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Why MAC clauses are no Covid-19 silver bullet

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The uncertainty brought by Covid-19 is already filtering through to private equity (PE) and M&A deals. As buyers look to protect themselves against unexpected changes, they will be making increasing use of material adverse change (MAC) clauses in negotiations.

"In my experience deals haven't been called off because of Covid-19, but there have been delays because of the inability to travel," said Peter Wittmann, managing director at private equity firm Asia-IO. "Consumer sector deals have been much more heavily affected and we're seeing the impact right away, but things aren't looking so bright for the rest of the year."

He added: "The impact of the virus may be short term, which means many PE deals – which focus more on the longer term – can proceed, and continue to look ahead for the next two to three years."

While the situation in China is improving and the country is looking to bounce back from the virus as the number of infections drop, the number of cases continue to rise quickly in Europe and the US.

The M&A counsel at a multinational company said: "While [coronavirus] has had a huge impact on businesses and their supply chains, it's hard for buyers to pull out of deals simply because of the virus, since many sellers would view that the virus-caused disruption to business is temporary, and should not jeopardise strategic buyers' underlying long time value creation assumption in the mid to long term."

She continued: "But depending on the market, buyers might be able to renegotiate deals, depending on how hard the impact of the virus is on a specific market, and the perceived time required to recover from the virus situation."

According to Marcia Ellis, partner at Morrison & Foerster, based in Hong Kong SAR, many buyers are considering invoking MAC clauses in agreements entered into prior to the Covid-19 outbreak – with sellers equally concerned by this eventuality. "So far we are just at the analysis and discussion stage. We haven't seen anyone actually pull the trigger on this," she said.

[MAC clauses](#) were popular in the aftermath of the global financial crisis. The 2008 Sichuan earthquake also resulted in similar situations.

Tips for invoking a MAC clause

"The challenge with invoking MAC clauses is that they need to be precise," said Wittmann.

Some clauses are sector-specific. For instance, agreements for semi-conductor deals will have clauses specifying rare earth supplies not being affected by trade agreements. Others focus more on regulatory changes, especially for foreign buyer approvals.

According to Nandakumar Ponniya, principal at Baker McKenzie Wong & Leow, where the event does fall within the scope of the MAC clause, there can be challenges whereby parties have differing views on whether the clause can and should be invoked, the level impact of the supervening event on performance of the obligations under the contract, or the steps parties should take to mitigate or minimise the risk.

Ellis added that whether a MAC clause can be invoked really depends on the specific wording of the clause and the governing law of the relevant agreement. In general, an event would have to have a significant and long-term adverse impact on the business in question.

"In the case of the Covid-19 outbreak, it might be possible to show a sufficiently significant adverse impact, but it would be much more difficult, in most cases, to prove that that impact will be long-lasting," said Ellis.

Force majeure clauses provide coronavirus relief

In the case of the Sars outbreak, for instance, businesses in China and other parts of Asia were significantly impacted, but they bounced back fairly quickly.

According to Ellis, it's generally difficult to successfully invoke a MAC clause. Courts and arbitral tribunals are generally reluctant to find that a MAC clause has been triggered as the event must be covered expressly in the clause and must persist in a durationally significant way. "If there were an earthquake and the sole production facilities of a manufacturing company were completely swallowed up by the earth, a court would likely find that a MAC clause has been triggered," she said. "But short of that, the party resisting the invocation of the MAC clause can always argue that in the long term the company will bounce back, even if it requires significant restructuring of the business."

Ellis said that in the US, MAC clauses are quite standard in the purchase or merger agreement when a fund is acquiring a company. They're less common on private UK deals. Purchase agreements will contain MAC clauses about 25% of the time in the UK.

"The situation in Asia is somewhere between the US and the UK," she said. "MAC clauses are more commonly accepted by corporate sellers in Asia, but financial sponsor sellers often push back on them. But the trend is that even financial sponsor sellers in Asia usually end up having to accept at least a limited MAC clause."

The enforceability of a MAC clause depends not on the location of the relevant assets, but on the governing law of the agreement that contains the MAC clause and its specific wording. In general, however, a MAC is intended as a high hurdle and proving that an unexpected event has had a material adverse effect is

challenging. Companies have used them as a way to try to back out of a deal or as a negotiation tool. For instance, [Verizon](#) invoked the MAC clause to get a better purchase price in its of Yahoo in 2017 due to data breaches. In one of the few cases where a buyer was able to walk away from a deal, in 2018, a Delaware judge allowed German healthcare company Fresenius to invoke a MAC clause on Akorn, the generic drug maker it aimed to acquire, after it ran into unexpected market competition for some of its mainstay products and its performance had "dropped off a cliff".

As a practical tip for negotiations, Ellis said that if the buyer is a fund with sufficient leverage in negotiations, it should negotiate the specific financial thresholds for a MAC, in addition to the general material adverse effect language. For example, if the target's revenue decreased by a certain percentage or more for a certain period of time, then a MAC will be deemed to have occurred.

"If there are no specific benchmarks then it will be hard to successfully invoke a MAC clause, except in very limited cases," said Ellis. "If a fund is the seller, it should strongly resist any specific financial thresholds for a deemed MAC."

Ellis believes that PE houses will begin to intensify their focus on MAC clauses going forward, not only because of the possibility of further outbreaks of disease, but also because of the likelihood of an increased number of climate change-related events that could have a sudden and very severe impact on businesses.

The M&A counsel said that it's very difficult to justify and invoke a MAC clause because of the virus as it's unclear how long the impact on a target company will last. She said that in the future, buyers will want to include epidemic-related MAC clauses – but it's not something that sellers will easily give in to.

"With prices surging and lots of dry powder in the market, it's hard for buyers to push for MAC clauses in negotiations, but they will come up more after Covid-19," said Wittman. "It's an unprecedented incident; we've never had a global epidemic. Sars and Mers were contained in certain countries."

However, Wittman said that buyers need to know what they want to include and what to push for. "Buyers will try to push for broader clauses, but sellers will push back," he said.

"Targets that might have been thinking of doing an IPO might instead be considering a bilateral sale, as there's better deal certainty and less exposure to capital market volatility," said the M&A counsel. Sectors such as online groceries and online education can be expected to grow because of the way people have changed their habits due to remote working/learning and staying home.

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