WEX Win Interpreting COVID-19 Material Adverse Effect Shows M&A Drafting Traps

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On October 12, 2020, in *Travelport Ltd & Ors v WEX Inc [2020] EWHC 2670*, Justice Cockerill of the English High Court held that WEX had in large part correctly interpreted the terms of the material adverse effect (MAE) clause that it invoked to pull out of a $1.7 billion acquisition. The ruling demonstrated that:

- There was no presumption that MAE clauses should be narrowly construed. They are part of contracts between well-advised business entities, and the terms should be given their natural and objective meaning.
- U.S. case law — indicating that MAEs allocate business-specific risks to sellers but industrywide risks (such as a pandemic) to buyers — was informative but not dispositive. Each contract is different and needs to be interpreted on its own. Business purpose arguments around risk allocation could not displace the contract's clear terms.
- Careful drafting was essential.
  - An MAE triggered by disproportionate injury to the target business relative to the wider "industry" must carefully define what "industry" means. Does it mean — as it did in this case — the overall payments industry or just payment business-to-business (B2B) service providers, like the target businesses, which specialize in travel sector customers? In the context of a pandemic that shuts down the travel sector, that distinction was crucial.
  - If some disproportionate injuries (such as natural disasters, strikes or pandemics) trigger the MAE but others (such as legislative changes) do not, then how should the MAE address a combination of events? Where, as here, a pandemic both discourages travel and is followed by legislative change (such as the imposition of travel restrictions), it is essential that the clause address how MAE event combinations should be treated.

The case is a preliminary ruling on contractual interpretation, which both sides are understood to be appealing. A trial on the merits, including whether — applying the preliminary findings — WEX was indeed entitled to invoke the MAE clause is expected for April 2021. The case will be closely watched for the English courts' approach to MAE clauses.

As Justice Cockerill put it: "[i]t may well be that one result of this case is that future drafters will do differently." This is advice that all transactional lawyers should take heed of.

Background

The orthodoxy holds that MAE clauses are almost never successfully triggered in an M&A context. Deal agreements — much pored over by sophisticated advisers with millions or billions at stake — carefully anticipate and legislate for every risk. Diligence identifies potential issues. Disclosure letters, warranties or sometimes indemnities address "known known" concerns. Post-signing covenants legislate for how the business should be prudently run in the ordinary course prior to closing. An MAE provision is a backstop to this careful, choreographed process. It is designed for the extreme eventuality of something unforeseen that so materially damages the target business that the buyer can walk away from the deal.

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Even then, the provision is typically drafted so that *external* industry risks (regulatory changes, strikes, terrorism, pandemics) are generally borne by the buyer. They can be taken to have assumed the risk of vicissitudes in the industry they are buying into. Sellers take *internal* business risks. If the business operates in a manner disproportionately vulnerable to injury relative to the broader sector, that is a risk the seller may be accountable for.

The Acquisition

WEX agreed to buy eNett and Optal (the Targets) from Travelport and others (the Sellers) in late January 2020. Shortly thereafter, the COVID-19 pandemic caused a global downturn in the travel sector. The Targets are payment service providers currently focused on the travel industry (with the potential for expansion into other markets), whose businesses were affected by the travel downturn. On May 4, 2020, WEX informed the Sellers that it was invoking the MAE clause to terminate the acquisition. The Sellers brought proceedings for specific performance before the High Court and the judge ordered expedited trial of preliminary issues, including on construction of the MAE.

By August 30, 2020, all conditions to closing under the share purchase agreement (SPA) had been satisfied, save for the question of whether the COVID-19-related global decrease in travel (and resulting decrease in payments to and from companies within the travel industry) constituted an MAE, such that WEX was not required to complete the acquisition of the Targets.

The MAE

The SPA defined an MAE as including any event, change, development, state of facts or effect that, individually or in the aggregate, has had and continues to have an MAE on the business, condition (financial or otherwise) or results of either Target Group (*i.e.*, each Target together with its respective subsidiaries, taken as a whole). The definition provided for carve-outs, including "conditions resulting from […] pandemics" and "changes (or proposed changes) in Tax, regulatory or political conditions (including as a result of the negotiations or outcome with respect to Brexit) or Law." Limited exceptions from carve-outs were provided for, *e.g.*, conditions resulting from pandemics could constitute an MAE only to the extent that the resulting adverse consequences had a "disproportionate effect" on either Target Group "as compared to other participants in the industries in which" the Targets or their respective subsidiaries operate. By contrast, no carve-out exception was provided in respect of changes in regulatory or political conditions or law (Political or Legal Developments).

Analysis

The Industry Benchmark Issue

WEX argued that "industries" meant the payments industry (or B2B payments industry) rather than any particular niche within it. Since the Targets focused on the travel sector, WEX claimed they had been disproportionately affected by the pandemic relative to the broader payments industry, and the MAE was validly invoked. The Sellers countered that the Target Groups operated in the "travel payments industry," the entirety of which had been similarly adversely affected.

The court ruled that the natural and ordinary wording of the MAE could not be to narrow the meaning of "industries" to the travel payments industry: Instead, the MAE concerned the B2B payments industry (or, alternatively, the wider travel payments market). Further, the High Court found that there is no travel payments industry in the manner defined by the Sellers.

The Effect of Overlapping Carve-Outs

The MAE was drafted so that some events (such as pandemics) triggered the MAE if the Targets were disproportionately injured. Political and Legal Developments, regardless of disproportionate injury, did not. In this case, the impact on travel involved both the pandemic (which discouraged travel) and, in some cases, legal changes (such as travel restrictions). The Sellers argued that because there were legal changes, the disproportionate injury trigger did not apply, and it did not matter that the Political and Legal Developments related to the pandemic. WEX argued that because the root cause was the pandemic, even if legal changes followed, the disproportionate injury trigger applied.

The court favored the Sellers' construction. The SPA provided a carve-out such that events resulting or arising from or in connection with Political or Legal Developments could not be taken into account in determining whether there had been an MAE. There was no exception to this carve-out and, in the court's view, the fact that such events may also fall within another category of MAE could not overcome the express wording providing that (by virtue of their relationship with Political or Legal Developments) such events could not be taken into account. Accordingly, to the extent that the worldwide collapse in travel arose from or in connection with Political or Legal Developments, they could not be taken into account in establishing an MAE, even if there was also a clear connection with the COVID-19 pandemic.

The court acknowledged that distinguishing between the effects caused by the pandemic and by the connected Political or Legal Developments would be challenging and likely require expert

assistance, and expressed concerns as to whether any such exercise could be conducted on "any principled basis." However, this did not detract from the conclusion that the plain wording of the SPA would require such an assessment.

Burden of Proof on Demonstrating an Exception

The court decided that the burden of proof on establishing the scope of an MAE carve-out rested on the Sellers, because it is the Sellers that asserted that the effects fell within the Political or Legal Developments carve-out. This will be a significant point in the ultimate trial, as the Sellers will presumably argue that there is no MAE because the collapse of the travel market falls (at least in part) within the Political and Legal Developments carve-out (such that it cannot be taken into account in establishing an MAE even if the pandemic also caused the same injury, as set out above).

Prospective MAEs

The court found that the clear wording of SPA militated against the carve-out exceptions being available in respect of prospective, potential MAEs. Again, this conclusion was based on the wording of the SPA: The parties had clearly delineated the circumstances in which future events would (and would not) be relevant to the MAE definition.

Takeaways

The message from the court is clear: SPAs are detailed agreements, generally drafted by sophisticated lawyers, with the precise wording chosen with specificity. The key points to consider in light of this ruling include the following.

Rigid contractual construction:

- The court applied the ordinary principles of contractual construction, and it was not argued that any special construction principle or *contra proferentem* should apply. Justice Cockerill accepted that the wording of the MAE definition was "probably largely taken from a *pro forma*," but she noted the SPA was "nonetheless a major and heavily negotiated contract where I must assume that all wording has been carefully scrutinised by lawyers and is used wittingly and advisedly."
- The court noted the "dearth" of relevant English authority and treated the relative wealth of authorities from the U.S. (in particular, *Akorn Inc. v. Fresenius Kabi AG*[1] before the Delaware courts) as useful guidance, considering that ignoring these authorities "would plainly be imprudent" and "discourteous" to the Delaware court system. However, reference to the U.S. approach was not at the expense of focusing on the precise wording of the SPA in the present case. In particular, if the natural and ordinary meaning of an MAE clause is that an MAE has occurred, the English courts will not be reluctant to uphold that meaning; it should not be expected that there is a presumption against an MAE having occurred.

Renegotiation and settlement:

- The prospect of renegotiation was identified as a potential virtue of MAE clauses. The court highlighted that, in *Akorn*, it was noted that commentators have argued that parties may intentionally leave the word "material" undefined because the resulting uncertainty generates productive opportunities for renegotiation. Justice Cockerill remarked that several articles had supported the role of MAE clauses in renegotiation.
- In her concluding remarks regarding the difficult assessment of whether effects were caused by the COVID-19 pandemic or related Political or Legal Developments, Justice Cockerill reiterated her view: "this is an area where the learning as to the use of MAE clauses as a trigger for renegotiation seems particularly apt." This encouragement toward renegotiation is consistent with the Concept Notes by the British Institute of International and Comparative Law (BIICL) regarding "breathing space": The BIICL recognizes that MAE clauses may become increasingly litigated in the context of COVID-19[2] and states generally that it would be preferable to continue a viable contract rather than bring it to an immediate end.
- With these comments in mind, parties may wish to consider whether — in the context of a potential MAE — a renegotiation or settlement can be reached rather than lengthy, costly litigation with an uncertain outcome (which may not become clear until after a transaction's closing or long-stop date). Indeed, there are examples in the U.S. of parties renegotiating the terms of their deal (Forescout / Advent) or canceling transactions and settling (L Brands / Sycamore) rather than continuing litigation to determine whether the deal must be upheld.

Expert evidence:

- In the present case, it appears that expert evidence will play a significant role in determining both whether: (i) there was a disproportionate and MAE on the Target Groups; and (ii) any such effect resulted from the COVID-19 pandemic or from related Regulatory and Legal Developments. It would be prudent for companies considering alleging that an MAE has occurred to obtain expert input at an early stage, to gain a better understanding of the merits of their case.

[1] No. 2018-0300-JTL, 2018 WL 4719347 (Del. Ch. October 1, 2018).

[2] Concept Note 2 on the effect of the 2020 pandemic on commercial contracts, May 2020, paragraphs 60-62.

Developments in the U.S.:

- The U.S. has seen a considerable uptick in bidders attempting to pull out of deals as a result of COVID-19, and the Delaware courts in particular were initially inundated with claims to that effect. As noted above, some claims are have led to renegotiations or settlements, but others (*e.g.*, Simon Property Group / Taubman, which is being litigated in Michigan) are likely to test the U.S. courts' approach to determining the relevance of COVID-19 to the ongoing viability of M&A transactions. This may lead to significant precedent in the U.S., which the English courts may also take into account.

Next Steps

Both parties have indicated they will apply for an expedited appeal by October 19, 2020. Subject to any appeals that proceed, the trial is scheduled for April 2021.

In the meantime, the court's judgment in *Travelport* is an important reminder that the courts will be loath to second-guess the parties' intentions where a natural and ordinary meaning can be discerned. This is all the more true for agreements in complex, heavily negotiated, high-value transactions.