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English Courts Consider Material Adverse Effect Clause Invoked by the Effects of the COVID-19 Pandemic

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In the recent case of *Travelport Ltd v Wex Inc [2020] EWHC 2670 (Comm)* (the "Travelport Case"), the High Courts of England considered the construction of a material adverse effect clause ("MAE Clause") in which a party sought to invoke the provision as a result of the effects of the COVID-19 pandemic. Given the prevalence and importance of MAE Clauses in many commercial contracts such as facility agreements and acquisition agreements, we explore in this article the issues that the UK Courts considered when determining the construction of this MAE Clause in the context of a global pandemic.

MAE Clauses

An MAE Clause aims to give parties to a contract a way out of their contractual obligations if an event that causes a material adverse change or effect occurs. A key part to a MAE Clause is the definition of what constitutes a material adverse change, as this will be the trigger in which a party then becomes entitled to exercise its rights under it.

Whilst this core principle and objective is consistent to all MAE Clauses, the specific form and content of an MAE Clause can vary depending on the nature and circumstances of a transaction and the practices of the relevant jurisdiction. For instance, in the context of a lending transaction, it is often used as a catch-all clause to allow lenders to call a default if there is a material adverse change to the borrower's position or circumstances. In the Travelport Case, the MAE Clause was used in the context of the acquisition of a target business, with the aim to give the purchaser the right to walk away from the acquisition if there is a material adverse change in the target company or its assets during the time between exchange and completion.

MAE Clauses are common features in many commercial contracts, particularly in facility agreements and acquisition agreements. That said, they are rarely invoked due to the high burden of proof that they carry in order to demonstrate that a material adverse change did indeed occur within the meaning of the provision. As such, there is actually very little in English case law on MAE Clauses to give guidance on the matter, and the Travelport Case is a rare opportunity to explore the Courts' analysis.

Travelport Case – Background

In January 2020, a share purchase agreement (the "SPA") was entered into between the defendant (the "Purchaser") and the claimant (the "Seller") in which the Purchaser agreed to acquire the entire issued share capital of two companies, eNett International (Jersey) Limited ("eNett") and Optal Limited ("Optal") for a total consideration of approximately US$1.7 billion. eNett's main business was in providing B2B payment services to customers operating in the travel industry. eNett was Optal's key client (accounting for approximately 98% of its total revenues).

Completion of the SPA was conditional upon the satisfaction of certain conditions, including the following:

"*Since the date of this Agreement there shall not have been any Material Adverse Effect and no event, change, development, state of facts or effect shall have occurred that would reasonably be expected to have a Material Adverse Effect.*"

Material Adverse Effect ("MAE") was defined as follows:

". . . *any event, change development, state of facts or effect that, individually or in aggregate: . . . (x) has had and continues to have a material adverse effect on business, condition (financial or otherwise) or results of operations of [eNett] . . . or [Optal]. . . .*"

The MAE definition also included a number of express carve-outs such that certain matters or events would not constitute an MAE, which included the following: (i) Conditions resulting from pandemics (the "Pandemic Carve-Out"), and (ii) changes/proposed changes in Tax, regulatory or political conditions (including in respect of Brexit) or law (the "Change in Law Carve-Out").

An important proviso, however, stated that the Pandemic Carve-Out would *not* be applicable if there is a disproportionate effect on eNett or Optal taken as a whole, as compared to other participants in the *"industries"* in which eNett and Optal operate (the "Carve-Out Exception"). The Change in Law Carve-Out was not subject to this proviso.

Following the exchange of the SPA, the global spread of COVID-19 continued to worsen and by 11 March 2020, the World Health Organisation classified the outbreak as a pandemic. With many authorities imposing restrictions and lockdown, a dramatic global decrease in travel ensued, and thus payments between companies within the travel industry decreased, impacting on the revenues of eNett and Optal.

On 4 May 2020, the Purchaser served a letter to the Seller notifying them that pursuant to the terms of the SPA, an MAE had occurred as a result of the COVID-19 pandemic. As a result, it was no longer obliged to complete the acquisition under the terms of the SPA. The Seller disputed this and, amongst other claims, sought to bring proceedings for specific performance of the Purchaser's obligation to complete the acquisition under the terms of the SPA, together with a declaration that no MAE had occurred under the SPA.

It is worth noting that after proceedings were commenced, the parties did continue to take the necessary steps to complete the transaction, and by 30 August 2020 all conditions precedent to closing had been satisfied, subject only to the question of the existence of an MAE. However, the Courts nonetheless tried as preliminary issues certain key points that were still in dispute, including the following regarding the construction of the MAE Clause:

- (i) For the purposes of the Carve-Out Exception, what was the industry in which eNett and Optal operated in? The Seller argued that the relevant comparable would be the narrower payments industry in the travel sector (being the industry of providers of products and services to facilitate B2B payments to participants in the travel industry). Conversely, the Purchaser argued that there was no such industry, and that the more appropriate comparable would be the much broader and general B2B payments industry or payments industry as a whole.
- (ii) Do the effects of the changes in regulatory or political conditions or law (such as the travel bans, closure of businesses and lockdown restrictions) fall only within the Change in Law Carve-Out (and thus the Carve-Out Exception does not apply) regardless of whether they arose from or are connected with the Pandemic Carve-Out which was subject to the proviso of the Carve-Out Exception, as the Seller contended?

Decision – (i) Meaning of "Industry"

The Courts favoured the Purchaser's position, finding that they operated in the broader B2B payments industry for the purposes of the Carve-Out Exception. The Courts noted that as a matter of pure analysis of the word "*industries,*" the Purchaser's construction was preferred, highlighting that the SPA was clearly a heavily negotiated contract where it must be assumed that all wording had to have been carefully scrutinised by lawyers and that words were used wittingly and advisedly.

The Courts further explained that the parties had specifically chosen the word "*industries*" as the comparator, as opposed to other words such as "*markets*" or "*sectors*" or "*competitors,*" which would denote more business/company specific parameters. "*Industry,*" however, is by its natural and ordinary meaning a broader word in which it captures a group of participants in a wide sphere of economic activity.

As such, the Courts held that the Carve-Out Exception could be engaged; of course, this remained subject to the fact that the Purchaser would indeed have to demonstrate that eNett and Optal had been disproportionately affected by the COVID-19 pandemic when compared against other businesses in the wider B2B payments industry.

Decision – (ii) Changes in Law or Regulatory/Political Conditions Is Just a Change in Law Carve-Out?

The Courts agreed with the Seller's construction, concluding that the effects of the changes in Law Carve-Out had to be considered in isolation, and thus the Carve-Out Exception did not apply irrespective of whether the events,

changes, developments or effects also fell within the Pandemic Carve-Out.

The Courts explained that as a matter of language, whether an event was excluded by the Change in Law Carve-Out from being taken into account would depend only on whether that event resulted, arose from or in connection with any of the matters within the Change in Law Carve-Out.

The Court further explained that the fact that the Carve-Out Exception applied only to certain carve-outs and not to others must have meant that the parties did not intend that the Carve-Out Exception should qualify the effects of the other non-specified Carve-Outs (being the Change in Law Carve-Out). If the Purchaser's argued construction was correct, then that would mean that it could potentially pick and choose among various overlapping effects in connection with an event that may have arisen, which the Courts said could not be the commercial intention.

With this said, the Courts did acknowledge that the Seller's construction had its shortcomings. For instance, if the parties did intend that if certain effects resulting from conditions within the Pandemic Carve-Out are to be excluded from the Change in Law Carve-Out insofar as they also fell within such Change in Law Carve-Out, then it would be equally arguable that this would require the express removal of such effects (like the travel bans, lockdowns and other restrictions that resulted from the pandemic), which the Courts noted would likely require expert assistance, and even so would be difficult to achieve.

Concluding Thoughts

As noted previously, MAE Clauses are a very common feature in many commercial contracts such as facility agreements and acquisition agreements. Despite the fact that we in the industry acknowledge that MAE Clauses are seldom engaged, a lot of time and effort is nonetheless spent negotiating and refining them. As such, the Travelport Case is a useful reminder of why we do so, given how the Courts view an MAE Clause with such scrutiny and assumption of precision by the parties and their lawyers in order to agree and conclude the drafting. Needless to say, the Travelport Case also provides some interesting commentary on the notion that a lack of specificity or a degree of ambiguity in drafting may equally serve a potentially desired purpose of incentivising parties to come together to discuss and renegotiate as a worthy alternative to incurring costs and risking the uncertainty that comes with litigation.