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English High Court Considers Invocation of Material Adverse Effect Provisions

A buyer seeking to rely on an MAE clause in a share purchase agreement to justify termination should proceed with caution, whether in the US or under English law.

In the recent case of *BM Brazil & Ors v Sibanye BM Brazil & Anor* [2024] EWHC 2566 (Comm) ("**Sibanye**"), the English Commercial Court considered whether the buyer under two sale and purchase agreements relating to nickel mines in Brazil (the "**SPAs**") was entitled to terminate the SPAs on the basis that a material adverse effect ("**MAE**") had occurred at one of the mines prior to completion. The Court's decision was rendered by The Hon. Mr Justice Butcher.

Background

A buyer may seek to include MAE provisions in a share purchase agreement to allow it to terminate the agreement if the target suffers an MAE between the signing and completion of the transaction.

An MAE provision will typically cover events or changes which materially and adversely affect a target's business, operations, assets, liabilities, condition (whether financial, trading or otherwise) or operating results, but will often be subject to carve-outs relating to changes in interest rates, commodity prices, wars, natural disasters, etc. MAEs are a customary provision in share purchase agreements governed by Delaware law (and other US state law), but less common where English law is the governing law.

In *Sibanye*, a "geotechnical event" occurred at one of the mines between signing and completion. The buyer claimed this constituted an MAE so as to discharge it from its obligation to complete the transactions and allow it to terminate the SPAs. The seller asserted that the geotechnical event was not an MAE and that the purported termination was therefore wrongful and repudiatory, allowing the seller to terminate the SPAs and bring a claim against the buyer.

Decision

The Court ruled that the geotechnical event was not, and was not reasonably expected to be, an MAE under the SPA. In reaching that decision the Court had to decide on the central issue of whether the geotechnical event was an MAE.

There being no standard meaning of "material adverse effect" or "material adverse change" under English law, the Court confirmed that the proper approach to determining this issue was to apply the ordinary principles of construction of contracts governed by English law. The three main issues of construction or interpretation of the MAE provisions considered by the court in reaching this decision were:

- Whether a 'revelatory event' would be an MAE for purposes of the SPAs. The Court considered that matters did not count as material for the purposes of the MAE definition by reason only of their 'revelatory' effects.
- The assessment of what 'would reasonably be expected to be material and adverse'. The Court considered that it was common ground that this analysis required an objective rather than subjective assessment, and that the assessment should be made from the perspective of a reasonable person in the position of the parties at the time when cancellation on the basis of the alleged MAE is notified.
- What is meant by 'material'. The Court determined that the geotechnical event was not material. On this point, the Court agreed with certain Delaware case law[1] that there is no bright line test for what constitutes materiality that will be applicable to all MAE clauses. In *Sibanye*, the Court considered that the size of the transaction, the nature of the assets concerned, including that they are susceptible to such matters as geotechnical events, the length of the process of the sale of the mines and the complexity of the SPAs were all relevant factors militating against setting the bar of materiality too low. Although not determinative in establishing materiality in *Sibanye*, the Court referred to Laster VC's view in *Akorn* that a reduction in the equity value of the target of more than 20% was material in that case, and went on to note that a reduction of more than 15% might well be considered material.

Relevance of the United States perspective

In contrast to practice in the US, MAE clauses are not customarily included in share purchase agreements governed by English law (i.e. buyers are required to complete a transaction even in the event an MAE occurs), although this will be dependent on the circumstances, including the location and respective bargaining power of the parties.

As a result, there is a relative dearth of relevant English authority on MAE clauses with a better developed body of case law in the US, notably in Delaware[2]. Interestingly, the Court noted in

Sibanye that the "comparative dearth is beginning to be made good" by reference to four English law authorities[3].

While agreeing that US cases are neither binding nor formally persuasive, the Court considered various US authorities which many lawyers in the US consider seminal (including *Re IBP, Frontier Oil, Hexion* and *Akorn*)[4] in reaching its decision. Although it did not view those decisions as binding precedent, the Court weaved into its own textual and contextual analysis some of the key thinking from those US cases. Particularly on how to analyse the qualitative, quantitative and durational impact of an event on the equity value of a company.

Notably, the Delaware court has in certain cases[5] granted the seller the remedy of specific performance and ordered the buyer to close the transaction, flowing from the Court's findings that there has been no MAE excusing the buyer from closing.

Whilst there are multiple grounds for the English Court to refuse an order for the equitable remedy of specific performance, there are instances where the Court has granted orders requiring parties to close on contracts for the sale of shares[6]. However, these cases have not involved the invocation by the buyer of MAE provisions under such contracts.[7] Those cases determined that specific performance could be granted on the basis that damages would not be an adequate remedy. In *Gaetano*, damages were not considered to be adequate because there was no ready market for the shares and the shareholding was difficult to sell as a result of the target's poor financial performance.

Therefore, a well-advised buyer negotiating an English law share purchase agreement will seek to exclude, and a well-advised seller will seek to include, specific performance as a remedy - particularly in circumstances where it is likely that there would not be a ready market for the shares.

The *Sibanye* decision adds to the growing body of English authority on MAE clauses and will reassure parties seeking deal certainty that England and Wales continues to be a strong jurisdictional choice for major M&A transactions on the basis that establishing the occurrence of an MAE is not an easy route to abandon a transaction.

Invoking an MAE clause

A buyer seeking to rely on an MAE clause in a share purchase agreement to justify termination should proceed with caution, whether in the US or under English law. The buyer will need to establish that the MAE has occurred within the meaning of the contract and, as proved to be the case in *Sibanye*, that can be a challenging task. The exercise is heavily fact-specific and it is hard to know what it might entail at the time of contracting. If the buyer wrongly asserts an MAE, it risks incurring liability to the seller for wrongful termination and/or repudiatory breach of contract.

[1] *Akorn Inc v Fresenius Kabi AG* (Court of Chancery of Delaware, Memorandum Opinion 1 October 2018, Laster VC) and *Snow Phipps Group LLC v KCake Acquisition Inc* (Court of Chancery of Delaware, Memorandum Opinion 30 April 2021, McCormick VC).

[2] Cockerill J in *Travelport Ltd v WEX Inc* [2020] EWHC 2670 (Comm) (at [175]-[176]).

[3] *Grupo Hotelero Urvasco v Carey Added Value SL* [2013] EWHC 1039; *Decura IM Investments LLP v UBS AG* [2015] EWHC 171 (Comm); *Travelport Ltd v WEX Inc* [2020] EWHC 2670 (Comm); and *Finsbury Food Group PLC v Axis Corporate Capital UK Ltd* [2023] EWHC 1559 (Comm).

[4] *Re IBP Inc. Shareholders Litigation Del. Ch.*, 789 A.2d 14 (2001), the Court of Chancery of Delaware (Strine VC); *Frontier Oil Corp. v Holly Corporation* (Court of Chancery of Delaware, Memorandum Opinion 29 April 2005, Noble VC); *Hexion Spec. Chemicals v Huntsman Corp* Del. Ch. 965 A. 2d. 715 (2008); *Akorn Inc v Fresenius Kabi AG* (Court of Chancery of Delaware, Memorandum Opinion 1 October 2018, Laster VC); and *Snow Phipps Group LLC v KCake Acquisition Inc* (Court of Chancery of Delaware, Memorandum Opinion 30 April 2021, McCormick VC).

[5] *Snow Phipps Group LLC v KCake Acquisition Inc* (Court of Chancery of Delaware, Memorandum Opinion 30 April 2021, McCormick VC).

[6] *Gaetano Ltd v Obertor Ltd* [2009] EWHC 2653 (Ch); and *MSAS Global Logistics Ltd v Power Packaging Inc* [2003] EWHC 1393 (Ch).

[7] Specific performance was not part of the decision in *Sibanye*, where the claim was for declaratory relief and damages.

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