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Commercial Court Gives Important Guidance on Material Adverse Change Clauses

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On 10 October 2024, the Commercial Court handed down judgment in *BM Brazil I Fundo De Investimento Em Participações Multistrategia & Ors v Sibanye BM Brazil (Pty) Ltd & Anor* [2024] EWHC 2566 (Comm).

The decision concerns the termination of a $1.2 billion acquisition of two Brazilian mines on the purported basis that a geotechnical event ("**GE**") that occurred at one of the mines between signing and closing constituted a material adverse effect which would entitle the buyers of the mine to terminate the relevant share purchase agreements.

What is a MAC/MAE clause?

Material adverse change ("**MAC**") clauses[1] in share purchase agreements ("**SPAs**") entitle the buyer to terminate the SPA if an event that is sufficiently materially adverse occurs between signing and closing. While relatively frequently addressed in the U.S., very few English cases have considered MAC clauses in SPAs. They are rarely litigated, as when MAC clauses are invoked it is often with a view to renegotiating the price under a SPA, rather than a termination by the buyer leading to litigation.

While every MAC clause will have to be construed in the context of the agreement in which it appears, the Commercial Court sets out some generally applicable principles in relation to the interpretation of MAC clauses and addresses the novel question of whether a change can be material, not because of its own effects but because it reveals something potentially negative about the broader business.

Background

The claimants are the owners of two open pit mines in Brazil. On 26 October 2021, they agreed terms to sell the mines to NYSE-listed South African mining company Sibanye Stillwater Ltd ("**Sibanye**") for more than $1.2 billion. The relevant SPAs contained MAC clauses.

Whilst awaiting regulatory approval for the acquisition, a GE occurred at one of the mines. The mine treated the GE as a relatively routine event which occurs in open-pit mining and developed a remediation plan, with *de minimis* additional cost when compared to the value of the transaction. For unrelated reasons, the acquiror had soured on the transaction and having failed to close on the contractual closing date, it purported to terminate the SPAs on the basis that the GE constituted an MAC.

The claimants commenced proceedings against the defendants shortly thereafter seeking damages for breach of contract. The core issue was whether the GE constituted an MAC.

The Commercial Court handed down judgment in which it held that the GE was not a MAC, that the acquirors had breached the SPAs in failing to close and purporting to terminate and that the claimants were therefore entitled to terminate the SPAs and seek damages (to be assessed at a second trial listed for November 2025).

Kirkland & Ellis act for the claimants.

What does this mean for MAC clauses?

This decision provides a thorough review of the English and U.S. authorities on the construction of MAC clauses.

As addressed further below, it is of particular interest for its analysis of:

1. the threshold for materiality in the context of SPAs — in this case the judge found that a reduction in equity value of between 15% – 20% 'might be' considered to be material and a reduction of 20% in equity value 'is' material;
2. whether MAC clauses are applicable to revelatory events — they are not. MAC clauses only apply to the change, event or effect *itself* and not to anything that might be revealed by such change, event or effect; and

3. whether a range of views held by reasonable people in the position of the parties should be taken into account when assessing whether a matter was reasonably expected to be material — they should not. Rather this is an assessment of what a reasonable person would have regarded as the position at the time the MAC was relied upon to terminate the contract, looking forward from that date.

Key takeaways on the interpretation of MAC clauses

Well-established principles

The Commercial Court set out some well-established principles of relevance to the construction of MAC clauses:

- There are commonly two limbs to the definition of a MAC — whether the 'change, event or effect
  i. 'is'; or
  ii. 'would reasonably be expected to be'

  material and adverse to the matters stated in the MAC clause, such as business, financial condition (etc.) of the company/group of companies.
- The point at which to assess whether the 'change, event or effect' was or would reasonably be expected to be material and adverse is the point at which the notice of termination is served relying on the 'change, event or effect' as being a MAC (consistent with *Decura IM Investments LLP v UBS AG* [2015] EWHC 171 (Comm))
- The test for what would reasonably be expected is objective and does not depend on what either party subjectively thought at the time.
- Under English law there is no 'special rule' as to the construction or application of MAC clauses or the burden on a party invoking a MAC clause (consistent with Cockerill J in *Travelport Ltd & Ors v WEX Inc* [2020] EWHC 2670 (Comm)).

As noted above, the decision addresses three key issues of construction of the MAC clause in the SPAs, which are of broader application:

1. The meaning of 'material'.
2. Do MAC clauses apply to revelatory occurrences?
3. Does the assessment of what would reasonably be expected involve consideration of a range of possible views?

Key issues applicable to construction of MAC clauses

1. The meaning of 'material'

A key question was what threshold of 'materiality' was required.

The judge held that for an acquiror seeking to purchase the target company as part of a long-term strategy 'the important thing is whether the company has suffered a Material Adverse Effect in its business or results of operations that is consequential to the company's earnings power over a commercially reasonable period, which one would think would be measured in years rather than months' (quoting Strine VC *in Re IBP Inc. Shareholders Litigation* Del. Ch., 789 A.2d 14 (2001), the Court of Chancery of Delaware).

The key points in the judgment on materiality in general are:

- It is not sufficient for the alleged MAC to simply be more than *de minimis*. 'Material' means 'significant or substantial'.
- The judge approved Burton J's comment in *Decura* that 'the fact that such a clause is relied on to discharge a party's obligations and terminate a contract obviously emphasises its significance'.
- There is no bright line test for materiality that is applicable to all MAC clauses. A number of considerations will be relevant as to what is to be regarded as material in a particular case. In the present case, the following factors were relevant and militated against setting the bar of materiality too low: (i) size of the transaction; (ii) the nature of the assets concerned, including that they are susceptible to matters such as geotechnical events; (iv) the length of the process of the sale of the mines; and (v) the complexity of the SPAs.

Given that this MAC arose in the context of a SPA, the judge considered that materiality was to be judged by reference to the effect of the 'change, event or effect' on the equity value of the target. The judge noted that in *Akorn Inc v Fresenius Kabi AG* (Court of Chancery of Delaware, Memorandum Opinion 1 October 2018, Laster VC), Laster VC had expressed the view that a reduction in the equity value of over 20% of the target was material in that case. The judge considered *Akorn* to be of significance given the extensive experience and jurisprudence of the Delaware Court of Chancery in relation to M&A agreements in general and MAC clauses in particular.

On the facts of this case, the judge held that a reduction in equity value of 20% or more *would* be material and that a reduction of more than 15% *might* be material (without providing any guidance as to what other factors would be relevant to determining whether it was). In light of his factual findings, the judge found that regardless of the threshold applied, the GE was not material.

2. Do MAC clauses apply to revelatory occurrences?

The court considered whether an event that revealed a broader problem with the business constituted a MAC. In particular, the defendants argued that the GE revealed that the design of the mine was unsafe and would require a very costly revision.

While the decision considered this in the context of the specific wording of the MAC clause in the SPAs, the language in the MAC clause of no 'change, event or effect' is commonly used in MAC clauses, and the Commercial Court's decision is therefore likely to have broad application.

The claimants argued that the GE did not reveal or lead to the revelation of wider problems with the design of the Santa Rita pit but submitted that, even if it did, that did not qualify the GE as a MAC.

The judge agreed with the claimants finding that MAC clauses do not apply to revelatory occurrences:

- MAC provisions must be read in the context of the SPAs as a whole, including their other risk allocation provisions such as warranties and indemnities.
- The conditions of closing in the SPAs and the MAC definition show that these provisions are concerned with a 'change, event or effect' which has occurred since signing.
- The MAC definition dictates that a matter is only a MAC if that 'change, event or effect' is material and adverse, not with what such a 'change, event or effect' may indicate about the possibility that there may be other problems that existed at the time of the signing of the SPA.
- Materiality and adversity have to be features of the 'change, event or effect' *itself* for there to be a MAC.
- The use of the words 'individually or in the aggregate' in the MAC clause apply to the 'change, event or effect' itself. They *do not* mean that the 'change, event or effect' *extends* to something distinct and pre-existing.

The question is whether the GE itself was or would reasonably be expected to be material and adverse. What might have been revealed as a consequence of the GE and the investigations it triggered as to alleged problems in the mine are not relevant to the materiality of the GE.

The consequences of the 'change, event or effect' could be taken into account but only if and to the extent that they quantify or illuminate the significance of the 'change, event or effect' itself. Consequences that quantify or illuminate the significance of some other distinct problem to which attention has been drawn are not relevant to considering materiality.

The judge recognised that that line may not always be easy to draw, but nonetheless held that it is a line which is drawn by the contract and one that the court should draw when giving effect to the contract.

As to the meaning of the term 'effect', the judge found that the use of 'effect' was in relation to the 'change, event or effect' itself which, if material and adverse, is the MAC. The use of 'effect' is not to the effects or consequences of *another* change, event or effect. Indeed, the question would remain as to whether *that* effect was or would reasonably be expected to be material. It would not be whether the effects of that effect were or would reasonably be expected to be material.

3. Does the assessment of what would reasonably be expected involve consideration of a range of possible views?

The claimants contended that what was required was an assessment of whether or not it would reasonably be expected that the matter was material and adverse — this would give a single answer, yes or no.

The defendants argued that there might be a range of views held by reasonable people in the position of the parties. If any of those views led to the conclusion that the matter was expected to be material, then it was 'reasonably expected to be material.'

The judge held that the claimants' construction was correct.

The question is whether the relevant matter 'would reasonably be expected to be material and adverse'. The use of the word 'would' indicates that this is not an assessment that anyone needs to have made at the time. It is not concerned with whether a conclusion *actually* reached was within a range of reasonable answers, because no conclusion on the subject need have been reached at all.

It involves an evaluative judgment, ultimately for the court in the event of a dispute, as to what was reasonably to be expected. There is no requirement for that process to involve assessing the range of reasonable views. This would add an extra degree of uncertainty to the applicability of the clause.

In assessing what would reasonably have been expected:

- The court will consider the parties' contemporaneous assessment of the position. That may shed light on what it was reasonable to expect. Indeed, such a contemporaneous assessment might carry considerable weight in the court's assessment *if made carefully and in good faith* (which the judge found the defendant's assessment was not).
- The assessment is to 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 MAC is notified.
- A question might arise as to what information it is to be assumed that such a person had, and whether they are to be treated as being possessed of information only actually known to one party.
- The notional reasonable person is to be regarded as having the information that was available to either party, which was relevant to the question of whether the 'change, event or effect' would reasonably be expected to be material and adverse.

On the question of degree of likelihood implied by 'would reasonably be expected':

- A mere risk that a matter may turn out to be material cannot be enough. The assessment is whether a reasonable person *would* have considered it more likely than not that the matter would be material.
- There must at least be 'some showing that there is a basis in law and in fact for the serious adverse consequences prophesied by the party claiming the MAC'.
- That requires an assessment of what a reasonable person would have regarded as the position as at the time when the MAC was relied upon to cancel the contract but looking forward from that date.

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1. For the purposes of this *Alert*, the reference to MAC clauses encompasses material adverse effect clauses (as was the clause at issue in this case). ↩

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