

COVID-19: A pandemic, a force majeure and a material adverse change
written by Mohana Roy | March 20, 2020



As another week passed by, the utter state of bewilderment brought by novel coronavirus (COVID-19) pandemic continues to claim lives across the world. The impact of COVID-19 is not limited to human lives but also to operation of businesses eventually affecting a broad swathe of economy. The stock valuations are going down as the stock market has come to a halt. Due to supply chain disruption, performances under many contracts are in question. Even M&A transactions and financing agreements may be affected as the question now arises that whether COVID-19 would trigger material adverse change (MAC). The growing health emergency has led to various restrictions upon people and delivery/supply of goods and services which is directly impacting the performance under business agreements. In such a scenario, force majeure clause and MAC clause may come to rescue the parties to a contract.

COVID-19 Material Adverse Change clause

Transactions such as mergers and acquisitions remain under the cloud of vagueness until they are closed. Generally, in an M&A transaction, the time between the signing of the agreement and closure of the transaction is very crucial. It is when a MAC clause comes to operation. MAC clause confers the parties to a contract with a right to terminate the contract upon occurrence of any event which affects materially on the viability of the transaction. However, to agree upon the materiality of an event by both parties of a contract, is not an easy task, on one hand, the seller in an acquisition transaction would prefer to narrow the scope of the definition of materiality, on the other hand, the buyer would prefer to keep it open and as broad as may be possible so that it is easier for them to walk out of the transaction, and that is why often such transaction agreements shy

away

from defining what is material to the transaction. Further, the courts in India

have failed to provide for any systematic guidelines for determining the materiality of events and have limited themselves to opine that any event which

will restrict or make it impossible for any reasonable party to enter in to such

contracts will be a material adverse change. Further, the Indian laws also prescribe

that anything which in the eyes of a reasonable person becomes impossible or prevents them from fulfilling their obligation due to reasons uncontrolled by the parties under the contract can be deemed as material adverse change.

Regulation

23(1) (c) of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, prescribes that *"any open*

offer can be +withdrawn in circumstances where any condition stipulated in the

agreement for acquisition attracting the obligation to make the open offer is not met for reasons outside the reasonable control of the acquirer, and such agreement is rescinded, subject to such conditions having been specifically disclosed in the detailed public statement and the letter of offer", meaning thereby that the parties can withdraw themselves from the obligations under a contract if it becomes impossible to meet the conditions for reasons which are

beyond the reasonable control of the parties. Further, section 56 of the Indian

Contract Act, 1872, which entails the concept of doctrine of frustration of contract prescribes that any act which by reason of some event if occurs after

the contract is made and such an event is something which the promisor could not prevent then such a contract becomes void. In future, while dealing with cases involving materiality of events, Indian courts may take cues from the US

court's judgments which rely upon durational significance and long term impact

of the event before providing relief by invoking MAC clause^[1].

COVID-19: Whether MAC clause can be triggered

While the outbreak of

COVID-19 pandemic subsists, the parties to a contract may resort to renegotiations or avoidance of performance of their contractual obligations by

invoking MAC clause. The party invoking the MAC clause will have the ultimate burden

to prove that the pandemic has affected materially to the transaction. Say for

instance, disruption in the supply chain due to COVID-19 may be sought to avoid

performance of various business agreements or may also delay the performance. Presently, the

durational significance and long term impact of COVID-19 is yet to be

determined. Thus, it is early to conclude that if MAC claims vis-à-vis COVID-19

will be entertained by the courts.

However, in case if a

party in future invokes MAC due to the impact of COVID-19, it is pertinent that

the party should take note and in fact double-check prior to invoking the MAC clause that, whether any alternate means of performance of the contract is available. If yes, then the parties should deliberate on such alternatives.

The

Party shall have to strike a balance between what has been agreed under the contract and its right to terminate the contract under the disguise of MAC clause.

Further, it is

necessary for the party invoking the MAC clause to follow the due process and serve a proper notice to the other party before taking any further action. If the other party objects then the court will determine the materiality of the impact of COVID-19 upon the transaction based on the specific facts of the matter.

Those who are

deliberating upon entering into any business agreements including M&A agreements should consider including warranties pertaining to adverse effect of

COVID-19. While conducting due diligence exercise, a party must take in to consideration the other party's preparedness to mitigate the adverse effects of

COVID-19. Further, specific disclosures must be sought pertaining to COVID-19 from

the other party and COVID-19 may be included while defining the material adverse

change in the transactional agreements subject to the risks as may have come out while conducting the due diligence exercise.

COVID-19: Declared a force majeure

A corollary of MAC

clause can be equated with force majeure clauses. However, force majeure clauses specifically prescribe the conditions or events which will excuse the performance of the contract whereas, the MAC clauses are vague and do not specify the triggering events. Further, MAC clauses intend to allocate risk between the parties that may arise between the signing and closing of the transaction. Whereas, force majeure can be claimed at any time when a force majeure event arises.

Spread of COVID-19 is

impairing the abilities of parties of a contract to perform their obligations,

thus, leading towards seeking relief under force majeure clause and MAC clause.

However, the question here arises whether the pandemic will fall under the guise of force majeure. In India, the

Ministry of Finance on February 19, 2020, has issued an office memorandum which

effectively declares that COVID-19 can be treated as a natural calamity and

hence a force majeure. The same may be invoked following the due procedures. Force majeure means events which are beyond human control and hence extra ordinary. It is by and large believed that force majeure includes an act of god, natural disaster, war, labour unrest, epidemics and strikes, etc. It is an exception which may be claimed by the performing party to a contract.

In the case of *Energy*

Watchdog Vs. Central Electricity Regulatory Commission & Ors.[2], the Supreme Court of

India, restated the law of force majeure and laid down the following guidelines

to be mindful of while invoking a force majeure clause:

1. The very basis of such clauses is that the events are beyond the reasonable control of the parties and in such conditions parties cannot be held liable for non-performance of obligations under the contract.
2. While analysing the force majeure clause, it is also necessary to analyse if best endeavours have been taken to mitigate force majeure event.
3. For an event to qualify as a force majeure, it is necessary that the same is unforeseeable by the parties.
4. The event has actually rendered the performance impossible or illegal.

Thus, any impact of

COVID-19 may be covered as a force majeure event provided that the parties invoking the same shows that reasonable steps towards mitigating the same have

been taken and as a result no alternate means for performing the obligation is left.

Further, in absence of

force majeure clause or MAC clause in any agreement, does not bar the party's right to invoke them. In such a scenario, a party may resort to section 5 of the Indian Contract Act, 1872, which is the law of frustration of contract under the Indian regime.

Conclusion

Since COVID-19 pandemic is already declared a force majeure, the parties are likely to resort to the same in case of any impossibility towards performance under a contract. In absence of force majeure clause in a contract, the parties may resort to MAC clause or frustration of contract under section 56 of the Indian Contract Act. However, even after being declared a pandemic by the World Health Organization and a force majeure by the Indian government, it is yet to gauge the long-term impact of COVID-19. Therefore, whether the impact of COVID-19 will trigger MAC clause is difficult to determine at this point in time.

The triggering of force

majeure or MAC clause actually depends upon case to case basis. The party invoking the force majeure or MAC, should carefully review the wordings around

the clause prior to beseech the same, it is also pertinent to take in to consideration such aspects under the contracts which can be performed so as

to
avoid any dispute between the parties. Additionally, it is necessary that the parties assess their business sustainability and take steps to reduce the impact of COVID-19 upon the work and ability to perform the obligations under a contract.

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- [\[1\]](#) Akorn, Inc. v. Fresenius Kabi AG, 2018 WL 4719347, at *47 (Del. Ch. Oct. 1, 2018).
 - [\[2\]](#) (2017) 14 SCC 80
Contributed By - [Rajesh Sivaswamy](#) & [Mohana Roy](#)
[King Stubb & Kasiva](#),
Advocates & Attorneys
[Click Here to Get in Touch](#)
[New Delhi](#) | [Mumbai](#) | [Bangalore](#) | [Chennai](#) | [Hyderabad](#) | [Kochi](#)
Tel: [+91 11 41032969](#) | Email: [info@ksandk.com](#)