CASE UPDATE

Decura IM Investments LLP v UBS AG, London Branch: [The Materiality Standard in Material Adverse Effect Clauses]

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Introduction

In the recent case of *Decura IM Investments LLP and Others v UBS AG, London Branch* [1], the English High Court had to interpret the term "*material*" in the context of determining whether a termination event had occurred under an exclusivity agreement. In holding that "*material*" means "*substantial*" or "*significant*" within the factual matrix of the case, this case largely echoes the earlier decision of the English High Court in *Grupo Hotelero Urvasco SA v Carey Value Added*[2] ("**Grupo Hotelero**"), which considered a material adverse change clause in a loan agreement.

The Facts

This case concerns a claim brought by Decura IM Investments LLP and others (collectively, "**Decura**") against UBS AG, London Branch ("**UBS**") in relation to an agreement between them, dated 31 May 2012, referred to as the Introduction and Outsourcing Agreement (the "**Agreement**").

Pursuant to the terms of the Agreement, UBS contracted to cease to develop internally, or to source from third parties (with limited exceptions), financial products and services defined in the Agreement as "Exclusive Business Services" ("**EBS**") and to acquire from Decura any EBS products required for UBS Investment Bank ("**IB**") or its clients.

Although the Agreement was not limited in duration, the Agreement permitted termination under certain circumstances. In particular, Clause 20.3(a) of the Agreement specified that a termination event would occur where UBS "*ceases to carry on a material part of its UBS IB business at any time*" and "*such cessation… has a material adverse effect on UBS IB's ability to market the Exclusive Business Services*".

[1] [2015] EWHC 171 (Comm)

[2] [2013] EWHC 1039 (Comm)

On 30 October 2012, UBS issued a public announcement on a strategy named "*Project Accelerate*". The central issue in this dispute was whether there were changes made to the business of UBS IB as a result of Project Accelerate, which constituted a termination event pursuant to Clause 20.3(a) of the Agreement. Decura did not terminate the Agreement but asserted that it was entitled to do so by a notice dated 31 July 2014 (the "**Notice**"); and it sought a declaration in that regard.

Burton J considered that three specific issues arose for the Court's determination:

1. What was the effect and meaning of the term "*material*" in both instances in which it appeared in Clause 20.3(a) of the Agreement? ("**Issue 1**")
2. Did Project Accelerate have the effect that UBS ceased to "*carry on a material part*" of its IB business? ("**Issue 2**")
3. If such a cessation had occurred, did it have a "*material adverse effect*" on UBS's ability to market the EBS? ("**Issue 3**")

In order for Decura to succeed in its action, both Issues 2 and 3 had to be resolved by the Court in favour of Decura.

The Decision

Issue 1

On the effect and meaning of the term "*material*" within the matrix of the Agreement, the Court agreed with both parties' submissions that "material" equated with "*substantial*" or "*significant*". In reaching this decision, the Court cited with approval the earlier decision in *Grupo Hotelero*, where Blair J interpreted a material adverse change in the context of a loan agreement to mean a change which "*significantly affects [a party's] ability to perform its obligations*".

The Court also made several observations in relation to material adverse effect and material adverse change clauses (collectively, "**MAC clauses**"), some of which are considered below:

1. In the absence of any subjective element in the formulation of the MAC clause in question, such as the phrase "*in the reasonable opinion of [Decura]*", the test as to whether the MAC clause was triggered was an objective one.
2. As Blair J noted in *Grupo Hotelero,* in order to trigger a MAC clause, there must necessarily have been a change; and, in this regard, a party would not be able to invoke a MAC clause "*on the basis of circumstances of which it was aware at the time of the agreement*".
3. Following the decision in *Grupo Hotelero,* it was clear that a change must not merely be temporary in order for it to qualify as a material change.

4. The materiality of an adverse change or effect must be assessed at the relevant time, which was, in this case, at the time when the Notice was served by Decura on the basis of its asserted entitlement to terminate the Agreement.
5. With reference to an American academic commentary that cited a line of American authorities espousing that a MAC clause requires the discharge of a "*high standard*" and that a party seeking to invoke such a clause has to bear a "*heavy burden*"[3], the Court observed that the fact that the MAC clause in dispute was relied upon to discharge a party's obligations and terminate a contract underscored its significance[4].

Taking into consideration the factors above, amongst others, the Court concluded that the proper interpretation of "*material*" within the matrix of the Agreement was "*significant*" or "*substantial*".

Issue 2

In relation to Issue 2, Decura asserted that by the time of the service of the Notice, UBS had ceased to carry on a material part of its IB business as a result of Project Accelerate.

On the facts, the Court found that Project Accelerate had caused "*significant changes*" and a "*shrinking*" of the business. However, although there was a reduction in the number of structured fixed income products offered by UBS IB, the Court held that there was no cessation of any part of the UBS IB business. Accordingly, Issue 2 was resolved by the Court in favour of UBS.

Interestingly, the Court observed in *obiter* that, as opposed to the identification of a part of a business that had ceased, it would be an "*unsatisfactory and uncommercial*" way to construe the termination clause in question by reference to an (unspecified) percentage decrease in overall business (not least because Clause 20.3(a) of the Agreement did not use the words "*material proportion*"), because such an exercise would lead to considerable uncertainty as to what proportion would qualify as "*material*" at any given time.

Issue 3

Since Issue 2 was resolved by the Court in favour of UBS, the Court's assessment of Issue 3 would not have affected the outcome of the case.

On the assumption that Decura had succeeded in Issue 2, the Court considered that the onus was upon Decura to establish that UBS's ability to market the EBS products was "*materially adversely affected*" or "*materially impaired*" by the relevant cessation of a material part of UBS IB's business

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[3] Andrew A. Schwartz, *A "Standard Clause Analysis" of the Frustration Doctrine and the Material Adverse Change Clause*, 57 UCLA L Rev 789 (2010)

[4] Blair J noted the severity of the possible implications of an overly wide construction of the MAC clause in dispute *viz.* "*a lender may be in a position to suspend lending and/or call a default at a time when the borrower's financial condition does not fully justify it, thereby propelling it towards insolvency.*"

pursuant to Project Accelerate. Upon an examination of the evidence placed before it, the Court held that Decura had failed to establish its case in relation to Issue 3, even if Issue 2 had been resolved in its favour.

As a point of interest, the Court highlighted two unusual features of the case, which had a substantial impact on the way in which Issue 3 was assessed (in contrast to how such a question would ordinarily be determined). First, both parties did not seek to rely on evidence from an independent expert, whose opinion could have assisted the Court in determining if the relevant cessation pursuant to Project Accelerate had a material adverse effect on UBS's ability to market the EBS products. Second, as at the time of the service of the Notice and the commencement of the relevant proceedings, UBS had not commenced any marketing activities in respect of any EBS product. As such, there was no marketing data by which analysis could be performed in the Court's determination of whether UBS's ability to market the EBS products had been materially impaired by the changes pursuant to Project Accelerate.

Comments

Although MAC clauses are commonly used in commercial and financial documentation, there has been, until recently, a dearth of case law interpreting such clauses. This case provides useful guidance and reaffirms the approach that the English courts are likely to adopt in interpreting the standard of materiality in a contract and, in particular, in the context of MAC clauses.

It remains to be seen whether the Singapore courts will adopt the English approach in construing the standard of materiality in contracts in the context of MAC clauses[5]. What is clear is that the effect and interpretation of such clauses depend largely on the drafting of the relevant clause. Until further guidance on this issue is given by Singapore courts, it may be prudent to be mindful of the developments in other major common law jurisdictions.

[5] It appears that there is *dicta* by the Singapore High Court in *Downeredi Works Pte Ltd v Holcim (Singapore) Pte Ltd* [2009] 1 SLR(R) 1070 interpreting the term "material" to mean "significant" in the context of a MAC clause. (at [47]) However, the material issue in that case related to whether the reference to "material" within the phrase "material price movement" in the disputed clause was to contrast the price of materials against "operational" costs, as opposed to describing the extent of a price movement.