

Material Adverse Change (MAC) Clause in the COVID-19 Era

I. MAC clause governed by English law^[1]

What is a MAC clause?

A MAC clause is included in various transactions including mergers and acquisitions, as well as finance transactions. For example, a loan agreement may give the lender a drawstop if there is a MAC affecting the borrower's business, financial condition or prospects, or the loan markets generally (sometimes referred to as «market flex»); or it may provide for a MAC to give rise to an event of default. In an M&A transaction, the occurrence of a MAC may allow the buyer to terminate the sale and purchase agreement. Alternatively, there may be a representation or warranty to the effect that there is no MAC.

What triggers a MAC clause?

English case law has developed the following general conditions for an event to be recognized by courts as a MAC event: (1) the change must be «substantial» or «significant», meaning that it should have a significant effect on the party's ability to perform its contractual obligations,^[2] (2) the change must be durationally significant, i.e. it must not be merely temporary or recoverable in a short period of time,^[3] and (3) there must be a direct causal link between the event and a party's inability to perform its obligations.^[4] If the event giving rise to the MAC was known to the parties at the time of entering into a contract, this may prevent a party from being able to rely on the MAC.^[5]

It should be noted that court cases on enforcement of MAC clause are rare and very fact specific. Careful attention is given by the courts to the wording of the MAC clause and it will be interpreted in conjunction with the entire agreement and its language.

Whether COVID-19 may constitute MAC event for a contract governed by English law?

In general, English courts tend to construe the MAC event narrowly (and, as noted above, with reference to the specific facts of a case). Our view is that the existence of the COVID-19 pandemic should not, of itself, constitute a MAC; rather, regard has to be had to the specific measures adopted by individual countries to deal with the outbreak and the impact that these measures have on businesses. For example, if a country imposes an extremely hard, long-term lockdown that completely prevents businesses from operating then it is likely that this would have a material adverse effect on the finances and operations of a business. Therefore, a MAC clause that is triggered by such a scenario is likely to be upheld by the courts. However, the court is also likely to assess the possible awareness of the claimant at the time of entry into the contract about the possible effects of COVID-19 on businesses. So, for example, if the parties entered into the contract at a time when a limited lockdown had already been imposed, it might be argued that subsequent expansion to a hard lockdown (preventing businesses from operating) should preclude a party from relying on the existence of a MAC.

What to do if MAC clause is already included in an agreement?

If MAC clause is already included in an agreement: (1) review the language of the clause, (2) check whether a pandemic/epidemic, or quarantine measure are specifically covered by the MAC clause, (3) determine whether the MAC clause can be interpreted in a way which covers a pandemic/epidemic, or measures introduced to control it, and, (5) how the risk of a MAC is distributed between the parties.

II. MAC clause governed by Russian law

The Russian Civil Code contains a provision allowing a contract to be avoided if there is a MAC.[6] Thus it is not necessary to set out the relevant clause in the agreement, provided that the contract does not specifically exclude MAC as a ground for avoiding the contract. A MAC allows parties to change the agreement or to withdraw from it. The MAC clause does not have automatic effect, so a party has to specifically assert its right to withdraw from the contract on the grounds of MAC. If the parties do not agree on the existence of a MAC, the court will have to determine whether a MAC exists and its implications for the contract.

In general, a court will look for the following conditions before terminating an agreement based on MAC: (1) the event must have been unforeseeable by the parties at the moment of entering into the contract; (2) the party interested in enforcing the MAC clause could not overcome the MAC acting with the degree of care and discretion that was required by the nature of the contract and business practice; (3) the performance of the contract would violate the balance of the economic interests of the parties and cause such damage to the interested party that it will largely lose what it expected under the contract; and (4) the interested party does not bear the risk of MAC based on business practice or the contract.[7]

The terms of the agreement can be changed by the court in exceptional cases. For that, one of the following additional conditions must be confirmed by the court in addition to the four listed above: (1) the termination of the agreement would contradict public interest; or (2) the termination of the agreement would entail damage to the parties, significantly exceeding the costs required to execute the contract on the conditions proposed by the court.[8]

Whether COVID-19 may constitute a MAC for a contract governed by Russian law?

The Supreme Court of the Russian Federation has opined that MAC may exist in connection with the epidemiological situation or lockdown measures.[9] Nevertheless, it does not follow from the Supreme Court's opinion that those conditions may themselves be deemed a MAC event. Most likely, courts will continue to carefully evaluate the circumstances of each case in order to confirm whether a MAC has occurred. Russian court practice on MAC is inconsistent and highly fact specific, moreover there are statutory requirements for MAC events in certain industries (for example, insurance[10] and travel agency businesses[11]). It is likely that a unified approach to cases in connection with the COVID-19 outbreak may be developed by courts in the nearest future.

References:

- [1] Material Adverse Change (MAC) and Material Adverse Effect (MAE) are used interchangeably.
- [2] Grupo Hotelero Urvasco SA v Carey Value Added SL and another [2013] EWHC 1039 (Comm).
- [3] Ibid.
- [4] Ipsos S.A. v Dentsu Aegis Network Ltd [2015] EWHC 1726 (Comm).
- [5] Grupo Hotelero Urvasco SA v Carey Value Added SL and another.
- [6] [Art. 451 of the Russian Civil Code.](#)
- [7] [Art. 451\(2\) of the Russian Civil Code.](#)
- [8] [Art. 451\(4\) of the Russian Civil Code.](#)
- [9] Question 8 of «Review of selected issues of court practice related to the application of legislation and measures on counteraction to the spread of the new coronavirus infection (COVID-19) No. 1 in the Russian Federation» approved by the Presidium of the Supreme Court of the Russian Federation on 21 April 2020.

[10] [Art. 959 of the Russian Civil Code.](#)

[11] Art. 10 of the Federal Law «On the basics of travel business in the Russian Federation» No. 132-FZ dated 24 November 1996.

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For additional information or if you have any questions, please contact any of our lawyers below.