SPAs and post-closing price adjustments: missed deadlines are not always costly

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Interpretation of a share purchase agreement.

Judgment of the Federal Supreme Court of 4 September 2020
Case Reference : 4A_225/2020

Facts

On December 4, 2015, the main shareholders of F. SA (the "Sellers"), a corporation organized and existing under the laws of Switzerland, entered into a share purchase agreement (the "SPA") with a UK limited company (the "Buyer"; the Buyer and the Sellers: the "Parties"), whereby they agreed to sell their shares (the "Shares") in F. SA (the "Company") to the Buyer for a total aggregate consideration of CHF 7,700,000. At closing, the Buyer paid the amount of CHF 5,600,000 to the Sellers as preliminary consideration. The SPA allowed the Buyer to retain the outstanding consideration (i.e., CHF 2,100,000) as security for any claims for price reduction. The final consideration was to be reduced, according to the SPA's terms and conditions, if the Company's revenue for the year 2015 did not reach CHF 4,700,000. This final consideration could be adjusted in line with the Company's working capital, and reduced where other SPA provisions were met.

Pursuant to the SPA, the Buyer committed to deliver to the Sellers the "audited" financial statements of the Company, as well as other relevant financial documentation for the year 2015 by no later than April 30, 2016. Upon receipt, the Sellers would have a 21-day period in which to review and assess the documents and, where necessary, have the 2015 revenue and net working capital of the Company audited. The Parties would then have a 10-day period in which to agree on the revenue and net working capital, which would eventually determine the final consideration for the Shares. The final consideration was to be paid by November 30, 2016.

On June 19, 2017, the Sellers jointly filed suit at the Geneva Court of First Instance seeking payment of the final consideration for the Shares under the SPA. The Court granted the plaintiffs' motion on April 15, 2019, ruling that the Buyer had failed to deliver the audited financial statements and other relevant documents by April 30, 2016. The Buyer was therefore deprived of its right to claim for a price reduction based on the Company's revenue and working capital for the year 2015. The Buyer challenged this ruling before the Court of Justice of the Canton of Geneva, which partially admitted the appeal. It found that the April 30, 2016 deadline agreed upon by the Parties for the delivery of the financial documents could not be construed as a *conditio sine qua non* for a price reduction. The Court of Justice stated that this deadline was only indicative and its violation would not result in the loss of any related right. The Sellers were therefore entitled to CHF 296,648.35 in aggregate as final consideration for the Shares, instead of the full price of the outstanding consideration (CHF 2,100,000). The judgment of the Court of Justice was confirmed by the Federal Supreme Court.

Issue

The Federal Supreme Court had to determine whether the Buyer was entitled to claim a price reduction under the SPA even though it had failed to deliver financial information to the Sellers on the contractually defined date determining the final consideration due for the Shares.

Decision

The Federal Supreme Court first turned to the interpretation of the SPA reached by the Court of Justice of the Canton of Geneva with respect to the consequences stemming from the failure to meet the deadline of April 30, 2016, by which the Buyer had to provide the Sellers with the financial documentation of the Company. Applying Art. 18 para. 1 Swiss Code of Obligations (SCO), the Court of Justice ruled that pursuant to the true and common intention of the Parties to the SPA, the price reduction was not subject to the Buyer delivering the financial documents within the established timeframe.

Accordingly, the failure to fulfill this obligation in time would not entail forfeiture of the right to claim a price reduction. As the Federal Supreme Court stated, this constitutes a finding of fact, to which it is bound as a matter of principle (Art. 105 para. 1 of the Federal Supreme Court Act).

The Sellers argued that the findings of fact were established in a manifestly incorrect manner (Art. 97 para. 1 of the Federal Supreme Court Act). In short, they asserted that the Court of Justice erred in its conclusion that the Buyers could claim a price reduction without respecting the deadline of April 30, 2016. While acknowledging that the SPA did not specify the consequences of a failure to meet the deadline, they argued that the deadline was part of a specific procedure agreed by the Parties for the purpose of calculating the final consideration of the Shares on a common basis and according to stringent criteria.

The Federal Supreme Court was therefore called upon to determine whether the findings of fact were tainted by arbitrariness pursuant to Art. 9 of the Federal Constitution (Art. 105 para. 2 of the Federal Supreme Court Act). The scope of such review is limited; a court is deemed to have decided in an arbitrary manner when it disregards evidence that is likely to affect the decision without sound basis, when it manifestly misinterprets its meaning and scope, or when it reaches untenable findings on the basis of the evidence obtained.

The Federal Supreme Court found that the process agreed on by the Parties to determine the final consideration was dependent on the Parties' goodwill and cooperation because it provided that the Parties had to agree on the amounts of the revenue and net working capital, which would eventually determine the final consideration for the Shares. This process consequently lacked the precision and rigor the Sellers were insisting on. Further, the SPA provided for the possibility to increase the final consideration based on the net working capital. The Federal Supreme Court pointed out that if it were to follow the Sellers' argument that the Buyer had a strict deadline of April 30, 2016 to submit the documents, the Buyer could have avoided paying more (i.e., a higher final consideration for the Shares) by simply not delivering the financial documentation within the given deadline. The Federal Supreme Court found that such interpretation was neither consistent with the general outline of the SPA nor the true and common intention of the Parties.

In conclusion, the Federal Supreme Court ruled that the Court of Justice's findings of fact were not tainted by arbitrariness, and that its conclusion that a price reduction would not be adversely affected by delay in the submission of the required financial documentation was correct as a matter of law.

Key takeaway

This case serves as an important reminder that the parties negotiating an SPA with a post-closing sale price adjustment mechanism must precisely define this mechanism and specify the consequences should one of the parties fail to meet a deadline for submitting documents under this mechanism (see also Tschäni Rudolf/Diem Hans-Jakob/Wolf Matthias, M&A-Transaktionen nach Schweizer Recht, 3rd edn, Zurich (Schulthess) 2021, § 357). If the parties do not specify these consequences, this may lead to litigation (as in this case) where the courts will have to interpret the SPA (with the potential for diverging outcomes, as shown by the opposing conclusions reached by the Geneva Court of First Instance and the Geneva Court of Justice). The courts will have to interpret the agreement by examining the true and common intention of the parties pursuant to Art. 18 SCO. This is a finding of fact made by the cantonal courts that may only be reviewed by the Federal Supreme Court with very limited judicial scrutiny (the standard of review being arbitrariness).

Comment

When drafting a contract, one of the pivotal questions the parties should bear in mind is: "What are the consequences of a failure to meet an established deadline?" and clearly provide for the judicial consequences of such failure to avoid disputes like the one at hand.

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