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MAC Clauses in M&A and Debt Transactions During COVID-19

Client Advisories

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March 26, 2020 - Acquisition agreements and debt financing agreements typically address, either expressly or implicitly, the possibility of unforeseen changes in circumstances such as pandemics, in a material adverse change ("MAC") clause. This client alert examines MAC clauses as they relate to COVID-19 in the context of mergers and acquisitions and debt financing arrangements. You can find Hughes Hubbard's on-going coverage of the legal responses to COVID-19 [here](#).

MAC Clauses in Mergers and Acquisitions

The economics of a pending acquisition transaction may be undermined if a seller's business significantly deteriorates between the signing of the acquisition agreement and the closing of the transaction (most importantly, because the price for the target company or assets has been fixed in the contract and is typically not subject to adjustment based on such deterioration). Acquisition agreements typically address this circumstance through a MAC clause. A MAC clause, usually a highly negotiated term, allocates various contractually defined risks, or "adverse changes," between a buyer and a seller. If a MAC clause is triggered, the buyer will not be required to close the transaction.

An adverse change is material if the buyer, in seeking to invoke the MAC clause, can show that the change "substantially threaten[s] the overall earnings potential of the target in a durationally significant manner,"¹ i.e. the adverse change is material to the merger or acquisition agreement taken as a whole and is not just a "short-term hiccup."² This is a difficult but not impossible standard to overcome. Whether a MAC clause can be invoked will depend on an examination of the terms of the relevant agreement as well as the nature of the business and transaction.

It was not until 2018 that a Delaware court for the first time validated a buyer's termination of an acquisition agreement based on the occurrence of a MAC. There, the Delaware Chancery Court found that a MAC had occurred where, in the four quarters after the seller signed the merger agreement, the seller's revenues were down more than 25 percent each quarter, and earnings per share were down more than 100 percent per

quarter.³ While New York law generally follows similar principles, a court ruling under New York law has found that a MAC occurred in less drastic circumstances: a three-month period of sharp declines in business performance.⁴

A typical MAC clause in an acquisition agreement allocates company-specific risks to the seller, who is often seen as better situated to foresee and prevent an adverse change in its business, but carves out general market or “systemic” risks and allocates them to the buyer. Generally speaking, enumerated systemic risks will include risks related to “acts of war, violence, pandemics, disasters, and other force majeure events.”⁵ Even where systemic risk is initially allocated to the buyer, MAC clauses often provide an exception for circumstances in which an event disproportionately (or materially disproportionately) affects the seller compared to its industry peers. In such a situation, the risk shifts to the seller.

A seller that is currently negotiating an acquisition agreement should ensure that, among others, its MAC clause includes language regarding COVID-19 and its effects, such that it is clear that the buyer bears the related risks, including those resulting from worsening conditions, and a buyer that is currently negotiating an acquisition agreement should expect to bear such risks (it being understood that the purchase price for the relevant asset(s) has presumably been adjusted downwards to reflect the current economic circumstances). With respect to an agreement that preceded the current crisis, a buyer seeking to invoke a MAC clause by citing the effects of COVID-19 would be required to demonstrate both that the crisis has had a material adverse impact on the seller’s financial condition or operations and that the harm of such adverse impact will persist for a significant period of time. While both the severity and the duration of the current crisis remain to be seen, COVID-19 may have significant and long-lasting effects, with certain industries affected more than others. To the extent that the crisis persists and becomes increasingly severe, a buyer’s argument that a material adverse change has occurred will be strengthened. However, as noted above, it is common for systemic risks in general, and the risk of a pandemic in particular, to be carved out of a MAC clause and allocated to the buyer.

MAC Clauses in Debt Financing Agreements

Whereas MAC clauses in acquisition agreements are typically consequential only during the period between signing of the agreement and closing of the transaction, a MAC clause in a debt financing arrangement has ongoing implications for a borrower. In particular, the occurrence of a MAC may constitute an event of default, require a borrower to give notice of the event to the lender, or affect a borrower’s ability to borrow funds under a revolving credit facility or delayed term loan to the extent that it cannot make a no MAC representation and warranty.

Default. Some credit agreements include a MAC provision as an event of default. Borrowers and their counsel should review the scope of such clauses and be prepared to act proactively in response to the pandemic’s developments.

Notice. Many credit agreements require borrowers to provide their lenders with notice of any events or circumstances that have had, or could reasonably be expected to result in, a MAC, and a failure to provide such notice could result in a default. Borrowers and their counsel should examine credit agreements to determine whether and when the impacts of COVID-19 could require a MAC notice.

Extensions of Credit. Typically, under a revolving credit facility or delayed draw term loan, to receive extensions of credit the borrower must represent and warrant that there has been no MAC since an earlier specified date. Borrowers and their counsel should determine whether COVID-19 will impact the borrower’s ability to make this representation and warranty. Companies concerned that evolving market conditions may impede their ability to make such a representation and warranty or access credit in the future should consider proactively drawing on remaining lines of credit.

In both the acquisition and debt financing contexts, the impact of COVID-19 will depend on the specifics of the MAC clause and the surrounding circumstances. Buyers, sellers, borrowers, and lenders alike should have their counsel review current MAC clauses and take special care in negotiating future MAC clauses.

[Click here to go to our COVID-19 Resource Center for more advisories, articles and other content related to the coronavirus pandemic.](#)

¹ *In Re IBP, Inc., Shareholders Litigation*, 789 A.2d 14 (Del. Ch. 2001).

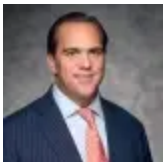
² *Id.*

³ *Akorn, Inc. v. Fresenius Kabi AG*, 2018 WL 4719347 (Del. Ch. Oct. 1, 2018).

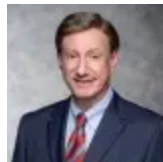
⁴ *Pan Am Corp. v. Delta Air Lines, Inc.*, 175 B.R. 438 (S.D.N.Y. 1994).

⁵ *Akorn*.

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