

Client Alert

Impact of COVID-19 on invocation of MAC/MAE clauses – India perspective

In the midst of an increase in the number of cases of COVID-19 worldwide, the apparent implications of the outbreak on human life, and consequently on businesses, are being amplified. The unsettling impact of COVID-19 on global markets and economies, including in India, are forcing many corporates to evaluate their potential exposure and their ability to rely on material adverse change/ material adverse effect (“**MAC/MAE**”) clauses in the context of mergers and acquisition (“**M&A**”), especially in cases where the (i) transaction documents have been signed before the onset of the pandemic, but the deal has not been closed; and (ii) a deal is being negotiated between the parties.

In the M&A context, where parties may want to, or have the option to, walk out of a transaction without incurring any loss or being in breach of covenants, they could seek to rely on MAC/MAE clauses as an escape route upon the occurrence of unforeseen events that would adversely impact the intended transaction. MAC/MAE clauses may come to the rescue of such parties without making them liable for any breach under the transaction documents.

Typically, MAC/MAE clauses provide for allocation of risk between the parties in M&A transactions. MAC/MAE clauses may be enforced upon the occurrence of the events that are covered under their ambit. The main contention between the parties during the enforcement of such clauses is what constitutes ‘material’, as this may not be

defined in quantifiable terms. Therefore, the party enforcing the MAC/MAE clause would want a broader interpretation of the clause to include this type of pandemic. Typically, these clauses are enforced by the buyer, and the seller would want the interpretation to be narrower, thereby excluding a pandemic from falling under the ambit of the MAC/MAE. In this context, it is pertinent to mention that COVID-19 would trigger a MAC/MAE clause only on a case-to-case basis. There are various factors on which such a determination would be made including, but not limited to, the following:

- The language of the MAC/MAE clause in the transaction document;
- Law governing the transaction document in question;
- Whether the alleged MAC/MAE event is material and has long-term impact. In this case, the duration of the COVID-19 outbreak may also play a crucial role in determining the invocation and enforcement thereof; and
- The sectoral impact of COVID-19 on the corporate entity’s industry.

Based on the above, the MAC/MAE clause may be invoked. However, it is the tribunal/court’s order/judgment that would ultimately decide whether this pandemic would constitute a MAC/MAE or not in specific cases. The jurisprudence on the subject is ever evolving, and with the onset of COVID-19, we may witness whether tribunals/courts treat this pandemic as

MAC/MAE or not. It is pertinent to mention that typically tribunals/courts are reluctant to excuse buyers from their commitments to effectuate a transaction on the basis of MAC/MAE. Various Indian courts, including the Supreme Court, have, on numerous occasions, affirmed that a party's obligation to perform a contract is to be governed by the provisions of the Indian Contract Act, 1872 and the terms of the contract. Parties may be absolved from the performance of an obligation only if the purpose or basis of a contract has been frustrated by occurrence of an event or if there is a change of circumstances which was beyond the reasonable contemplation of the parties at the time of entering into the contract.

Some important points to be noted in a situation where the transaction documents have been signed before the onset of the pandemic but the deal has not closed are as follows:

- The parties should identify the actual and anticipated risk to seller's business. Some of the factors that need to be weighed in are disruption in the supply, downturn of economy, employment related issues such as downsizing, detailed analysis of business continuity plans and prospects of future earnings, etc.;
- Seller's financial obligations and whether these would be fulfilled by them in light of the COVID-19 outbreak. A detailed analysis with respect to loan agreements of the seller must also be done to ensure whether the concerned bank would invoke MAC/MAE clause or not;
- The parties to the contract may consider conducting a thorough assessment of the impact of the COVID-19 outbreak on the existing representations and warranties in the transaction documents;
- The seller should analyse whether they would be able to fulfil their existing contractual obligations, or if they should consider invoking *force majeure*/termination clauses. This may also be relevant for the buyer as some of the contracts may be key long-term contracts or financing contracts.

In addition to the above, some important points for consideration in a situation where the deal is still being negotiated are as follows:

- Due diligence conducted by the buyer's financial and legal advisors must take into account the impact of COVID-19 on the business and the valuation of the asset;
- The clauses pertaining to representations and warranties should be carefully negotiated as the buyer is an outsider and may have limited access to crucial information despite having conducted due diligence. The buyer may consider requesting warranties around risk assessments, business continuity, etc. The seller may consider a general COVID-19-type exclusion of liability;
- The parties may consider deferring the proposed transaction or agree to defer the closing till the end of the pandemic. Depending upon the stage of the deal, the parties may also consider

restructuring the transaction to suit the business objective in the changed circumstances;

- The parties may also consider including a break-up fee in relation to termination of the deal;
- The parties should negotiate the MAC/MAE clause and make it exhaustive to avoid any scope of ambiguity.

There may be certain instances where the transaction has closed, however an agreement does not contain a MAC/MAE clause. In such cases, the parties may resort to the force majeure clause or rely on Section 56 of the Indian Contract Act, 1972 relating to frustration of the contract.

Additionally, during the subsistence of the pandemic, some buyers may be on the look

out to buy distressed assets. In such an event, the buyer must be extra cautious while closing the deal, as for them it may be difficult to rely on the COVID-19 situation to walk away from the transaction.

In light of the above, the invocation and enforcement of MAC/MAE clause is determined factually, depending on, *inter alia*, the various factors enumerated in this document. The effects and impact of COVID-19 are still unfolding, and the buyer may invoke MAC/MAE clause in light of the COVID-19 pandemic in view of the fact that the pandemic may significantly impact the financial standing of the seller. However, at the time of enforcement of such a clause, merely a drop in revenues for a short duration may not be considered material. Therefore, a close watch should be kept on the unfolding of events associated with COVID-19 and the impact thereof on the business.

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