



COVID-19 PANDEMIC: A GUIDE TO FORCE MAJEURE AND MATERIAL ADVERSE CHANGE CLAUSE UNDER MERGERS AND ACQUISITIONS TRANSACTIONS

By Megha Sharma

From Alliance School of Law, Bengaluru

ABSTRACT

With the deepening crisis of the covid-19 crisis, the economic growth has come to a halt by adversely affecting various sectors in the economy. Globally and India in particular has seen unparalleled recession this year. There has been a consequent shift in the merger and acquisition landscapes. The impact of the pandemic has already started to affect the Mergers and Acquisition activity in India. The companies and businesses are facing problems with regard to the valuation, liquidity, reallocation of resources and most importantly disruption in the supply chains. The author tries to discuss in detail about the force majeure clause and MAC/MAE (market adverse change or market adverse effect) clause which is invoked by either parties to the contract on the non-performance of the contract or failure to carry out the specific performance due to unforeseeable and unavoidable circumstances where stringent lockdowns and restricted social involvement is practiced. The article has also discussed about the guidelines issued by the Finance Ministry regarding the Force majeure clause and how the acquirers, sellers, buyers and investors can invoke the given clauses to protect themselves from incurring losses.

INTRODUCTION

In the recent years it has been observed that mergers and acquisitions has led to the expansion of the business lines to leverage the existing operations of various businesses or venturing into an unexplored chain of businesses.

The outbreak of the novel coronavirus has had a diverse effect on the economic sectors. As the virus continues to spread, it has led to the cancellation and postponement of majority of events worldwide. Businesses in different sectors have suffered multiple cancellations of contracts and other transactional activities. The lockdowns and the restricted social participation in different parts of India and globally has had a severe effect in evaluating potential impact on business prospects. As a repercussion, there has been a disruption in the supply chain of commodities, reduction in the capacity of consumer consumption and liquidity crisis.

There has been seen different impact of the pandemic on different sectors in the economy. The sectors such as aviation, hospitality, and tourism have had an adverse impact on their businesses i.e. they are facing direct impact of the economic crisis. On the other hand the manufacturing; consumer goods had a less severe impact on their businesses. The digital sector has seen a boom at this period as people have resorted to online works.

Due to this outbreak, various companies are struggling for their survival in the market and are facing various economic challenges. The companies and businesses are not only witnessing financial crisis but also human crisis which is essential for making strategic decisions with respect to the mergers and acquisitions. Generally companies make



deals on the basis of the estimated valuation or turnover of the company which in the prevailing situation is difficult to estimate as the businesses are adversely affected.

Significant delays have been observed with regard to taking of the approval from the government authorities or the third party including the lenders and counter contractual parties as departments are not working with its full strength of employees and at times these departments are closed.

There are various challenges faced by the businesses with respect to the cash flows which has led to the decline in the liquidity ratio as banks or the third party are not providing loans to the companies. Moreover companies or the acquirers are observing delays and dropouts at the structuring stage of the acquisition. The due diligence process has undergone a drastic change as the parties are moving to virtual data rooms rather than relying on site visits and physical meetings. In the prevailing situation where the companies are walking away from the acquisition agreements or transactions, it is important to see whether the Covid-19 situation invokes the force majeure clauses or MAC clauses and to have a better understanding of the current jurisprudence of the MAC clauses how these clauses are interpreted by the courts in a case to case basis.

Businesses whose production has come to a halt or their supply chains have collapsed has become an easy target of buying as they are facing a drastic decline in the turnover of the business. Loans preferentially provided by the banks or any assistance provided by the government is of no aid as these businesses are experiencing a sharp fall in the production

capacity thereby weakening their capability of repayment.

Nevertheless at this prevailing situation the businesses, companies, investors and acquirers need to consider various provisions and clauses to make a sound evaluation with respect to mergers and acquisitions transactions. The courts need to interpret certain clauses to make the situation favorable as companies are walking away from the mergers and acquisitions transactions and backing out of deals citing the MAC (material adverse change) clauses due to which adverse impact is faced by many companies and are finding it difficult to survive in the economy.

There is a urgent need of amendments with respect to financing methods, pricing and other material terms and conditions.

WHETHER COVID 19 WOULD TRIGGER FORCE MAJEURE?

To understand the concept of force majeure, it is important to know the literal meaning of the term. The term “force majeure” is a French word which means “greater force”. It is equated with the concept of “act of god” where no party will be held accountable. The concept is neither defined nor dealt with in the Indian statutes but there are some references which can be seen in Section 32 of the Indian Contract Act, 1872.

“Section 32: Enforcement of Contracts contingent on an event happening - Contingent contracts to do or not to do anything if an uncertain future event happens, cannot be enforced by law unless and until that event has happened. If the



event becomes impossible, such contracts become void¹.”

In order to constitute an event to be Force Majeure, it should be unavoidable, unforeseeable and external to the parties of the contract. Force majeure protects the party from any financial liability for its failure to perform a contractual obligation.

LAWS RELATED TO FORCE MAJEURE IN INDIA

The Indian Contract Act 1872 determines the circumstance in which promises in a contract shall be legally binding is silent on the term force majeure. The clause force majeure cannot be implied under Indian law. It must be expressly provided in the contract.

IS COVID 19 A FORCE MAJEURE EVENT?

The Force majeure clause rarely covers an endemic or a pandemic. It is only used for the natural calamities like earthquake and volcanoes.

MINISTRY OF FINANCE in February clarified that disruption in supply chain due to spread of coronavirus qualifies as a force majeure event and companies or businesses can invoke force majeure clause due to their incapacity to fulfil the required agreement².

IMPACT OF FORCE MAJEURE CLAUSE IN THE CONTRACTS

1. **HIGH PROBABILITY OF RESOLUTION:** The parties who have expressly provided the force majeure clause in their contracts will have the opportunity to resolve their conflicts in a quick and easy manner. Either of the parties to a contract will not be held accountable for not executing the performance of the contract as the occurrence of the event is unavoidable and unforeseeable.
2. **MISUSE OF THE FORCE MAJEURE CLAUSE:** There is a chance where various companies and businesses can take advantage of the current situation and misuse the clause of force majeure to escape out of the payment performance.

CONTRACTS WHERE FORCE MAJEURE CLAUSE IS NOT EXPRESSLY PROVIDED BY THE PARTIES.

There are cases where force majeure clauses are not expressly provided or included in the contract, in such circumstances Section 56 of the Indian Contract Act 1872 will come into play.

India unlike other civil law countries like Germany³, United States⁴, France⁵ does not have definition of Force majeure codified in the legislation. The law of force majeure in India is similar to the English laws. Parties have the right to expressly provide the clause of force majeure in the contract and can declare the unforeseeable and unavoidable

¹ Indian Contract Act 1872

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<https://doe.gov.in/sites/default/files/Force%20Majeure%20Clause-%20FMC%20.pdf>

³ See Section 275 (1)-(3) of the German Civil Code § 275 German Civil Code provides that a claim for specific performance of a contractual obligation is excluded, if the performance is impossible for either specifically the contracting party or for everyone. The

obligor may also refuse performance, if the efforts required are objectively seen as unreasonable.

⁴ <https://www.law.cornell.edu/ucc/2/2-615>

⁵ 148. there is no place for any damages when, as a result of a force majeure or an accident, the debtor has been prevented from conveying or doing that to which he was obliged or has done what was forbidden to him.”



events as force majeure required that such events must be specifically covered under the clause. The pandemics or such events can trigger force majeure clause provided, it should be covered under such clause.

SECTION 56 OF INDIAN CONTRACT ACT 1872

Agreement to do impossible act— An agreement to do an act impossible in itself is void. —An agreement to do an act impossible in itself is void." Contract to do act afterwards becoming impossible or unlawful.—A contract to do an act which, after the contract is made, becomes impossible, or, by reason of some event which the promisor could not prevent, unlawful, becomes void when the act becomes impossible or unlawful.¹ —A contract to do an act which, after the contract is made, becomes impossible, or, by reason of some event which the promisor could not prevent, unlawful, becomes void when the act becomes impossible or unlawful.² Compensation for loss through non-performance of act known to be impossible or unlawful.—Where one person has promised to do something which he knew, or, with reasonable diligence, might have known, and which the promisee did not know, to be impossible or unlawful, such promisor must make compensation to such promisee for any loss which such promisee sustains through the non-performance of the promise. — Where one person has promised to do something which he knew, or, with reasonable diligence, might have known, and which the promisee did not know, to be impossible or unlawful, such promisor must make compensation to such promisee for any loss which such promisee sustains through the non-performance of the promise⁶."

Therefore this section has dealt with the frustration of contracts i.e. a situation where fulfilling a contract becomes impossible or unlawful after signing of the contract.

Traditionally the courts have chosen a narrow interpretation of the law in ruling on disputes where section 56 comes in. According to the analyst, it is difficult to prove frustration than proving Force majeure.

Due to increase in number of cases, it will lead to the decline in the economic growth even after the recovery in the situation from Covid.

According to various experts this will not only impact the port sectors but also the other sectors including real estate, cross border trade, EPC (Engineering, procurement and construction) and joint venture as well as mergers and acquisitions deals.

WHETHER COVID GIVES RISE TO MAC (MATERIAL ADVERSE CHANGE) CLAUSES ON MERGERS AND ACQUISITIONS

In order to understand the invocation of MAC/MAE (material adverse effect or material adverse change) in the contract one must know about the MAC clause.

MAC/MAE clauses are the standard elements in acquisition agreements and investments that allow investors or acquirers to walk away from the transaction prior to completion, on the ground that event should have a material adverse effect on the target business or sectors.

Throughout the mergers and acquisition transactions, there lies an associated risk with the buyers and sellers. The invocation of the

⁶ <https://indiankanon.org/doc/648614/>



MAC (material adverse change) clause in the acquisition agreement will allow the purchaser to walk away from the transactions between signing and closing. The English Courts while interpreting the MAC (material adverse change) clauses seeks to reflect the intention of the parties for withdrawing from the offer.

Looking at the current scenario where various domain systems like the government machineries and the businesses are currently experiencing enormous due to the slowdown of the economic growth. India is no different and is facing recession to an unprecedented level.

The MAC clause which has rarely come into the forefront is being invoked by various companies and acquirers in order to prevent them from growing uncertainty.

A study conducted in 2005⁷ stated that MAC clauses are the main cause for the 69% of termination of acquisition agreements and 80% of the agreements got renegotiated. Therefore it is difficult to enforce MAC clauses and the courts need to interpret the clauses consistently as events invoking MAC clauses are differs on the case to case basis.

The **Securities Board of India (Substantial Acquisitions of Shares and Takeovers) Regulations 2011** is the law regulating mergers and acquisitions of listed entities in India.

Regulation 23(c) of the Takeover Code which provides that “if any condition

enumerated under the agreement for acquisition is not met, the agreement is rescinded, provided that the conditions must be fairly disclosed in the detailed public statement and letter of offer and the fulfilment of such conditions must be beyond the reasonable control of an acquirer⁸.”

AT WHAT STAGE THE ACQUIRER CAN INVOKE THE MAC clauses?

The acquirer can invoke the MAC clause at any point of time before the closing of the event. Witnessing the current situation of the pandemic, it is advisable for the acquirers or entities to invoke the clause in the very first instance. The acquirer can use the defence of invoking the MAC clause even if the company has issued the notice of completion of the condition precedents. No judicial guidelines are issued by the government with regard to the MAC clause. The inferences can be made with regard to the guidelines issued where the party can invoke force majeure event⁹.

➤ **Other resorts available to the parties to mergers and acquisition transactions who has signed prior to the closing:**

The parties entering into the agreement can mutually postpone the acquisition or investment to a later date or when the situation is under control or suspend the relevant contract as the situation demands. The transactional clauses can be amended keeping in mind the prospects of the business and can also reconsider valuation on how the

⁷ David J. Denis and Antonio J. Macias, Material Adverse Change Clauses and Acquisition Dynamics, The Journal of Financial and Quantitative Analysis, Vol. 48, No.3 (June 2013)pp.819-847

⁸<https://rmlnlulawreview.com/2020/04/24/interpretin-g-regulation-231c-of-the-takeover-code-applicability->

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eement.



entities are expecting the target to don in the coming year (12 months).

➤ **In case of specific performance where the acquirer seeks termination of the transaction**

In certain cases where the acquirer seeks dispute arising with the invocation of MAC/MAE clauses, the provisions mentioned in the contract should be taken into consideration where specific performance of the acquirer should be looked into where the commitment of the acquirer is stated. It will further depend upon the factual circumstances where specific performance is considered as a relief and the burden of proof will lie on the acquirer that the non-discharging of the specific performance is due to the pandemic invoking MAC/MAE clause.

COVID-19 AS AN EVENT FOR INVOKING MAC/MAE CLAUSE?

The courts will look into the cases with different factual situations having multiple factors such the definition of MAC/MAE clause and the business which is been targeted and decide the matter further. Most importantly the court will look into sectors which have been targeted. For instance the travel and the hospitality have been adversely affected whereas on the other hand, the IT sectors and those providing digital services have seen a boom in the past six months. Therefore the burden of proof will lie on the company who is invoking the MAC/MAE clauses or claiming that covid-19 has prevented the companies from carrying out the specific performances. There might be cases where the parties are entering into a contract in between the pandemic where the parties are aware of the situations and risks associated with it, and then it will be difficult for the parties to prove the incompetency to

perform the contract. Therefore the party walking away from the transaction needs to prove that the non-performance of the contract is due to the pandemic situation. The MAC clauses will be triggered differently in different factual circumstances and hence the matter will be decided further depending on the same.

CONCLUSION

The Covid-19 pandemic has been declared as a force majeure by the Ministry of Finance, therefore either party to the contract can take these resort as a defence if the entities are unable to fulfill their specific performance under a contract. The parties can invoke MAC/MAE clause in the absence of the force majeure clause. In circumstances where the parties has not expressly provided the force majeure and MAC clauses in the contract, they can to resort to Section 56 of the Indian Contract Act 1872 i.e. frustration of contract. Even after the declaration of the covid pandemic to be force majeure it is intriguing to see whether the impact of Covid 19 will trigger the MAC clauses and this determination is difficult at this point as it will change with different factual situations. There has been no judicial guidelines prescribed with respect to the MAC clause but a parallel can be drawn from the inference taken from the force majeure clause which has already been declared by the government with respect to Covid pandemic.

The invocation of the force majeure or MAC clause will depend on the definition or wordings which is defined in the respective contracts and most importantly looking into the business sector which is been affected. The burden of proof will lie on the acquirer/company or the investor to prove that the nonfulfillment of performance has



been hindered due to the Covid pandemic which has triggered the force majeure or MAC clauses. Lastly it is necessary for the business entity or a company to assess their valuation and business sustainability and reduce the impact of Covid 19 in order to fulfill the obligations of the respective contracts.

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