WINSTON & STRAWN LLP

CLIENT ALERT

Is the MAC clause now showing its pearly whites?

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Outside of an insolvency, when would an airline actually be in a position where it ceases to carry out all or a substantial part of its business? When is it likely that a lender will really be able to trigger a material adverse change clause in a loan agreement? These are some of the issues that airlines are currently having to deal with as a result of the catastrophic impact that COVID-19 has had on their cash flow and revenue.

Many airlines are now operating a skeleton fleet, with the majority, if not all, of their fleet grounded. World travel has dried up as quarantine and travel restrictions have been put in place, and where a cessation of business event of default has been included in lease or loan documentation, airlines will be seeking to have these defaults waived.

Financial covenants under loan documents may also be negatively impacted. Whilst it may be too soon for the reporting requirements to have taken into account the full effects of COVID-19 at this stage, as the pandemic becomes further prolonged, lack of earnings will impact upon these covenants giving rise to further breaches.

Material adverse change defaults may also come under challenge. English court judgments on MAC clauses are few and far between and lenders have always been very reticent to call on such events of default – the risk of getting it wrong is too great, potentially leading to both reputational harm and financial losses stemming from any wrongful termination. The burden is thus on the lender, reflecting the court's expectation that parties should perform contracts where the commercial risks are understood by the sophisticated parties entering into such contracts. But why should pandemic risk fall to a creditor?

MAC clauses can be heavily negotiated and so what may constitute a material adverse change will vary greatly between credit agreements. The LMA definition refers to a material adverse change in the "*business, operations, property, condition or prospects of the borrower*" or "*on the ability of the borrower to perform its obligations under the [finance documents]*".

Guidance that we do have from the courts indicates that materiality is key. The material adverse change must be "significant" or "substantial" and must not be temporary in nature. The impact of COVID-19 on a borrower may indeed be significant, but is it only temporary in nature? At this stage, it is unknown as to how long the pandemic will continue, and for how long the effects of the pandemic will be felt.

In addition, the party seeking to call on the MAC clause will need to provide evidence of the adverse effect on their counterparty which goes beyond general or market changes. COVID-19 may constitute an external event that could have significant impact on the economic outlook of companies generally, but its impact on each individual company may be different and may not constitute a material adverse change for that company. Any specific evidence may need to focus on the particular company, the jurisdictions that the airline's aircraft travel to / from / within, the timing of relevant government measures and restrictions on travel in such jurisdictions, the duration of such restrictions, the financial impact on the airline and the mitigating steps which have been taken (or could have been taken) by the airline in response to COVID-19 developments.

Whether or not a creditor would be successful in arguing a MAC as a result of COVID-19 therefore remains to be seen, and will largely depend upon the facts of the particular case and the ability of the borrower to meet its relevant obligations under the credit agreement. In the meantime, it is clear that lessors and lenders are being asked for lenience in the current economic climate, with rent and debt holidays or reductions top of the agenda for discussion with the airlines. The MAC clause may be a discussion for another day.

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