International Law Office

CORPORATE FINANCE/M&A - SWITZERLAND

MAC clauses in Swiss M&A transactions

May 03 2017 | Contributed by Meyerlustenberger Lachenal

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Introduction

The completion of larger M&A transactions is usually conditional on the absence of material adverse changes (MAC). This can be achieved either by including an explicit condition – usually referred to as a MAC clause – or by including a condition that all warranties must be true at completion in combination with a warranty confirming the absence of a MAC. In essence, a MAC clause defines what is deemed to be a MAC of the target company and entitles the acquirer *de lege* to step back from – and *de facto* to renegotiate – the proposed transaction in case a MAC event has occurred or is alleged to have occurred.

This update summarises the legal structuring from a Swiss law perspective of MAC clauses in private M&A transactions and outlines the conditions for permissibility of MAC clauses in public M&A transactions.

Timing of transfer of economic risk to purchaser

The objective of MAC clauses is to protect the acquirer from adverse changes between signing and closing that make the target company substantially less attractive and thus materially change the bargain agreed between the parties (ie, the balance between the value of the target and the purchase price agreed on).

MAC clauses are contained in larger private and public M&A transactions under Swiss law. Conversely, such conditionality is much less common in smaller private M&A transactions. This is substantially attributable to a different contractual foundation regarding the allocation of risk. In larger private or public M&A transactions, influenced mainly by US legal traditions, an acquirer is generally unwilling to assume material risks regarding the target company before closing a transaction. Accordingly, it is customary in such transactions to include a MAC clause in the agreement to protect the ability of the acquirer to walk away or re-open the price negotiations in case a MAC occurs. By contrast, in smaller private M&A transactions the parties work on the basis that the acquirer is willing to assume the risk from the time of entering into the agreement, subject only to legally required conditions, and influenced by the default rule in the Swiss Code of Obligations which provides that – subject to a contractual provision to the contrary – the buyer assumes the risk relating to the purchase object with signing. MAC clauses are therefore less frequent in these transactions. For similar reasons, the use of locked-box mechanisms – rather than closing accounts mechanisms often used in larger cross-border private transactions – is also more common. The primary difference between the two mechanisms is the timing of the transfer of the commercial risk to the purchaser. If a closing-accounts approach is used, the purchaser must pay for the actual level of assets and liabilities of the target as per closing, while in case of a locked-box approach the parties agree the final purchase price based on the most recent historical balance sheet of the target available before signing. The commercial risks and benefits of the target pass from the seller to the purchaser as of the relevant balance sheet date (ie, the date of the locked-box reference accounts).

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MAC clauses in private M&A transactions

In private M&A transactions, MAC clauses are usually structured as follows:

- Non-occurrence of a MAC event as a closing condition – in case a MAC event arises between signing and closing, the respective closing condition is not met and the acquirer is not obliged to complete the transaction; or
- Absence of a MAC event as representation of the seller (combined with the closing condition that all representations are still accurate at closing) – in case a MAC event arises between signing and closing, the respective closing condition is not met and thus the acquirer is not obliged to complete the transaction.

In any case, the definition of what is deemed to be a MAC event is crucial and often heavily negotiated between the parties. The seller seeks to negotiate a narrow definition containing as many exclusions as possible, typically for any kind of adverse change relating to developments in the economy or industry at large (ie, not directly resulting from the business of the target – eg, for any adverse changes arising out of general economic conditions, currency exchange fluctuations or changes in applicable laws, whereas the acquirer strives for a broad definition, ideally without any such exclusions). However, the term 'material' is rarely defined in private M&A transactions and parties tend to pay insufficient attention to specifying the thresholds of materiality. In some cases, this is done intentionally, allowing the acquirer to invoke the broadest interpretation, while the seller tries to narrow its meaning as much as possible.

MAC clauses in public M&A transactions

In public M&A transactions, Swiss takeover law rules and Takeover Board case law on the permissibility of MAC clauses must be considered.

As a general rule, MAC clauses are not allowed within mandatory offers. In voluntary offers, MAC clauses are generally valid; however, they must comply with the following requirements established by Takeover Board case law:

- MAC clauses may refer only to events occurring between the pre-announcement of the offer and the end of the offer period (ie, MAC clauses are not permissible until closing of the transaction);
- MAC clauses may refer only to events which specifically affect the target (ie, market-related MAC clauses are not allowed unless the specific event or change has a direct negative impact on the target);
- MAC clauses may refer to future events as well as to events which have already occurred, but only if the effect of the event that has already occurred is not yet known;
- MAC clauses must be transparent and clearly quantified in specific amounts or in percentages of certain financial metrics;
- MAC events must reach a certain minimum threshold – pursuant to Takeover Board case law, a MAC event must have at least:
  - 5% on turnover level;
  - 10% on earnings before interest and taxes or earnings before interest, taxes, depreciation and amortisation level; or
  - 10% on equity level; and
- The question of whether a MAC event has occurred must be determined by an independent third-party expert (reference is usually made to internationally acknowledged auditing firms or investment banks).

In practice, in most private M&A transactions providing for a MAC clause, acquirers rarely walk away when a MAC occurs, but rather try to renegotiate the purchase price using the MAC clause as a means to improve their negotiation power. However, in public M&A transactions, once the offer is launched (or pre-announced), except in certain very specific cases, an acquirer can neither lower the offer price unilaterally nor agree with the target company to lower the offer price. Thus, in case of the occurrence of a MAC that was confirmed by the independent third party acting as an expert, the offeror has only the options to waive the condition and declare the offer successful or to walk away from the transaction.

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