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Memorandum

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COVID-19 AND THE LAW: MAC/MAE Clauses in New York Credit Agreements

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With the COVID-19 pandemic continuing to adversely impact businesses across the globe, for the past year lenders have been reviewing their portfolios for credit degradation. Credit agreements will often contain a clause in which further lending obligations cease upon the occurrence of a "Material Adverse Change" (MAC) or a "Material Adverse Effect" (MAE). In a few cases, clauses will expressly exclude pandemics from the definition of MAC or MAE. More typically, however, such clauses will define an MAC or MAE broadly to encompass *any* negative change to the borrower's business, operations, balance sheet or financial condition.

Does the 2020-2021 coronavirus pandemic qualify as an MAC/MAE? Research to date has uncovered no COVID-specific case law on this particular subject, and it will likely be years before the courts definitively address the question. Under existing New York law, an MAC or MAE occurs when post-signing events "substantially threaten the overall earnings potential of the [party] in a durationally-significant manner. A short-term hiccup in earnings should not suffice".[i] For many borrowers, it would seem, that threshold has already been met.

Nevertheless, in order to avoid a breach of contract claim, before invoking an MAC or MAE clause, a lender should carefully review the specific language of its credit agreement. That lesson was made clear in *In re Lyondell Chem. Co.*[ii] In that case, a lender invoked a MAC clause in refusing to fund a request for a $750 million loan draw, just days before the borrower filed for bankruptcy.[iii] The Court held the lender to have breached the parties' revolving credit agreement, which did not expressly list borrower insolvency as a material adverse change. As the Court explained: "MAC clauses ... are subject to the same rules of interpretation as any other contract provision. Under New York law, '[t]he fundamental, neutral precept of contract interpretation is that agreements are construed in accord with the parties' intent' [and] '[t]he best evidence of that intent is the parties' writing."[iv]

The current pandemic, and the related government shutdown orders, are having such a great and unanticipated impact on so many businesses that it is hard to imagine parties *not* intending for an event of such magnitude to constitute an MAC or MAE. Case law after 9/11, the only other tragedy of similar scope in recent memory, offers some confirmation for this supposition.

In one such case, a New York state court discussed whether declining rental prices in Lower Manhattan in the wake of the September 11, 2001 terror attacks would have constituted a material adverse change.[v] While not reaching the ultimate issue, the Court found it "questionable" that the lender had repudiated the parties' credit agreement by invoking the MAC provision to withdraw funding. As the Court noted, the lender had "a right ... to declare a Material Adverse Change .... [g]iven that there were several appraisals indicating that the value of [the project] had decreased materially in the wake of 9/11".[vi]

One can expect courts to eventually make similar findings in cases to come.That said, one should also expect outcomes to be highly fact-dependent, based on contract language and borrower condition.

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[i] *In re IBP, Inc. Shareholders Litig.*, 789 A.2d 14, 68 (Del. Ch. 2001) (applying New York law).
[ii] 567 B.R. 55 (Bankr. S.D.N.Y. 2017), *aff'd*, 585 B.R. 41 (S.D.N.Y. 2018).
[iii] *Id.* at 85.
[iv] *Id.* at 122 (citations omitted).
[v] *River Terrace Assocs., LLC v. Bank of N.Y.*, 10 Misc.3d 1052(A) (Sup. Ct., N.Y. Cnty.), *aff'd*, 23 A.D.3d 308 (1st Dep't 2005).
[vi] *Id.* at 6.