



PROTECTION OF BUSINESS FROM COVID-19 BY THE VACCINE OF MAC AND FORCE MAJEURE CLAUSE: MYTH OR REALITY

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Abstract

COVID 19 started as a health crisis, it has also resulted in shattered economies and societal breakdowns. The rapid increase in corona cases and continuous extension in the lockdown period increases demands for justice, from the employment crisis to potential concerns in liquidity to commercial disputes. There are continuous strains in the Indian justice system and access to justice have become a premium. Given COVID 19 induce anxiety among the masses, the legal response to this time must be rapid to avoid medical pandemic from turning into a humanitarian tragedy. In light of the pandemic, commercial organizations in the sector are having difficulty in fulfilling certain of their contractual obligations.

In the wake of the pandemic, businesses are considering to invoke the force majeure clause or material adverse change clause as a legal option to mitigate the impact of the crisis on their business. In this paper, authors have focused majorly on the effect of the pandemic on the merger and acquisition contracts and further elaborate upon the viability of invoking force majeure or material adverse change clause under the same contract to secure their interest against the financial crisis in the market.

Keywords: Material Adverse Change, Material Adverse Event, Force Majeure, COVID- 19, and economy.

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Introduction

The current outbreak of the coronavirus has not only worsened the public health system but has also disrupted international trade and other commercial activities as the performance of contract has become a Hercules task in this catastrophe.³ When such a situation of non-performance of the contract on part of any of the parties arises, the innocent party in normal circumstances sue the defaulting party for compensation. Under a contract, the defaulting party can invoke force majeure in case of commercial contracts and material adverse change clause under merger and acquisition contract, as a defence if failure to complete the contractual obligation is caused by an event out of human control.

The invocation of these clauses will excuse the defaulting party from any obligation under the contract and the innocent party will not receive any compensation for non-performance of the contract.⁴ However, these circumstances raise a question on the doctrine of rule of law stressing on the idea that when there is a right, there is a remedy available under law to safeguard the same. Thus, it is really important to ensure that the protection of the rights of the innocent party is not doing more harm than good to both the parties.

³ Lora Jones, Daniele Palumbo & David Brown, Coronavirus: A Visual Guide to the Economic Impact, 29th June, 2020, BBC News.

⁴O'Melveny, 'Possible Impact of a Coronavirus Disease (COVID-19) Pandemic on Contractual Obligations' <<https://www.omm.com/resources/alerts-and-publications/alerts/possible-impact-of-covid-19-pandemic-oncontractual-obligations/>> accessed on 17th August 2020.



Material Adverse Change Clause (MAC)

Material Adverse Change clause forms an integral feature in merger and acquisition agreements and the clause exhibits substantial cross-sectional variation in the number of events that are excluded from being Material Adverse Events (MAE). The need for the MAE clause arose between the long duration from the announcement of acquisition to the completion of the whole process of acquisition.

The MAE clause protects the interest of the buyer by configuring them with the right to terminate the acquisition agreement and or abandon the transaction upon the substantial deterioration of the seller's business. There is a high probability that there might be a change in certain events that might have an impact on both that target and acquiring company's shareholders. The MAC clause gives the right to walk away from the acquisition, without penalty, if a material adverse event occurs between the announcement and the completion of the acquisition.

Moreover, MAC clauses ultimately lead to large changes in the price offered to target shareholders. MAC clauses are the underlying causes of 69% of acquisition terminations and 80% of renegotiations.⁵ However, if an MAE occurs between the announcement date and completion date, then only the acquirer company can abandon the contract. Some of the conditions differ from contract to contract. The following are a few kinds of risk outside the control of the seller that buyers should accept as a risk of making an acquisition:

- (a) Changes to general economic or political conditions;
- (b) Changes to conditions generally affecting the seller's industry;
- (c) If publicly traded, changes in the price or trading volume of the seller's securities;
- (d) Changes in geopolitical conditions, such as terrorism, acts of war, sabotage or calamity;
- (e) Natural weather disasters.⁶

⁵David J. Denis and Antonio J. Macias, 'Material Adverse Change Clauses and Acquisition Dynamics' (2013)48 JFQA819, 819-822.

⁶Adams, K. A. 'A Legal-Usage Analysis of 'Material Adverse Change Provisions' (2004) FJCF 9, 10.



Therefore, merger agreements often consist of a contractual mechanism that allows the acquirer party to walk away from the contract between the announcement period and completion of the acquisition in the wake of the MAC clause as enshrined in the contract. Hence, in the authors' opinion MAC clause acts as an abandoned option in the world of corporate mergers.

There are two kinds of views on the invocation of the MAC clause by any party when any of the above-mentioned risks has arrived.⁷ One side has the notion that MACs play an important role in allocating the risks of the acquisition between the targets and acquiring firms. It is a mechanism for efficiently allocating risk that arises from the lengthy period between the signing of an acquisition agreement and the closing of the transaction.

An alternative view however, is that MACs may be difficult to enforce legally as courts had imposed a very high standard on acquirers for claiming that a Material effect event has occurred.⁸ Therefore, it is very necessary to build the MAC clause with proper due diligence as it plays a significant role in allocating the risks of potential mergers between the companies. However, a lot of precedents also do establish that invoking the MAC clause is not a cakewalk, and enforcing them legally certainly comes out as difficult and varies from case to case. It is also pertinent to notice that MACs are the most common risk allocating clause between the shareholders of the targeting and acquirer entity.

In one of the most celebrated cases,⁹ It was observed that there existed a very high standard on the acquiring company at the time of invoking of the MAE clause and if they are difficult to enforce, there is a high probability that the alleged circumstances would not be having an impact on the dynamics of corporate merger or acquisition.¹⁰ Hence, the completion of an agreement related to mergers and acquisitions is directly related to the exclusions followed under the MAE clause.

⁷Gilson, Ronald J. and Schwartz, Alan, 'Understanding Macs: Moral Hazard in Acquisitions' <<https://ssrn.com/abstract=515105> or <http://dx.doi.org/10.2139/ssrn.515105>> accessed on 16th August 2020.

⁸Genesco, Inc. v. The Finish Line, Inc., Dec. 27, 2007, Memorandum and Order, Case No. 07-2137-11(111) (Tenn. Ch. 2007).

⁹Frontier Oil Corporation v. Holly Corporation, C.A. No. 20502 (Del. Ch. Apr. 29, 2005).

¹⁰ David J. Dennis & Antonio J. Macias, 'Material Adverse Change Clauses and Acquisition Dynamics'(2013) JFQA 819, 820.



Invocation of MAE clause in times of pandemic

It has been already established in the earlier parts of the article that the MAC clause in the agreement defines the conditions under which a party can walk out from the agreement in the view of the happening of an MAE. MAEs are firm specific, keeping the dynamics of the market and economy in mind. It has been seen in recent times that MACs are made more restrictive by including very limited conditions and excess of exclusions in MAEs.¹¹ The burning question in the present condition would be whether COVID-19 affects an M&A agreement or commercial contract?

This will depend on the specific language of the clause. Under M&A agreement, for terminating the agreement, the buyer has to show that a long-term and materially negative change to the seller's business.¹² Likewise, a non-performing party seeking to invoke a force majeure clause in a commercial contract must also establish a link or causal connection between the underlying COVID-19 event and the inability to perform its contractual obligation. It is more common in M&A deals for risk allocation related to outside events, such as a hurricane or pandemic, to come by way of the MAE provision as opposed to a force majeure clause.

It is pertinent to note that the application of concept of force majeure under acquisition contracts are generally difficult as it only involves obtaining approvals or clearances from regulators and antitrust authorities and delivering consideration at closing. For instance, the COVID-19 situation is unlikely to make cash unavailable to the buyer, and if the agreement does not include a financing condition, it would become hard for the buyer to prove the financial failure of his or her business. There exists an almost negligible precedent on 'material adverse change' in the view of cases of mergers and acquisitions. The closest Supreme Court of India has reached to material adverse change is in the case of *Nirma Industries Ltd. & Anr. v. SEBI*.¹³

¹¹ Ronald J. Gilson & Alan Schwartz, 'Understanding MACs: Moral Hazard in Acquisitions', (2004) JLEO 330, 330-332.

¹² Adams, K. A. 'A Legal-Usage Analysis of 'Material Adverse Change Provisions' (2004) FJCF 9, 11.

¹³ *Nirma Industries Ltd. & Another v. SEBI*, AIR 2013 SC 2360.



It is well settled that SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 is one of the most important regulation in India which governs the acquisition of shares or control in an Indian listed company. Regulation 23(1) (c) of Securities And Exchange Board of India (substantial acquisition of shares and takeovers) regulations, 2011¹⁴ avail remedy against these unforeseeable events to those target company that is undergoing merger or takeover, that if any condition stipulated in the agreement for acquisition attracting the obligation to make the open offer is not met because of reasons outside the reasonable control of the acquirer, and such agreement is rescinded, they can withdraw the offer for acquiring the shares. This remedy is useful in times of these pandemics where the obligation under the contract cannot be performed due to reason outside the control of the acquirer.

Many corporate entities are facing competing challenges as they continue to conduct business in the time of global pandemic caused by COVID- 19. The crises faced by the body corporate in the form of variable cost structures, digital transformation, and agile operations among many others.¹⁵ The pandemic has caused a massive shock to the world by pushing the corporate deep into the depression wherein the companies are adopting new measures to deal with the same. According to the official statement as released by the World Bank, there will be a shrink of 5.2% in the global economy this year and the economic activities in 2020 are expected to shrink down as demand and supply along with trade and finance are disrupted in the pandemic times.¹⁶ The blow is hard in areas such as global trade, tourism, export, and external financing, and per capita incomes is expected to drop by 3.6% as claimed by the World Bank.¹⁷ Even the financial institutions are required to change the way of operations as there is going to be an increase in Non- Performing Loans (NPLs) and they are expected to recalibrate their risks appetite for low risk assets.¹⁸

¹⁴Securities and Exchange Board of India (Substantial Acquisition Of Shares And Takeovers) Regulations 2001 s 23 (India).

¹⁵Accenture, 'Turn Massive Challenges into Meaningful Change' <<https://www.accenture.com/in-en/about/company/coronavirus-business-economic-impact>> accessed on 24th august, 2020.

¹⁶ The World Bank, 'Per Capita Incomes to Shrink in All Regions'<<https://www.worldbank.org/en/news/press-release/2020/06/08/covid-19-to-plunge-global-economy-into-worst-recession-since-world-war-ii>> accessed on 24th August, 2020.

¹⁷*Ibid.*

¹⁸Rajosik Banerjee, 'Reimagining Risk Management for Financial Institutions in the post COVID- 19 World'<<https://home.kpmg/in/en/home/insights/2020/08/reimagining-risk-management-for-financial-institutions-in-the-post-covid-19-world.html>> accessed on 24th August, 2020.



Therefore, there lies no doubt in predicting the downfall of the global economy at an alarming rate which has an impact on the operations of the business. One of the MAE conditions is of economic downfall but it also varies from the contract that the parties have undersigned.

To look more deeply into it; the international jurisdictions have also been reluctant to find the occurrence of an MAE and thereby allow a buyer to escape its contractual obligations. The Delaware Court of Chancery helpfully described an MAE as an adverse change to the seller that “substantially threatens” the financial potential of the entire seller business in a “durationally significant manner.” The Delaware court observed that a seller’s downturn was durationally significant when it had “already persisted for a full year and showed no sign of abating.”¹⁹

Moreover, it is also pertinent to notice that courts have been flexible in considering the decline of earnings in consecutive quarters for invoking the MAC provision in question²⁰ a case wherein there was a decline of 64% in quarterly earnings did not constitute a reasonable reason for invoking MAC as it did not have durational significance.²¹ Likewise, in Argentina, during a financial crisis, a law was repealed which formed the base of many bilateral investment treaties and as result, dozens of arbitrations were brought against it.²² It is an established fact that invoking of MAC, and having the extraordinary situations coming under the umbrella of agreed MAE is another challenge.

Hence, the other resolution which the corporate bodies have in their favour in the opinion of authors is to invoke the force majeure clause which also forms an important part of the contracts. However, there are certain conditions which shall be met to successfully take advantage of force majeure clause and the same shall be extensively dealt in the next section of the paper.

¹⁹Akorn, Inc. v. Fresenius Kabi AG, C.A., No. 2018-0300-JTL (Del. Ch. October 1, 2018).

²⁰Raskin v. Birmingham Steel Corporation, No. 11365, 1990 WL 193326 (Del. Ch. Dec. 4, 1990).

²¹In re IBP, Inc. Shareholders Litig., 789 A.2d 14, 40 (Del. Ch. 2001).

²² Amin G. Forji, ‘Drawing the Right Lessons from ICSID Jurisprudence on the Doctrine of Necessity’ (2010) 76 Arbitration 44, 47.



Force Majeure Clause

A "force majeure" clause is a provision in a contract allowing parties involved to forfeit their contractual obligations due to unforeseeable circumstances. The party to the contract shall be lifted from responsibilities and obligations of the contract due to an event that was not foreseeable earlier and hence made the performance of the contract impossible; the same is possible with the force majeure clause. These clauses can be invoked in the event which must be beyond the party's control, not foreseeable at the time the contract is signed, and lastly, an event that could not reasonably have been avoided or overcome.²³ Invoking such clause would excuse the party from the contractual obligations. In jurisdictions like U.S. law, the contract liability is strict.

Therefore, the defaulting party is liable to pay damages for breach of contract even if circumstances cannot anticipate. But in several other jurisdictions, the party needs to establish that the event was beyond the imagination of a reasonable man and hence the party chooses to walk away from the contract. Force majeure events in commercial contracts include acts or directives from governmental authorities such as business closures, shelter-in-place orders, quarantines; labor lockouts, disruptions or shortages; and other "Acts of God". But it is extremely difficult to predict the effect and extent of an unforeseen event. Although past human induced disasters like Bhopal Gas Tragedy had devastating local consequences, however the national and international impact of the tragedy or catastrophe was not much.

In a different approach, global failure of the internet from cybercrime or a prolonged power grid in the U.S. would definitely attract a national and international commercial inconvenience.²⁴ According to ICC arbitrators the force majeure defence only in extreme cases such as war, strikes, riots, embargos or other incidents listed under the force majeure clause of the contract.²⁵

²³Mark Augenblick & Alison B. Rousseau, 'Force Majeure in Tumultuous Times: Impracticability as the New Impossibility' (2012) JWIT 13, 13.

²⁴Jennifer M. Smith, Andrew Behrman, 'The Importance of a Strong Force Majeure Clause in an Unstable Geopolitical Environment' (2015)8 JWELB116, 118-119.

²⁵ICC, 'ICC FORCE MAJEURE CLAUSE' <<https://iccwbo.org/content/uploads/sites/3/2020/03/icc-forcemajeure-hardship-clauses-march2020.pdf>> accessed on 26th August, 2020.



There is no universally accepted definition of the requirements to successfully invoke force majeure. Different laws and jurisdictions attract for different approaches to the situation.²⁶ The term 'force majeure' finds no presence under the Indian Contract Act, but the doctrine of 'force majeure' finds its relevance within the ambit of scope. The fundamental spirit of 'force majeure' is enshrined in Section 32 and 56 of the Indian Contract Act.²⁷

'Force majeure' would operate under Section 32 of the Indian Contracts Act on contingency whereas, the impossibility of contract under certain conditions makes the contracts to be void under Section 56 of the Indian Contracts Act.²⁸ The impossibility which is defined under Section 56 of the act of includes impracticability or useless as well, as a change in circumstances in which the contract was earlier entered into upsets the very foundation of the condition in which the contract was entered into between the parties and therefore finds it impossible to do the act which he has promised to do so.²⁹ In the event of an unanticipated change of circumstance which makes the performance of the contract impossible and causes hardship for the same has to be considered in the light of whether such change in circumstance has caused the difficulty.³⁰

Invocation of Force Majeure Clause amid Covid-19

The virus which emerged from the wet markets of China has caused huge destruction to life and the health of people from various nationalities. Apart from human beings lots of business models and their contractual liability has also been affected by the same. The government in the light of the current pandemic has stopped the movement which has resulted in decline and loss of business. Therefore, a lot of business entities have requested to invoke 'force majeure' in such circumstances.

²⁶Chengwei Liu, 'Force Majeure: Perspectives from the CISG, UNIDROIT Principles, PECL and Case Law' <<http://www.cisg.law.pace.edu/cisg/biblio/liu6.html>> accessed on 19th August, 2020.

²⁷ Indian Contracts Act (1852) S 32 & 56.

²⁸Energy Watchdog v. Central Electricity Regulatory Commission, (2017) 14 SCC 80.

²⁹*Ibid.*

³⁰Pameshwari Das Mehra v. Ram Chand Om Prakash, AIR 1952 Punj 34, 38.



A landmark Indian case *M/s Alopi Parshad & Sons Ltd v. Union of India*³¹ reiterated that the Indian Contract Act does not enable the party of a contract to ignore the covenants, or thereof let them claim for consideration of the contract at a different rate than what was agreed upon earlier on the plea of equity on the account of an unexpected events. The unexpected events might constitute of change in prices which was unexpected obstacle to the execution of the contract. However, the court held that temporary hardships cannot be made a ground for invoking the clause of 'force majeure' as the temporary suspension does not constitute penance as to cause frustration.³² Hence, the parties cannot walk away from performing the obligations of the contract merely because the circumstance under which the contract was entered has altered and its performance has become onerous because of reasonably unforeseeable events.³³ In an approach taken by ICC, the court in a case held³⁴ wherein there was a dramatic decrease in petrol prices after the contract was entered between the parties and hence one of the parties claimed to not take the delivery owing to fall of petrol price.

However, the tribunal found that the change in price was a foreseeable event and no exemption can be provided with respect to the liabilities of the contract. To give reasoning to the above case, Yves Derains in the commentary said that "*fall in market price cannot be accepted as a ground for non-performance of the contract as it would put in danger the security of transactions.*"³⁵ Therefore, the companies entering into long term agreements must consider potential significant changes in economic and financial uncertainties which might be resultant of an increase in climate change.³⁶

It is a well-settled law in Indian jurisdiction that mere commercial difficulty in the performance of the contractual obligation does not suffice to be a ground for invocation of force majeure clause.³⁷ But it is equally important to note that each case calls out for interpretation for putting an event under the force majeure clause. Given, an office memorandum was issued by the Ministry of Finance in February 2020 declaring the current circumstance of the pandemic to be declared as force majeure for disruption of the supply chains.

³¹M/s AlopiParshad & Sons Ltd. v. Union of India, 1960 (2) SCR 793

³²Satyabrata Ghose v. Mugneeram Bangur & Co., AIR 1954 SC 44

³³Nihati Jute Mills Ltd. v. Hyaliram Jagannath, 1968 (1) SCR 821

³⁴ICC Award No. 2478 IN 1974, YCA 1978, at 222 et seq; ICC Case No. 2216 of 1974

³⁵*Ibid.*

³⁶ Mark Augenblick & Alison B. Rousseau, 'Force Majeure in Tumultuous Times: Implacability as the New Impossibility' (2012) JWIT 13, 14- 15.

³⁷*Supra* 24.



Additionally, it has been clarified by the Ministry of Government of India that the corona virus is to be considered as a case of 'natural calamity', therefore force majeure clause can be invoked wherever it is deemed fit.³⁸ In the recent judgement of Delhi High Court the court invoked the force majeure clause and stopped a company from putting guarantees to perform the contract as it involved overseas travel³⁹ whereas the Bombay High Court took a different view in not allowing to the relief under Section 56 of the Indian Contracts Act for distribution of essential services as no restriction was implied in movement of essential services.⁴⁰

Therefore, in the view of this invoking of force majeure clause depends on circumstances to the circumstance of the concerned case and the party wanting to invoke the clause must establish the direct link between the outbreak of the pandemic and non-performance of the contract by the party. Many attorneys caution that force majeure clauses are rarely enforced under a court of law unless the specific impediment is defined in the clause. It is also pertinent to remember that if a client does want to invoke a force majeure clause to attempt to get out of a deal, while the other party to the contract would want to have the contract in force and try to keep the deal of the parties alive. There are three primary reasons tribunals find that a force majeure defence fails are that the party invoking the event (1) foreseeable circumstance, (2) an alternate way to perform the contract, or (3) not complying with the notice requirements in the clause of force majeure.⁴¹

Analyzing different cases for invoking force majeure clause in different jurisdictions has made a bold observation that courts view the force majeure clause in consideration of the circumstances pertaining to different concerned cases. If a valid force majeure event resulting from COVID-19 applies to a contract, a party could be excused from performing, potentially for the duration of the COVID-19 event and may even be allowed to terminate the contract all together without liability. Invoking of force majeure clause under the pandemic situation suspends the performance of the contractual obligations. Their lies a heavy burden of proof on the party wanting to invoke the force majeure clause. The party must prove to the court that it undertook reasonable steps to perform the contract but pandemic has resulted in arisen of certain conditions that make the performance of the contract impossible and hence must be suspended.

³⁸Government of India Ministry of Finance, Force Majeure Clause (FMC) , Office Memorandum 19th February, 2020 <<https://doe.gov.in/sites/default/files/Force%20Majeure%20Clause%20-FMC.pdf>> accessed on 20th August, 2020.

³⁹Halliburton Offshore Service v. Vedanta Limited, 2020 SCC OnLine Del 542.

⁴⁰ Standard Retail Private Limited v. M/s G.S. Global Corp &Ors., 2020 SCC OnLine Bom 704.

⁴¹Parsons &Whittemore Overseas Co. v. SocieteGenerale de L'Industrie du Papier, ICC Case No. 1703/1971, Pieter Sanders (ed.),



Conclusion

This pandemic has made every party insist on including the clauses of protection from any potential fatalities like COVID-19 in the future at the time of construction of the contract. For those who have already entered into any contract, they should determine whether the specific language of the contract excludes the impacts of the COVID-19 pandemic. For Merger and acquisition agreements, sellers should push to add pandemics or wide-spread disease language to the list of MAE exclusions.

The clauses of Force Majeure under commercial contracts and MAE under Merger and Acquisition contract are equipped to protect the interest of the defaulting party when the performance of the contract is not executed due to circumstances, not under human control. What is pertinent to focus is that these clauses must be invoked only when such an unforeseeable event causes substantial damage to the defaulting party, otherwise, this will act against the principle of natural justice. If these clauses are invoked just to avoid the performance of an obligation under the contract, then such an invocation is the abuse of right available to protect the party in the time of such an unforeseen event.
