International Corporate Rescue

Published by

Chase Cambria Company (Publishing) Ltd

www.chasecambria.com

Centre for Commercial Law

Published by:
Chase Cambria Company (Publishing) Ltd
4 Winifred Close
Barnet, Arkley
Hertfordshire EN5 3LR
United Kingdom

www.chasecambria.com

Annual Subscriptions:
Subscription prices 2017 (6 issues)
Print or electronic access:
EUR 730.00 / USD 890.00 / GBP 520.00
VAT will be charged on online subscriptions.
For ‘electronic and print’ prices or prices for single issues, please contact our sales department at:
+ 44 (0) 207 014 3061 / +44 (0) 7977 003627 or sales@chasecambria.com

International Corporate Rescue is published bimonthly.

ISSN: 1572-4638

© 2020 Chase Cambria Company (Publishing) Ltd

All rights reserved. No part of this publication may be reproduced, stored in a retrieval system, or transmitted in any form or by any means, mechanical, photocopying, recording or otherwise, without prior permission of the publishers.

Permission to photocopy must be obtained from the copyright owner.
Please apply to: permissions@chasecambria.com

The information and opinions provided on the contents of the journal was prepared by the author/s and not necessarily represent those of the members of the Editorial Board or of Chase Cambria Company (Publishing) Ltd. Any error or omission is exclusively attributable to the author/s. The content provided is for general purposes only and should neither be considered legal, financial and/or economic advice or opinion nor an offer to sell, or a solicitation of an offer to buy the securities or instruments mentioned or described herein. Neither the Editorial Board nor Chase Cambria Company (Publishing) Ltd are responsible for investment decisions made on the basis of any such published information. The Editorial Board and Chase Cambria Company (Publishing) Ltd specifically disclaims any liability as to information contained in the journal.

ARTICLE

Return of the MAC: The English Courts' Approach to Material Adverse Change Clauses

Jeremy Richmond QC, Barrister, and **Liisa Lahti**, Barrister, Quadrant Chambers, London, UK

Synopsis

In light of the significant business downturn occasioned by the COVID-19 pandemic, we anticipate that the meaning and effect of 'Material Adverse Change' or 'MAC' clauses will be of critical potential importance to all businesses reliant on debt financing, and the professionals who advise them.

MAC clauses are commonplace in loan facility agreements and are provided for in substantially all loan facilities on the Loan Market Association standard forms (save for certain investment grade debt). MAC clauses are also found in business acquisition agreements (most typically, in the UK at least, in public acquisitions) and other more general contracts (such as long-term supply agreements in the commodities context). In the interests of brevity we only consider in this article the paradigmatic case of MAC clauses in loan facility agreements. However, the principles applicable to the consideration of MAC clauses in loan facility agreements will have general application to MAC clauses in other business contexts.

Where are MAC clauses typically found?

While their meaning and effect obviously turn on their precise terms, MAC clauses are often found in the following instances:

- as 'event of default' clauses that provide that in the event of a generally unforeseeable event that materially effects the borrower, the lender will have the option to accelerate the debt due or to place a stop on drawdowns;
- as part of a borrower's representations and warranties to the lender either between the signing of the loan facility and first drawdown, or before each drawdown e.g. there has been no material adverse change in the financial condition of the borrower since the most recent borrower's audited financial accounts provided to the lender; and
- as an important qualifier to certain covenants, representations or warranties provided by the borrower to the lender (e.g. the borrower is not in breach of any covenants where such breach would give rise to a Material Adverse change in the borrower's business).

Guidance from the Court

The leading English case on the interpretation of MAC clauses is *Grupo Hotelero Urvasco SA v Carey Value Added SL* [2013] EWHC 1039 (Comm).

The case concerned the financing of a hotel in London by a Spanish fund that invested in hotels (Carey). Grupo Hotelero Urvasco (GHU) was involved in developing the hotel and had entered into a loan agreement with Carey in 2007. The agreement contained a 'plain vanilla' MAC clause pursuant to which GHU represented that there had been 'no material adverse change in its financial condition'. The representation was made and repeated at specified times. Carey ceased lending in 2008 after it become concerned about GHU's financial position given the decline in the Spanish economy due to the collapse of the Spanish property bubble. Work on the hotel development stopped and GHU claimed damages for breach of contract. Carey argued that it was entitled to refuse drawdown because a MAC to GHU's financial position had taken place.

Though the interpretation of the MAC clause turned on the specific wording of the clause in question Blair J's judgment in *Carey* provides some helpful guidance as to the approach a Court is likely to take (see [334-364] of the Judgment). In particular:

1. If the MAC clause requires a change in the 'financial condition' of the borrowing company that condition will be assessed *primarily* by reference to the company's financial information (interim financial reports and/or management accounts), though other information relevant to the company's financial condition can be taken into account (such as missed debt payments in *Carey*). If the clause in question refers to the '*business* and financial condition' it is likely that a wider range of matters can be considered.
2. Evidence of 'external economic or market changes' (e.g. the collapse of the Spanish property bubble in *Carey*) will not generally be sufficient to trigger a

MAC clause. This is because the individual borrower may perform better or worse than the sector in question. However it is worth noting that evidence of external economic or market changes may be more relevant and persuasive in the context of the COVID-19 pandemic than it was in the context of the collapse of the Spanish property bubble. This is because the strict lockdowns imposed across the world have meant that certain sectors have simply been unable to trade at all such that questions about a company's ability to perform better or worse than others in the same sector do not arise in the same way.

3. There must be a change. Therefore a lender cannot rely on circumstances that it was aware of when the agreement was entered into unless 'conditions worsen in a way that makes them materially different in nature'. This is most relevant to contracts entered into after the pandemic was under way.
4. The change must be 'material'. It must affect 'the borrower's ability to perform its obligations, in particular its ability to repay the loan'. Further it must 'significantly' affect that ability because otherwise 'a lender may be in a position to suspend lending and/or call a default at a time when the borrower's financial condition does not fully justify it, thereby propelling it towards insolvency' and the impact must not be temporary (even if the event causing the impact is).
5. The burden of proof is on the lender (or party seeking to rely on the MAC clause). The importance of the quality of evidence required was emphasised in *Decura IM Investments LLP v UBS AG London Branch* [2015] EWHC 171 (Comm).

Key considerations when interpreting/drafting a MAC clause

Given the above, the key considerations when interpreting an existing MAC clause or drafting a new one include:

1. Scope of the clause: What needs to have changed? Is it only a change in a company's *financial* condition that will suffice or are other matters taken into account? There is a wide range of possible wording from clauses that allow a range of generally defined matters to be taken into account (finances, business, prospects and property for example) to clauses which are triggered on the occurrence of a specific narrowly defined event (a particular change in the company's accounts or a downgrading of its credit rating for example).
2. Timing: Does the clause require the material change to have occurred or is it enough to point to an event that has occurred and a change that is likely to (or may) occur. If the latter, what is the standard that is to be reached?
3. Whose assessment: Is the lender's subjective assessment enough or is the position to be determined by some objective criteria, and if so, what? On appeal from a decision of the British Virgin Islands Court of Appeal, the Privy Council in *Cukurova Finance International Ltd v Alfa Telecom Turkey Ltd* [2016] A.C. 293 considered a MAC clause in a facility agreement that provided 'Any event or circumstance which in the opinion of [the lender] has had or is reasonably likely to have a material adverse effect on the financial condition, assets or business of [the borrower].' It was common ground between the parties that the MAC clause only required the lender to believe that the MAC clause engaged and that such belief had to be both honest and rational. The Privy Council considered that the lender would have to convince the Court by admissible evidence that it had in fact formed the requisite opinion and that such opinion was honest and rational. See also *Torre Asset Funding Ltd v Royal Bank of Scotland Plc* [2013] EWHC 2670 (Ch) where the MAC clause was conditioned on 'the reasonable opinion of the [agent for certain lenders]' with the effect that the MAC clause was not triggered even though another event of default relating to the borrower's finances was.

Wider clauses are usually considered 'lender friendly' (and outside of the lending context friendly to the party entitled to trigger the clause if the relevant change occurs in its counterparty's finances). However it is worth bearing in mind that the interpretation and application of a clause drafted in wide and general (sometimes even intentionally vague) terms is inherently more unpredictable than a clause referring to a specific, narrowly defined event or events. Some lenders may prefer certainty especially given the risk of becoming liable to the borrower for a repudiatory breach of contract if a MAC clause is triggered when no material change has occurred. This could prove costly especially if the financing in question is central to the borrower's business (such that without it the borrower would become insolvent) or a particularly lucrative business venture.

In addition to the above matters, when drafting a MAC clause it is also important to consider practical matters such as what documents are likely to be required in assessing whether a MAC has taken place. As set out above the burden of proving a MAC is on the lender but the borrower will likely hold the most relevant information about its finances (and, if relevant, business prospects, property etc.). A lender may therefore wish to include express contractual obligations on the borrower to e.g. hand over relevant information periodically or when prompted to do so.

When drafting a clause it is also crucial to consider what the MAC clause is intended to achieve. Some MAC

© 2020 Chase Cambria Publishing

clauses can simply be relied on to trigger an event of default. Others allow for a wider range of outcomes and can be relied on to trigger an obligation to provide further security for example. There is a range of possibilities. It should not be assumed that a lender will always wish to call an event of default. In the current unusual circumstances where entire sectors of the economy are under threat a lender may reasonably take the view that it would be better to allow a borrower to try and (eventually) 'trade out' of a dire financial situation with the hope of keeping that company (or sector) as a client in the future. But such a lender may still wish to rely on the MAC clause to trigger further security or other similar protection in the event of a material change in the borrower's finances or business.

Conclusion

The meaning of each MAC clause will obviously turn on its wording. While perhaps the conventional reading of *Carey* is that a downturn in general or sectoral market conditions would not *generally* be sufficient to trigger a MAC clause, it may be arguable that the effects of the COVID-19 pandemic raise such widespread and novel circumstances that the English Courts will take a more expansive approach.

© 2020 Chase Cambria Publishing

International Corporate Rescue

International Corporate Rescue addresses the most relevant issues in the topical area of insolvency and corporate rescue law and practice. The journal encompasses within its scope banking and financial services, company and insolvency law from an international perspective. It is broad enough to cover industry perspectives, yet specialised enough to provide in-depth analysis to practitioners facing these issues on a day-to-day basis. The coverage and analysis published in the journal is truly international and reaches the key jurisdictions where there is corporate rescue activity within core regions of North and South America, UK, Europe Austral Asia and Asia.

Alongside its regular features – Editorial, US Corner, Economists' Outlook and Case Review Section – each issue of *International Corporate Rescue* brings superbly authoritative articles on the most pertinent international business issues written by the leading experts in the field.

International Corporate Rescue has been relied on by practitioners and lawyers throughout the world and is designed to help:

- Better understanding of the practical implications of insolvency and business failure – and the risk of operating in certain markets.
- Keeping the reader up to date with relevant developments in international business and trade, legislation, regulation and litigation.
- Identify and assess potential problems and avoid costly mistakes.

Editor-in-Chief: Mark Fennessy, Proskauer Rose LLP, London

Emanuella Agostinelli, Curtis, Mallet-Prevost, Colt & Mosle LLP, Milan; Scott Atkins, Norton Rose Fulbright, Sydney; James Bennett, KPMG, London; Prof. Ashley Braganza, Brunel University London, Uxbridge; Dan Butters, Deloitte, London; Geoff Carton-Kelly, FRP Advisory, London; Gillian Carty, Shepherd and Wedderburn, Edinburgh; Charlotte Cooke, South Square, London; Katharina Crinson, Freshfields Bruckhaus Deringer, London; Hon. Robert D. Drain, United States Bankruptcy Court, Southern District of New York; Simon Edel, EY, London; Matthew Kersey, Russell McVeagh, Auckland; Prof. Ioannis Kokkoris, Queen Mary, University of London; Professor John Lowry, University College London, London; Neil Lupton, Walkers, Cayman Islands; Nigel Meeson QC, Conyers Dill Pearson, Hong Kong; Professor Riz Mokal, South Square, London; Mathew Newman, Ogier, Guernsey; John O'Driscoll, Walkers, London; Karen O'Flynn, Clayton Utz, Sydney; Professor Rodrigo Olivares-Caminal, Queen Mary, University of London; Christian Pilkington, White & Case LLP, London; Susan Prevezer QC, Quinn Emanuel Urquhart Oliver & Hedges LLP, London; Professor Arad Reisberg, Brunel University, London; Jeremy Richmond QC, Quadrant Chambers, London; Daniel Schwarzmann, PricewaterhouseCoopers, London; The Hon. Mr Justice Richard Snowden, Royal Courts of Justice, London; Anker Sørensen, De Gaulle Fleurance & Associés, Paris; Kathleen Stephansen, New York; Dr Artur Swierczok, CMS Hasche Sigle, Frankfurt; Meiyen Tan, Oon & Bazul, Singapore; Stephen Taylor, Isonomy Limited, London; Richard Tett, Freshfields Bruckhaus Deringer, London; The Hon. Mr Justice William Trower QC, Royal Courts of Justice, London; Mahesh Uttamchandani, The World Bank, Washington, DC; Robert van Galen, NautaDutilh, Amsterdam; Miguel Virgós, Uría & Menéndez, Madrid; L. Viswanathan, Cyril Amarchand Mangaldas, New Delhi; Prof. em. Bob Wessels, University of Leiden, Leiden, the Netherlands; Maja Zerjal, Proskauer Rose, New York; Dr Haizheng Zhang, Beijing Foreign Studies University, Beijing.

For more information about *International Corporate Rescue*, please visit www.chasecambria.com