiating representations and warranties, which are the correct tools to provide recourse in these situations.

Material adverse change, event or effect?

BM Brazil 1 Fundo De Investimento Em Participacoes Multistrategia and others v Sibanye BM Brazil (Pty) Ltd and another sheds some light on the terminological idiosyncrasies of material adverse change (MAC) clauses (*[2024] EWHC 2566 (Comm); www.practicallaw.com/w-045-0982*). In both the UK and the US, "material adverse change" is often used interchangeably with the terms "material adverse effect" or "material adverse event". While there is academic support that these terms are functionally synonymous, the High Court in *Sibanye* suggested that there could be a practical difference. For example, while it is unlikely for there to be a situation where there is a material and adverse effect but no change or event, this could be possible where, for example, a disease was present before signing but its manifestations only became apparent some time after signing. In that case, there may be an adverse effect but not necessarily a change or event, as the disease was already present. To cover this situation, practitioners should ensure that MAC clauses are defined to include all three terms; that is, "any change, event or effect".

MAC and ESG issues

It is important to consider how the principles surrounding the interpretation of MAC clauses are likely to apply in relation to ESG issues. ESG ratings, such as S&P Global ESG and FTSE4Good, carry a lot of weight for many commercial parties and especially ESG-minded investors (*see feature articles "ESG issues in M&A deals: adapting to the new climate", www.practicallaw.com/w-043-5288 and "ESG standards and ratings: know the score", www.practicallaw.com/w-035-4811*).

While parties may include downgrades of ESG ratings in their definition of a MAC, they typically exclude systematic risks. These are risks that affect many companies due to the state of affairs in a given market. Therefore, parties usually specify exceptions for downgrades in credit ratings, decreases in the price of their securities or similar adverse actions by rating agencies as these tend to reflect current market conditions. On that basis, if an ESG factor such as a natural disaster or an act of terrorism causes a downgrade, a MAC clause is unlikely to provide recourse.

Another important aspect in relation to ESG issues is the distinction between quantitative and qualitative factors, as the courts in England and the US differ in their approach (*see "Quantitative vs qualitative tests" above*). In England, an ESG issue would arguably only be treated as a MAC if the price of the target company drops as a result of markets reacting to negative or poor ESG performance. In practice, this will be difficult to measure and will likely only apply to transactions concerning public companies whose price is more sensitive to external factors. There may also be some curious instances where a negative ESG issue leads to an increase in the target company's value. This phenomenon was most recently observed in the case of Elon Musk's arguably counter-ESG social media posts that led to an increase in Tesla's share price. Hypothetically, if the sale of Tesla was in the signing-to-completion period and a buyer wanted to withdraw from the sale due to negative publicity, they would not be able to rely on a MAC clause as the company's valuation was increasing.

As the US courts are willing to take into consideration the qualitative aspects of an event when deciding whether a MAC has occurred, this leaves a theoretical window of opportunity for US buyers to argue that a MAC has arisen even if an event's consequences are not purely quantitative. However, given how rarely even courts in the US find that a MAC has occurred, parties on both sides of the Atlantic are advised to implement contractual alternatives that govern specific ESG risks. For example, in relation to ESG ratings, a buyer may want a particular rating to be maintained during the signing-to-completion period, although the seller is likely to resist this. However, it is common to see social and governance issues addressed through SPA provisions that preclude sellers from terminating the employment of key employees, modifying their duties or adopting materially different management policies.

Sibanye serves as a reminder that MAC clauses in SPAs are designed to capture events in the period between signing and completion, and are not a substitute for proper due diligence. Therefore, buyers that place value on ESG issues are advised to conduct appropriate due diligence in the areas that they view as important.

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