

ASIC'S NEW VIEWS ON MATERIAL ADVERSE CHANGE CONDITIONS

14 November 2022 | Australia

Legal Briefings - By **Rebecca Maslen-Stannage**, **Nicole Pedler** and **Katerina Jovanovska**

In its [September Corporate Finance Update](#), ASIC outlined its expectation that material adverse change (**MAC**) conditions contain objective and quantifiable standards by which the parties to a transaction, and their securityholders, can determine whether a material adverse change has occurred.

MACs must be drafted such that activation of their triggers is not subjective or semi-subjective. However, unquantified material adverse change clauses are a common feature of commercial practice and contracting. They have for decades been viewed as applying an objective test, and the suggestion that they need to be quantitatively defined to be objective has surprised the market. Like all conditions in a takeovers context, MAC conditions need to be framed objectively so that they are not self-defeating conditions. However, this does not require quantification, and it would be a shame if unquantified MAC conditions can no longer be used as a key risk management device.

IN BRIEF

- In its [September Corporate Finance Update](#), ASIC outlined its expectation that material adverse change (**MAC**) conditions contain objective and quantifiable standards by which the parties to a transaction, and their securityholders, can determine whether a material adverse change has occurred.
- MACs must be drafted such that activation of their triggers is not subjective or semi-subjective.
- Following the turbulence of the COVID-19 pandemic and related business impacts, including for example the closure of Sydney Airport for periods preceding the largest takeover bid in Australian history for it, there have been numerous situations where a

MAC with a quantified threshold would be impracticable to set or would otherwise be inappropriate.

- ASIC's policy expectation that parties will limit themselves to quantified MAC triggers is not supported at law or consistent with broad commercial practice. If applied rigidly, would lead to the loss of an important risk management device.

ASIC'S NEW MAC EXPECTATIONS

In its September Corporate Finance Update, ASIC has outlined its expectation that MAC conditions contain objective and quantifiable standards by which the parties to a transaction, and their securityholders, can determine whether a material adverse change has occurred. It said:

"[W]e have recently seen a trend of uncertain MAC conditions in control transactions, where a 'material adverse change' is circularly defined as a 'material adverse change'.

An uncertain MAC condition which contains subjective or unclear thresholds poses a material risk that the condition may contravene section 629 of the Corporations Act: see *Goodman Fielder Limited 01 (2003) 44 ACSR 254*. That inherent uncertainty also means the risks associated with the triggering of such conditions may not be able to be adequately disclosed, contrary to the principle in section 602 of the Corporations Act requiring the acquisition of control to place in an 'informed market'.

Securityholders are entitled to an adequate level of disclosure about the terms of an offer, so they can make an informed decision on the merits of the transaction, including on the likelihood of a MAC occurring and the transaction subsequently proceeding.

Parties to control transactions should ensure they follow the established market practice of including objective and quantifiable standards in MAC conditions."

MATERIAL ADVERSE CHANGE CLAUSES

In essence, a MAC permits a party to a contract not to fulfill their contractual obligations because of the occurrence of a 'material adverse change', as defined within the contract.

Generally, a MAC is a condition precedent to the transaction requiring that no events, actions, change or circumstances occur or are discovered which (individually or in aggregate) have or may have a material adverse effect on the target. They may contain one or both of two key trigger types:

- **qualified thresholds (often financial):** events, actions, change or circumstances

occurring that result in changes that can be quantified and meet a pre-determined threshold. Often this type of MAC trigger is expressed as a diminution by a specified percentage in EBITDA, consolidated net assets or consolidated revenue; and

- **general thresholds:** general qualitative thresholds that are not linked to specific triggers. Often this type of MAC includes the undefined term “a material adverse change” and includes language about wholistic effects on the relevant target’s business. Use of the defined term wording in the definition itself is a common feature in many contracts without giving rise to circularity.

The final component of a MAC is its carve-outs. This is the list of events, changes or circumstances that are specifically excluded from qualifying as a ‘material adverse change’. These carve-outs vary considerably from deal to deal and are a key negotiation item. Commonly they include matters contemplated or required to be done under the contract or disclosed prior to entry into the contract and matters which relate to events that are not specific to the target to be acquired, following the principle that the MAC is to protect a bidder against problems in the subject business, not events going on in the industry or world at large generally.

In the public M&A context, a ‘no MAC’ or ‘no MAE’ (material adverse effect) condition is a common condition precedent to completion of a transaction. A key reason for this in a public M&A scheme or takeover bid is that the consideration is by necessity fixed. Unlike a private M&A deal, completion accounting mechanisms are not available to true-up for actual business performance between signing and completion of a transaction. The MAC acts as a somewhat blunt instrument to allow the bidder to avoid the transaction if the target is in a materially adverse position as compared to when the deal was struck.

MACS IN PUBLIC M&A IN AUSTRALIA

MACs (including those without a quantified limb) are an established part of the dealmaking landscape in Australia, especially in public M&A.¹

That MACs should not be uncertain or subjective should not be conflated with requiring quantitative metrics based triggers. In particular, in the Goodman Fielder decision from 2003 cited in ASIC’s Corporate Finance Update, the Panel was concerned with a general MAC in respect of the bidder’s (not the target’s) financial condition and a condition triggered by any adverse change in financial markets, without any materiality qualifier. The decision did not consider or find general MACs or unquantified MACs inappropriate as a general proposition.

There can be useful reasons to include diminution of certain financial metrics as triggers for a MAC. However, there are many circumstances where such metrics will not adequately address the risk sought to be addressed. Recent financial metrics for many companies have been disrupted in prior financial comparative periods by COVID-19 pandemic and government response related impacts such that financial metric comparisons are not meaningful. Appropriate triggers depend on the deal and the circumstances, for example, in the scheme implementation deed for Afterpay a general and broad MAC trigger is included, which would have aligned to the expectations and market norms of the US based bidder. In the implementation deed for Sydney Airport, which had suffered from broad travel restrictions in the financial year prior to execution of its scheme implementation deed, the triggers focussed on the loss of licences to operate the airport, destruction to it or a credit downgrade.

RE VIMY RESOURCES LTD

Earlier this year, the Western Australian Supreme Court considered the issue of an unquantified MAC in a scheme implementation deed in *Re Vimy Resources Ltd* [2022] WASC 233. At the first court hearing, the Court considered concerns raised by ASIC that the MAC was circular or provided a subjective threshold: [98] - [99]. The relevant limb of the MAC read:

“Material Adverse Effect means an event, matter or circumstance that occurs, is announced or becomes known to either party after the date of this deed which either individually or when aggregated with any other events, matters or circumstances, has a material adverse effect:

... otherwise on the assets and liabilities (taken as a whole), financial condition or business of the party (taken as a whole), ...”

Vimy submitted that as a matter of proper construction, no circularity or subjectivity arises, and that such clauses are a common feature of mergers and acquisitions and finance transactions, with clauses with which courts are familiar: [98]. Vimy sought to address ASIC’s concerns by more fully disclosing to shareholders the risk that the SID may be terminated by Vimy or Deep Yellow by reason of a MAC: [100]. The Risk section of the Scheme Booklet was expanded to include the following wording:

“There are myriad different circumstances that may, depending on their effect, trigger or engage this definition of a Material Adverse Effect. One of the risks of having a qualitative or principle-based Material Adverse Effect clause (as distinct from a strictly quantitative or monetary threshold clause) is that the clause may be engaged in a wider range of circumstances. Equally, having a quantitative test means that the individual elements of that test are also subject to argument or interpretation, quantification and temporal issues.

...While a Material Adverse Effect may result in a wide range of contractual and commercial outcomes, it is possible that the parties could end up in dispute over the existence of the Material Adverse Effect or its consequence under the Scheme Implementation Deed. This could result in the Scheme not proceeding, the Scheme otherwise being terminated, or a transaction being proposed on different terms in accordance with clause 3.4 of the Scheme Implementation Deed.”

ASIC did not seek to be heard at the hearing on the issue: [104]. On balance, the Court was satisfied that the scheme booklet made appropriate and prominent disclosure of the risk raised by ASIC, and that the conditions precedent did not ground a basis to refuse to convene the scheme meeting: [105].

It would be a shame if this becomes new boilerplate for scheme booklets, which are already long and hard documents to read. It is hard to see why a MAC condition would be singled out for this explanation as opposed to the many other clauses and conditions which can become subject to dispute.

This case was cited by Black J in *Kyckr Ltd* [2022] NSWSC 1316 in his Honour’s conclusion that the material adverse change condition in that case “is properly addressed by disclosure of that matter in the scheme booklet” (at [21]).

OBSERVATIONS

The Australian market is comfortable and experienced with both quantified and general MACs. An unquantified MAC is a well-known and understood tool to ensure one party is not forced to complete a transaction in circumstances that are materially different to the those at the time of entry into the contract.

Given MACs containing qualitative thresholds that are not linked to specific triggers are an established part of the dealmaking landscape, the impetus for ASIC’s statement is unclear.

Careful focus on the drafting of the MAC is always important. MACs must be drafted such that activation of their triggers is not subjective or semi-subjective. However, a rigid, quantification focused approach to drafting a MAC is not the way to ensure objectivity. We hope that ASIC’s position does not deprive the market of a key risk management device.

-
1. For examples of MACs containing a qualitative trigger, see the implementation agreements of AfterPay Ltd, ResApp Health Ltd, Edge Minerals Ltd, Asciano Ltd, Auzex Exploration Ltd, Sirius Resources NL, Recall Holdings Ltd, Diploma Group Ltd, Unity Mining Ltd, Skyland Petroleum Ltd, General Mining Corporation Ltd, Cuesta Coal Ltd, Vitaco Holdings Ltd, Metaliko Resources Ltd, Cobalt One Ltd, Black Range Minerals Ltd, Aphrodite Gold Ltd, Excelsior Gold Ltd, TMK Montney Ltd, Beadell Resources Ltd,

MacPhersons Resources Ltd, Oliver's Real Food Ltd, Wameja Ltd and Firefly Resources Ltd.

KEY CONTACTS

If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.



REBECCA MASLEN-STANNAGE

CHAIR AND SENIOR
PARTNER, SYDNEY
+61 2 9225 5500
Rebecca.Maslen-
Stannage@hsf.com



NICOLE PEDLER
PARTNER, SYDNEY

+61 2 9225 5694
Nicole.Pedler@hsf.com



**KATERINA
JOVANOVSKA**
SOLICITOR, SYDNEY

+61 2 9225 5324
katerina.jovanovska@hsf.com

LEGAL NOTICE

The contents of this publication are for reference purposes only and may not be current as at the date of accessing this publication. They do not constitute legal advice and should not be relied upon as such. Specific legal advice about your specific circumstances should always be sought separately before taking any action based on this publication.

© Herbert Smith Freehills 2022

SUBSCRIBE TO STAY UP-TO-DATE WITH INSIGHTS, LEGAL UPDATES, EVENTS, AND MORE

Close