

MAC clauses

16 March 2020 7 min read

by Shayne Krige, Director

The coronavirus has obvious impacts on the airline, events and tourism industries, but we are also seeing a knock-on impact on other sectors such as private equity, technology, manufacturing, construction, finance and insurance. Many of our clients want to understand:

- Firstly, what the impact of the coronavirus might be on contractual obligations they and their contractual counterparts have in case they wish to cancel or their counterparties move to cancel; and
- Secondly, how they should be modifying contracts they are currently negotiating to best protect themselves against the fallout from the pandemic.

"MAC clauses", like force majeure clauses, are used in contracts to allocate the risk of events that are unforeseen at the time of contracting to one or other of the parties to the contract. "MAC" refers to a material adverse change and these arise in a number of different forms.

In mergers and acquisition transactions, a MAC clause in a sale agreement allows the acquirer to cancel the deal without penalty if, between the date of signature of the contract and completion of the deal, there is a material change in the circumstances of the company or business being acquired. It may also allow the seller to cancel if there is a material adverse change affecting the acquirer although this is rare. The contract will define the circumstances in which a material change will be deemed to occur, such as a significant deterioration in the target's business between signing and closing. MAC clauses are also ubiquitous in lending transactions, where the lender's obligation to lend (and its right to call a default and demand repayment of amounts advanced) will be triggered by the borrower suffering a material adverse change.

MAC clauses are similar to force majeure clauses in that both seek to allocate liability in the context of unforeseen events. However, because MAC clauses generally refer to the impact of unforeseen events on the parties or the target of the transaction rather than the unforeseen event itself, it may be easier to enforce a MAC clause than it would be to enforce a force majeure clause. For example, a natural disaster in the United States of America may not be a force majeure for a business in South Africa, but the cancellation of orders from American clients may result in a material adverse change in the company's finances.

Will the coronavirus trigger MAC clauses?

Inevitably, the answer to this question will depend on the precise words used in the clause and the impact of coronavirus on the parties. Does the clause reference operational disruptions, has the coronavirus already had a financial impact on the parties and if so does the clause address that impact, who determines whether a material adverse change has occurred?

We were unable to find any litigated examples in South Africa of MAC provisions being invoked as a result of an epidemic or pandemic or even major political and economic events like the 9/11 terrorist attacks and the 2008 global financial crisis. There is some relevant precedent in the United Kingdom and the United States, where courts and regulatory bodies have repeatedly found against the party asserting that a MAC has occurred.

In the 2013 English case of *Grupo Hotelero Urvasco SA v Carey Value Added SL*, one of the lenders (Carey) to a hotel group (Urvasco) argued that a MAC had occurred as a result of a deterioration in the financial condition of Urvasco as a result of the 2008 global financial crisis, reducing property values in Spain and unfavourable currency exchange rates. Carey relied on a repeating representation by Urvasco that "there has been no material adverse change in its financial condition". The court found that a MAC had not occurred because Carey had not discharged the onus of proving that there was an adverse change in the financial position of Urvasco that was significant enough to affect its ability to repay the loan. The court held that the usual principles of contractual interpretation will be applied to MAC provisions and that to be material, the adverse change must substantially and permanently affect the borrower's ability to perform the transaction in question. The court also held that a MAC cannot be used in a situation where the party relying on the clause was aware of the circumstances in question at the time of the agreement and that the conditions must worsen in a way that makes them materially different in nature.

The courts in the United States appear to agree and have held that an adverse change is material if it "substantially threaten[s]" the fundamental agreement "in a durationally-significant manner". Neither short-term hiccups nor the mere risk of a material adverse change is enough. The US courts have also confirmed that a party invoking a MAC clause bears a "heavy burden" to show the clause has been breached (*Hexion Specialty Chemicals, Inc. v. Huntsman Corp*) and that a MAC clause is only proper when the change in circumstances was unforeseeable at the time the contract was drafted.

This foreign law will not be binding on South African courts, but it will have persuasive effect were a case was to be brought here. It is likely that our courts will also impose a heavy burden of proof on the party alleging the material adverse change. Circumstances of a global nature, like the coronavirus pandemic are unlikely on their own to constitute a material adverse change. It is arguable that a pandemic was not unforeseeable and although experts suggest that the effect of the virus may be felt for months if not years, it will be very difficult for a party relying on a MAC clause to show that the consequences for the particular business are enduring rather than temporary. The argument for enforcement of the MAC clause will, of course, grow as the severity, duration and harm caused by coronavirus develops. Even if the discretion to declare a change material and adverse belongs to the party seeking to enforce the clause, the determination will need to be honest and rational, and it will be subject to review by the courts.

The impacts of coronavirus are severe and undoubtedly there will be parties who seek to avoid the contractual obligations they have taken on. Whether or not they can be saved by a MAC clause will ultimately depend on the precise wording of the MAC clause and what the wording suggests about how the parties intended to allocate the risks arising from a pandemic. It will also depend on the facts and how the effects of the pandemic are being felt by the business in question.

For many businesses, notably banks, it will be important to act decisively, but lenders in particular should be wary of invoking MAC provisions in reliance on coronavirus given the potential reputational damage of wrongfully calling coronavirus a material adverse change and the risk of compensation claims for damage to business and reputation.

How can MAC clauses protect us from coronavirus fallout?

The problem with modifying your MAC clauses to specifically reference coronavirus or even pandemics more generally is that there is no doubt at this stage that the coronavirus risk is foreseeable. Since this pandemic has occurred, parties will find it harder to establish that a material adverse condition has occurred. The best way for lenders and purchasers to protect themselves in the MAC clause will be to reference more targeted objectives, such as specific net asset value or turnover figures so that an argument over whether the circumstances in question fit the definition of a more generally-worded MAC clause can be avoided.

There is, however, no one-size-fits-all answer to whether COVID-19 will constitute a MAC. An analysis will need to be done of the precise phrasing of the MAC clause and the specific circumstances impacting the counterparty. Whilst it may be tempting to act decisively in relying on MAC clauses to terminate existing contracts, the consequences of such cancellation may be severe and by inserting MAC clauses into existing transactions under negotiation you may not be properly protecting yourself from this or the next pandemic.

[Download](#)