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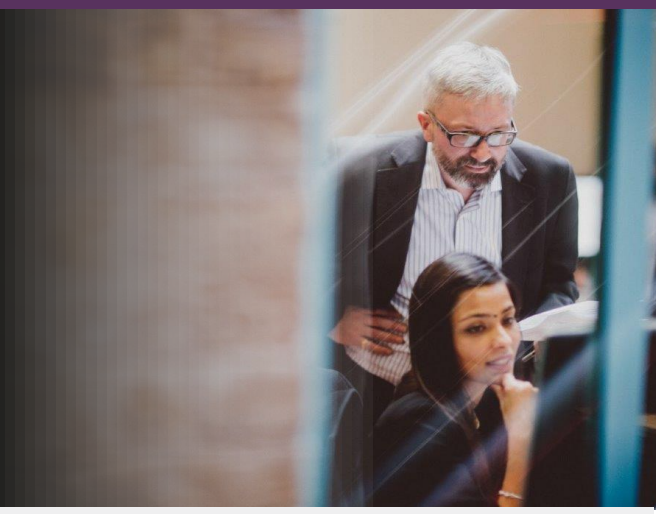
When dealmakers decide to clamp down on a MAC clause



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Court ruling highlights the challenge for buyers if a deal turns sour. Any MAC clause needs to be well drafted, so it is unambiguous.

The takeover of Twitter by Elon Musk hit the headlines last year when the billionaire tried to stop the deal, arguing that Twitter had misled him about the amount of spam on the platform.

When he announced his intention to abandon the acquisition rather than pay an over-priced valuation, the board of Twitter took legal action to enforce the original agreement, which saw a victory for the little blue bird's brand when they finally completed the deal.

Buyers generally look to protect themselves against change during dealmaking through material adverse change (MAC) clauses. These allow a party to a contract to back out or claim compensation if something happens that has a severe impact on the commercial transaction.

However, the challenge of getting MAC clauses right has just been reinforced by the latest ruling from the Court of Appeal in the case of an IT consultancy acquisition where predicted revenues failed to materialise.

The case involved the acquisition of IT consultancy Copperman by global technology services company Decision Inc.

In the sale and purchase agreement (a document that forms a binding legal contract obliging the buyer to buy and the seller to sell, generally known as a SPA), Copperman's shareholders offered various contractual warranties about the state of the company's business. These included stating that "Since the Accounts Date … there has been no material adverse change in the turnover, financial position or prospects of the Company".

The nature of Copperman's business meant it had a small number of large projects going on, making a pipeline of large contracts essential to its future performance. Negotiations for the sale focused on the potential business in the pipeline. During the dealmaking process, the buyer continually asked for an up-to-date position.

The sellers sometimes responded, but when they did, it was to present a more optimistic picture than the actual position, with inaccurate descriptions of the progress of crucial contracts that were critical to future performance. Even before Copperman completed the sale, they had been performing significantly worse than the forecast, with turnover running at half of predictions.

Although Decision Inc. expressed concerns at the information that Copperman gave them, the deal went ahead with an initial lump sum paid on completion and further payments under an earn-out if the company hit specific earnings targets.

When the predicted turnover failed to materialise, and the company started to generate substantial losses, Decision Inc. proposed restructuring the acquisition, asking for repayment of 40% of the initial purchase price and adjusted earn-out targets. Copperman's shareholders refused, and Decision Inc. took action, claiming a breach of warranties in the SPA.

When the case reached the High Court, the judge agreed there had been a breach of the MAC warranty, awarding damages of £1.31m to Decision Inc. But now, the Court of Appeal has ruled that the High Court applied the wrong test in deciding whether there had been a change in the company's prospects.

"The Appeal Court's ruling says the earlier judgement focused on the wrong date, comparison, reference data,

and assessment period. It might seem surprising that so much could be wrong, but this speaks to the complexity of MAC clauses and the challenge in interpretation." explains our head of corporate and commercial, Victoria Holland.

"There is no new law in this judgement, just a reinforcement of how difficult it can be to assess material adverse change. Any MAC clause needs to be well drafted, so it is unambiguous, but that's not easy, and it is why these clauses and warranties tend to be the focus of much negotiation during a deal."

Victoria added: "It's about finding a balance between a cover-all, which may be so generic as to be difficult to pin down, and one that is so specific that it may not relate to given circumstances.

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