

June 2021

MAC Clauses – are they required in commodity contracts?

*Travelport Limited v WEX Inc*¹ is the first reported decision of a material adverse event clause triggered by the COVID pandemic. With the major downturn in international business following the pandemic, parties have turned their attention to material adverse change ("MAC") or material adverse event ("MAE") clauses to terminate problematic agreements.

Traditionally MAC/MAE clauses have been found in financing agreements, but they are also used extensively in SPAs for assets and businesses (as in *Travelport*) and are attractive clauses where there is a time lag between the agreement itself and completion. They also appear in particular long-term commodity contracts, most likely at the request of the financial institutions supporting the trades, although many spot commodity contracts also now include a form of a MAC/MAE clause. The question then posed by those dealing with commodity contracts is whether MAC/MAE clauses are really required, and if they are, should they come with a "handle with care!" health-warning?

Interpretation of MAC/MAE clauses

MAC/MAE clauses come in different forms. In *Travelport* the MAE was complex. It was taken from a US law precedent and contained (a) the definition of an MAE, (b) a "carve-out" to that definition which, if applicable, excluded reliance on the clause, and (c) an exception to the carve-out which, if applicable, brought the clause back into play. While the usual position is for the burden of proof to rest with the party seeking to rely on the clause, in *Travelport* the clause was more complex. There, the buyer was relying on the MAC/MAE clause, the seller then had the burden of proving that the relevant event fell within the carve-out to a defined MAE, following which the buyer (who was relying on the MAE clause) had the burden of proving that the carve-out

exception applied. Clarity in the drafting is a key element as we shall see.

Nothing prevents the parties from creating their own definition of what constitutes a MAC/MAE. An example from the commodity market is the Standard Coal Trading Agreement ("SCoTA") which defines the MAC but provides (in the SCoTA Master Agreement) the ability of parties to elect an amendment to that definition through a "Definition Replacement" and any "Additional Events" from a selection of four options.

Although each MAC/MAE clause must be looked at individually, *Travelport* and an earlier decision of *Grupo Hotelro Urvasco SA v Carey Value Added S*,² together provide useful commentary on the principles of interpretation of MAC/MAE clauses:

- 1 The burden of proving a MAC/MAE is on the party relying upon the clause and identifying the party can be straightforward in the simpler MAC/MAE clauses. In a financing document it would invariably be the lender. In SCoTA it is the party relying upon the clause looking to terminate the agreement. In *Travelport*, where the clause was complex, it was the buyer (seeking to rely upon the original MAC/MAE definition, but also the carve-out exception in order to rely on the MAE clause).
- 2 The normal rules of interpretation of contract apply and there is no special principle of contractual interpretation such as the *contra proferentem* rule.
- 3 What is the precise wording of the clause?
 - 3.1 What is meant by "material", "adverse", "change" or "effect"?
 - 3.2 On whom does the burden lie?

¹ [2020] EWHC 2670.

² [2013] EWHC 1039.

- 3.3 How are those comparators and qualifications that need to be satisfied as part of the MAC/MAE defined and how is this to be assessed?
- 3.4 Over what period is the alleged MAC/MAE to have occurred and what evidence is required to prove it?
- 3.5 What is the decision making process and what does the MAC/MAE clause require a party to do before any rights triggered by a MAC/MAE clause can be exercised? This depends on the wording of the clause, which may introduce an element of discretion and decision-making.

For example, SCoTA only permits reliance on the clause where there is *"a material adverse change ... so that in the reasonable opinion of the other Party (exercising good faith) the ability of the Party ... to perform its obligations ... becomes materially impaired"*. Care is required as this MAC/MAE clause introduces requirements of *"discretion"* and *"good faith"* as part of the decision making process before a party can rely upon it. See also *Torre Asset Funding Ltd v Royal Bank of Scotland*³ and *Cukurova Finance International v Alfa Telecom Turkey*.⁴

The risk is always that if a party wrongfully terminates a contract relying on a MAC/MAE clause then unless otherwise provided for in the agreement, that party could be treated as in repudiatory breach of contract and be liable in damages to its counterparty.

So are MAC/MAE clauses necessary in commodity contracts?

We think not. The importance of a MAC/MAE clause in a contract to sell or buy a commodity with a market value is somewhat less than in pure financial and derivative contracts, and in cases like *Travelport*, which involved a large financial commitment to purchase a large illiquid asset such as a business, for the following reasons:

- Whilst there are material changes or events that meet the definition in a MAC/MAE and affect a buyer or seller's financial status, they may not adversely affect the ability of either party to perform the contract in terms of delivering and taking delivery of the commodity.
- Although the commodity's market value may change, that is an inherent market risk and not

a ground to rely upon a MAC/MAE clause. The position may be different if a buyer was obligated to make a pre-payment to a seller and where such a "change" or "event" would affect the ability of a seller to repay the pre-payment and/or produce and deliver the commodity against which the pre-payment was made. In short, it is not the status of business which necessarily counts, but the ability to deliver and take delivery and pay for the commodity.

- Using a MAC/MAE clause in addressing problems under a commodity contract is like using a sledgehammer to crack a nut. The issues faced are questions of failing to deliver/take delivery, quality, force majeure, price and payment, and rejection. All these issues are frequently addressed by the common law or Sale of Goods Act 1979. Questions of payment are addressed by an action for damages, and/or a claim on the price.
- Perhaps most significantly, where questions of insolvency of a seller or buyer are concerned, while insolvency itself is not a ground for treating a counterparty as being in repudiatory breach of a contract (unless of course the contract provides otherwise), the impact of an insolvency may permit a seller or buyer to exercise remedies; failure by a buyer to open a letter of credit may be treated as a repudiatory breach, for example.
- Insolvency of the buyer can also be addressed via the statutory remedies under the Sale of Goods Act 1979 (i.e. stoppage in transit, lien on goods, right of resale). There is the fact that an unpaid seller may still be the lawful holder of the bill of lading and entitled to constructive possession of a cargo not yet delivered and discharged or, if discharged, discharged and delivered to the wrong party.
- The contract may provide for other remedies where a seller or buyer is in default of contract, including a MAC/MAE if so defined. This may include the right to suspend deliveries or to take delivery.

³ [2013] EWHC 2670.

⁴ [2016] AC 293.

Finally, a cautionary note. A buyer wishing to rely upon a MAC/MAE clause but where the commodity can still be delivered or delivery taken needs to consider whether doing so causes more of an impediment to performance than would otherwise be the case.

Contact us



Peter Bennett

Partner, London

T: +44 20 7809 2665

E: peter.bennett@shlegal.com