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Coronavirus Disease (COVID-19) – Financing and M&A Agreements in Poland

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The Coronavirus Disease (COVID-19) outbreak is sending shockwaves across the world and starting to have ripple effects on companies and financial markets. Supply chain disruptions are touching businesses all over the globe and public fear and travel restrictions are stopping consumers from spending. Many companies have started to warn markets about the negative impact the COVID-19 pandemic will have on their results and financial condition. In this situation, parties to financing or M&A agreements are forced to consider material adverse effect clauses (MAEs). However, MAEs are not the only legal remedies aimed at addressing such extraordinary circumstances. In addition to the terms of the contract, the Polish legal system recognizes doctrines of *rebus sic stantibus* and *force majeure*, which may be applicable as well, as outlined briefly below.

MAE Principles

In brief, MAEs can be considered as playing one of several roles in typical financing or M&A agreements in Poland. In financing transactions, MAE clauses typically are used as default triggers where occurrence of an MAE affecting the borrower can give lenders the right to stop funding or accelerate outstanding loans. Lenders may benefit from a similar concept (usually labelled a disruption event) which exonerates lenders' funding defaults when there is a material disruption to financial markets, which are required to operate for payments to be made, which disruption is not caused by, and is beyond the control of, any of the parties to the loan agreement. In M&A, MAE clauses have historically been used to allow a buyer not to complete the acquisition, if the target business has been subject to an MAE.

Where included in an agreement, MAEs are heavily negotiated and come in different flavours, but typically they are defined as events that have had, or would reasonably be expected to have, a material adverse effect on the (a) business, operations, property, condition (financial or otherwise) or prospects of the party, (b) the party's ability to perform its obligations under the agreement or (c) the validity or enforceability of, or the effectiveness or ranking of any security granted by the party.

The peculiarity of MAEs lies in the fact that the parties typically do not specify the monetary threshold or other objective criteria that define the material event. Therefore, ultimately it is for the courts to

decide whether there has been an MAE. In Polish reality, this implied deference to courts may be one of the biggest pitfalls of this approach. MAE clauses migrated to Polish contracts from templates used in the United States and England, where the jurisprudence has developed a certain understanding of what an MAE is, although not as bright-line as one might imagine and not yet tested in pandemic scenarios. In general, MAEs encompass events that substantially threaten the overall earnings potential of a party for a significant period of time. The change in question cannot be temporary or transitory.

Is COVID-19 an MAE?

It is a very high standard to meet and U.S. and English courts are reluctant to rule in favour of parties claiming MAEs. As of now, it is difficult to judge the durational impact of COVID-19 and some legal commentators in the United States and the United Kingdom have suggested that the current outbreak would not likely constitute a MAE under a typical MAE clause. However, it is conceivable that extreme and unprecedented measures like border or business closings may have long lasting effects required for an MAE impact on commercial contracts, but it will take some time to have a better sense of whether lending banks would assert COVID-19 business degradation to accelerate repayment of a loan (or whether governments would not take steps to block such moves) or a buyer would seek to avoid completion of a corporate acquisition.

To the best of our knowledge, there have not yet been any MAEs litigated in Poland in the context of a financing or an M&A transaction, and certainly not with a pandemic in the background. How would it play out in Poland in the absence of any meaningful doctrine? It is rather difficult to tell. On one hand, it may be reasonable to assume that parties intend MAEs in Poland to have a similar meaning to the ones from where they have originated (i.e., more of a final tripwire). On the other, Polish courts may lack the foreign experience and expertise, be inclined to layer up with expert witnesses and follow their own path, which does not necessarily have to cross with what the parties intended at the outset.

Most importantly, any application of an MAE is case specific, so the precise phrasing of the particular MAE clause and factual circumstances affecting the party must always be considered. The analysis may be further impacted by governmental and statutory responses like declarations of emergencies and relief bills.

Finally, even though MAEs are frequently included in financing and M&A agreements, they are not often invoked for the reasons described above. A typical agreement will contain multiple other provisions like financial covenants, specific representations as to business and payment defaults, which may get triggered in the time of distress. It may be easier to seek remedies under those clearer and more objective provisions rather than claiming an MAE.

Rebus sic stantibus and *force majeure*

Irrespective of whether you have an MAE clause in your agreement, the doctrines of *rebus sic stantibus* and *force majeure* may affect contractual obligations and should be taken into account by business trying to understand the impact of the COVID-19 outbreak on their agreements.

Rebus sic stantibus is a principle that allows the terms of contracts to be modified in the event of substantial alterations to the conditions and circumstances under which they were first agreed. It may be available if the following conditions are met: (i) there are extraordinary circumstances, (ii) these circumstances have not been foreseen by the parties at the time of contracting, (iii) performance would require undue burden or suffering material losses by a party, and (iv) there is a nexus between

items (i) and (iii). If these conditions are met jointly, the court may, after considering the parties' interest and the rules of social conduct, modify the way the contractual obligations must be performed or the size of the consideration or even terminate the agreement. Contracts often exclude or modify the availability of the *rebus sic stantibus* remedy.

Because MAE clauses are prevalent in financing and sometimes found in M&A agreements, they typically do not have *force majeure* clauses of the type often appearing in various commercial contracts (i.e., giving parties an "out" in extraordinary circumstances). However, the legal doctrine of *force majeure* (not the type of a contractual clause) may be used to limit a performing party's liability. *Force majeure* is not statutorily defined but is understood in Poland as an event which is (i) external to the parties, (ii) unforeseeable, and (iii) unavoidable. Natural disasters, governmental acts, and social unrests are often cited as examples of *force majeure*. In essence, under Polish law a debtor is responsible for a breach of contract, unless the breach results from circumstances for which the debtor is not liable. *Force majeure* can be used to demonstrate that the party obligated to perform is not liable and, therefore, should not be responsible for resulting damages.

Of course, whether *rebus sic stantibus* or *force majeure* doctrines are applicable as a result of the COVID-19 outbreak is a question of specific facts in any given case.

Conclusions

MAE or not, business will be heavily affected by this horrific outbreak. Having a plan how to deal with potential fallout is essential. As briefly mentioned above, in addition to MAEs, there are other MAE-like contractual and statutory principles that may alter how contracts operate during extraordinary events (i.e., *rebus sic stantibus* and *force majeure*). Businesses may want to start thinking about their agreements proactively, consult with their legal counsel, and engage with counterparts accordingly.

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