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Case Summary

In *Decision Inc Holdings Proprietary Ltd v Garbett [2023] EWCA Civ 1284*, the Court of Appeal considered whether the High Court was wrong in ruling that a company had breached a warranty that there had been no material adverse change ("**MAC**") in a target company's prospects.

The Court of Appeal overturned the first instance decision of the High Court, on the basis that the High Court had applied the wrong test for determining if there had been a MAC. The Court of Appeal judgment does not set any new law; however, it provides useful guidance on how the Court will interpret MAC clauses.

Background

The claim relates to a share purchase agreement (the "**SPA**"), pursuant to which two individuals (the "**Sellers**") agreed to sell to, Decision Inc Holdings Proprietary Limited (the "**Buyer**"), the issued shares in an IT consultancy company, then known as Copperman Consulting Limited (the "**Company**").

As part of the due diligence process in the lead up to the parties entering into the SPA in October 2018, the Sellers provided the Buyer with a number of documents which had a bearing on the Company's financial position.

The success of the Company was linked to the continual winning of large and lucrative mandates from clients, meaning that the pipeline documents provided by the Sellers were essential for the Buyer to assess the financial state of the Company.

Shortly after entering into the SPA, the Buyer received further documents which had a bearing on the Company's financial position, most notably, monthly accounts for August 2018 and September 2018, which revealed significant net losses in the Company's turnover.
It became apparent to the Buyers that the actual financial position of the Company did not correspond with the financial prospects initially provided by the Sellers pre-completion. Subsequently, the Buyer issued a claim for breach of warranty against the Sellers alleging that there had been a MAC in the turnover or prospects of the Company at the time the SPA became effective, and that the records of the Company were not accurate.

High Court

The High Court suggested that the issue between the parties was "relatively straightforward" – the Sellers sold the Company to the Buyer, the Company performed substantially worse than expected in the months after the acquisition, and the Buyer feels that they were misled.

To establish if there had been a breach of a MAC warranty, the High Court adopted a threefold approach:

1. What was the baseline figure, i.e. the anticipated or projected forecast level when the SPA was entered into between the parties?

2. What was the actual figure, i.e. the accurate and up to date position of the Company as at the date of the SPA?

3. Do the baseline and actual figures vary and, if so, does that variation constitute a difference so great that it amounts to a MAC?

The High Court concluded that there had been a change between the baseline figure and the actual figure, and that the change had been both "*material*" and "*adverse*". Consequently, there had been a breach of a MAC clause.

Court of Appeal

The Court of Appeal stated that the High Court had applied the wrong test for determining whether there had been a change in the Company's prospects. The Court of Appeal's rationale for finding against the Buyer and upholding the appeal was as follows:

1. **Wrong date**: The correct approach would have been to assess the Company's forecasts and prospects as at 31 December 2017 (i.e. the Accounts Date) and to compare this with the Company's position as at the date of the SPA in October 2018. The High Court assessed the "*actual*" position in October 2018 but contrasted that with the "*expectation which a reasonable buyer would have had*" (as opposed to the position on 31 December 2017).

2. **Wrong comparison**: There were issues with the comparison. The allegation of breach of the MAC warranty called for a comparison between the same thing (the Company's prospects) on different dates (31 December 2017 and October 2018). It did not, however, call for a comparison between different things ("*the expectation that a reasonable buyer would have had*" and the "*actual*" position) on the same date. The High Court had therefore erred in attaching such great weight to the expectations that a reasonable buyer would have had and had failed to look at what the Company's "*prospects*" were at the two relevant stages.

3. **Wrong assessment period**: The period selected for the consideration of Earnings Before Interest, Tax, Depreciation and Amortisation ("**EBITDA**") was questioned by the Court of Appeal because the word "prospects" looks to the future, i.e. it takes into account what might happen after the relevant date. The High Court, however, focused on EBITDA for 2018 albeit more than nine months of that year had already passed by the time the SPA was concluded.

4. **Wrong reference data**: The High Court erroneously equated "*prospects*" with EBITDA. The Court of Appeal recognised that the meaning attributed to "*prospects*" may naturally differ according to the contractual context, but generally suggests "*chances or opportunities for success*" and does not simply refer to EBITDA. Had the parties intended for "*prospects*" to equate to EBITDA, they would (or should have) adopted that term in the SPA.

Practical Considerations

To reiterate, the Court of Appeal judgment does not set any new law; however, it provides useful guidance on how the Court will interpret MAC clauses.

Ultimately, the best way to avoid uncertainty and, possibly, costly and protracted litigation proceedings, is to ensure that any MAC clause is drafted clearly and unambiguously, with sufficient detail in respect to the particular transaction.

For further information, please contact Alexander Edwards or the Partner with whom you usually deal.