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MAC conditions in a COVID world
Where to from here?

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'Material adverse change/event', or MAC, conditions have found their ways into numerous M&A deals over the years. The rationale for a MAC condition is clear—that is, to protect purchasers against having to proceed with an acquisition where the value of the target business is no longer what it was prepared to pay for.

The Big MAC—what are the ingredients?

MAC conditions are especially common in deals involving long periods between signing and completion. For instance, a MAC condition is often included as a part of a takeover by scheme of arrangement or a transaction requiring regulatory consent, because the timing for implementation of those deals are out of the parties' hands. It is defendable because the purchaser should not be the only party that bears the risk of an unforeseen event that destroys the value of the target business between signing and completion of a transaction.

MAC conditions are a creation of contract. If the purchaser requires such a condition to form part of the deal, the transacting parties will negotiate its inclusion to strike an appropriate balance between enabling a party to walk away from a deal (in the case of the purchaser), and delivering deal certainty (in the case of the vendor).

Well-drafted MAC conditions also take into account the specific circumstances of the deal and the parties involved. Generally speaking, negotiated MAC conditions in New Zealand tend to be fairly balanced and clearly written. For example, such conditions can be expected to:

- refer to a specific financial hurdle for assessing whether a MAC event has occurred (such as reduction of the net asset value or earnings of the target business);
- require the party invoking the condition (most likely the purchaser) to act reasonably in making its assessment that a MAC event has occurred;
- only capture events that are not, nor would be, remedied prior to completion of the transaction; and
- exclude from MAC events any changes in law or accounting principles (including their interpretation), general change to economic, market or political conditions, and at times, matters that the purchaser is aware of prior to its entry into the transaction documentation (which would be specific to the target business).

Vendors are generally reluctant to accept a MAC condition, and should be particularly wary of such a condition now due to the recent market events caused by the COVID-19 pandemic. We have seen a number of public takeover transactions terminated for failure of the MAC condition, and private M&A deals have not been immune from this either. It will take some time for the market to forget about the carnage that has been caused.

So where does this leave MAC conditions—both in terms of deals that have been signed and awaiting completion, and for new deals in the pipeline?

MAC for deals pending completion

> If a MAC condition has not been negotiated properly, purchasers are likely to find themselves in an uphill struggle to rely on the condition.

Where the clause has not been drafted with sufficient specificity, the nature of the target business could become a relevant factor, as would be the question of whether it was foreseeable that the risk of a MAC-like event was accepted by the purchaser. For instance, if the nature of the target business is known to be cyclical and the current economic downturn happens to track the revenues and profitability trends of the target business, purchasers will find it harder to convince vendors that a MAC event has occurred.

Conversely, where the parties have invested the right level of resources and thinking into their MAC condition, with clear frameworks around what events do and do not constitute a MAC, they could find an easier way to terminate the affected transaction. In some cases, as we have seen, purchasers may decide to use the occurrence of a MAC event as an opportunity to re-negotiate the terms of the deal.

If there is no MAC condition in a signed transaction document, the parties will almost certainly have a contractual obligation to proceed to completion of an unconditional signed deal. The legal doctrine of frustration is unlikely to come to your rescue as that is a high threshold to meet.

MAC for deals in the pipeline

> If a MAC condition was not contemplated prior to COVID-19, purchasers are more likely to seek it now.

In that situation, Vendors would seek to limit purchasers' ability to cancel a transaction where a MAC event arises from pandemics such as COVID-19. They may also attempt to seek express comfort that purchasers have accepted these types of risks before the deal is struck.

Further, we could see vendors demanding payment of non-refundable deposits or "break fees" by purchasers to provide themselves with some financial protection against a MAC condition being invoked by purchasers. Purchasers, of course, are likely to resist such demands.

Where does this leave MAC conditions and what else could unfold?

> For as long as the memories of COVID-19 remain raw, we expect greater specificity to be included in future MAC clauses to limit their scope of potential application.

A COVID-20 outbreak (or whatever is the name of that future outbreak) would create further uncertainty for deals and undermine confidence in our markets. MAC conditions will attract and demand greater levels of scrutiny as transacting parties try to understand what the new market "standard" is, during a time when our understanding of the "normal" is severely challenged.

What could vendors look for?

We expect vendors to look for creative solutions to obtain comfort that purchasers have accepted the risk of pandemics and similar events on a deal, if those events cannot be excluded from the definition of a MAC. As noted above, payment of non-refundable deposits or "break fees" could become more prevalent to dis-incentivise purchasers from invoking MAC conditions to walk away from deals. All of these approaches will be resisted by purchasers, which could ultimately slow down our efforts to re-invigorate the economy.

How could purchasers respond?

From a purchaser's perspective, if a MAC condition cannot be included for whatever reason, it would be useful to make the deal conditional upon the purchaser obtaining satisfactory finance from its chosen lender (if this is indeed the approach the purchaser requires to fund the purchase price). This is because MAC conditions are fairly standard terms in any financing arrangements and the bank may interpret such conditions widely. This would certainly provide a degree of scope to blame the bank when walking away from a deal, rather than relying on a MAC condition. However, care needs to be taken when drafting a finance condition, and again, most vendors would seek to have such a condition struck out.

But I want my value meal now, thanks

A way through all this uncertainty is to shorten the period between signing and completion of an M&A transaction, to the extent that a MAC condition is no longer commercially required. Deals involving regulatory consents or processes, such as takeovers by scheme of arrangement, would not be able to benefit from this approach, but more flexibility would be available for mid-market private M&A deals that are not as constrained as to timing. Whether transacting parties would be willing to facilitate this type of approach to deal making remains to be seen, but that could be a way forward if MAC conditions become too difficult to agree.

If you would like to further discuss your options for drafting and negotiating MAC conditions, with either a negotiated M&A deal or one still to be negotiated, please get in touch with one of our experts, or your usual Dentons Kensington Swan relationship contact.

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