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COVID-19 as a *Force Majeure* in Corporate Transactions¹

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April 1, 2020

Abstract: This paper surveys the use of pandemic-related provisions in Material Adverse Effects (MAE) provisions in a large data set of publicly disclosed M&A transactions spanning the years 2003-2020. We document a trend towards greater use of such provisions, taking off particularly after the H1N1 crisis in 2009, and spiking again in late 2019 and early 2020. These terms are invariably located in the exclusions / carve-outs to the MAE, and they are overwhelmingly accompanied by "disproportionate effects" language that tends to dampen the effect of the carve out. There is little discernible statistical relationship between the inclusion of a pandemic-related carve-out and the inclusion of a reverse termination fee ("RTF") granting optionality to the buyer; but when an RTF is present, its magnitude tends to be smaller in the absence of any pandemic-specific carve-out, suggesting some degree of observational complementarity between these terms.

¹ A revision of this paper will be published in the *Michigan State Law Review*. This draft builds on a series of blog entries we originally posted on the [Columbia Blue Sky Blog](#). The original entries can be found [here](#) and [here](#). Thanks to [your name here] for comments and suggestions. All errors are ours.

A folk proverb from the American West teaches that the most important ingredient of a successful rain dance is *timing*. And the timing couldn't be worse for signed corporate deals hanging in the balance at the onset of the novel coronavirus pandemic. As of March 2020, we estimate that there were over 300 significant mergers and acquisitions (M&A) transactions signed and waiting to close, representing over half a trillion US dollars in economic value. The fate of these deals has been thrown into considerable doubt by the COVID-19 crisis. And, in an [uncanny resemblance to the onset of the financial crisis in fall 2008](#), corporate lawyers everywhere are spending their social-distancing hours scouring the terms of these deals in a frenzied search for an escape hatch that might unwind the transaction: And indeed, as of April 2020, a growing list of pending acquisitions (including [SoftBank / WeWork](#), [Gray Television / Tegna](#), [Volkswagen / Navistar](#)) appear headed for rough waters.

In *lawyer-speak*, the most likely candidate for an escape-hatch is something called a *force majeure* (or “Act of God”) provision, which governs when changed circumstances are deemed so significant as to obliterate an otherwise enforceable contract. In *business lawyer-speak*, *force majeure*s are usually called “material adverse change/material adverse effect” (hereinafter MAE) provisions; but they work pretty much the same way, conditioning a party's (usually the buyer's) duty to close a deal on the non-occurrence of a specific set of contingencies. MAEs are virtually ubiquitous in M&A; and—unlike many other boilerplate terms—they are heavily negotiated at the time of the transaction. This is for good reason: when an MAE is triggered, billions of dollars can hang in the balance.

Some recent transactions—such as Morgan Stanley's acquisition of E*Trade ([announced](#) on February 20)—[explicitly account for COVID-19 through their MAE](#), typically deeming it not to constitute a *force majeure*. But most “legacy” deals—signed up before the coronavirus threat exploded—are far more opaque. Consider, for example, LVMH's [pending \\$16 billion acquisition](#) of Tiffany & Co., announced in late 2019 and subsequently approved by Tiffany shareholders, but still not closed. [The MAE in that deal](#) is representative, featuring both affirmative and negative provisos that can be thought of metaphorically as something akin to a [slice of Swiss cheese](#):

- The affirmative terms represent the cheese, and they lay out situations that *would* allow LVMH to walk away. Included are contingencies that would materially affect the “business, condition (financial or otherwise), properties, assets, liabilities (contingent or otherwise), business operations or results of operations of Tiffany and its subsidiaries, taken as a whole.” Also included are contingencies that “would reasonably be expected to prevent, materially delay or materially impair” the closing of the deal.
- The negative terms represent the holes in the cheese, and they specify specific *carve outs* or exceptions to the affirmative provisions. Like many MAEs, the carve outs are far more numerous, and they include
 - changes or conditions generally affecting Tiffany's industry
 - general economic or political conditions in any country where Tiffany operates (including China);

- changes in the market price or trading volume of the Tiffany’s securities or credit ratings
- geopolitical conditions, including the outbreak or escalation of hostilities, acts of war, sabotage, terrorism;
- natural disasters, including hurricane, tornado, flood, earthquake or “other natural disaster”.

Conspicuously absent from either the cheese or the holes in the Tiffany deal is any explicit mention of a global pandemic. It seems likely that colorable arguments might be made on both sides. Although many of the items enumerated in the affirmative provisions may well be captured by the COVID-19 outbreak, several exclusions could touch on it as well. This deal may thus fall into a relatively difficult and far grayer (if not Gruyère) zone.

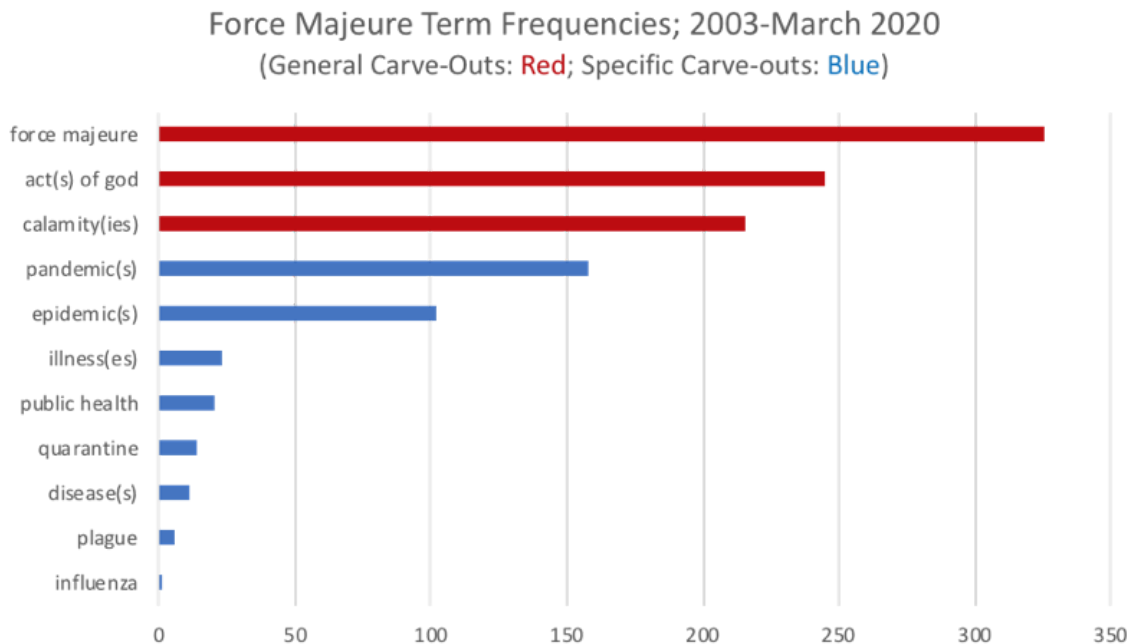
And that begs the question of whether the language of MAE provisions *in the aggregate* might be used to unwind signed deals in the face of a pandemic. To get a handle on this question, we deployed some tools of machine learning and natural language processing, an approach that has [already been shown to be helpful in studying MAE provisions](#) as well as [other business contracts](#).

To take on this question, we updated a data set that we had previously collected and cleaned, consisting of announced transactions and meta information associated with the deals (all drawn from FactSet). The combined volume of the deals is around 10 trillion USD. The dataset covers acquisitions in two dozen distinct industries for deals spanning the years 2003 through the end of 2020, thus providing a broad view of over fifteen years of market practice (including, importantly, the financial crisis). In all, our data set consists of 1702 MAE provisions over an 18-year time span (including about 80 of relatively larger deals representing around \$250 billion).²

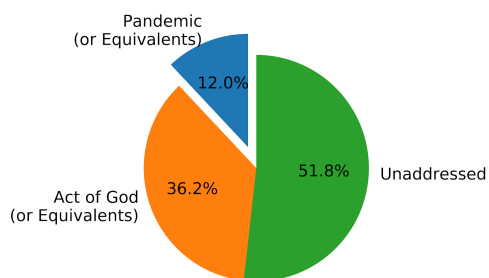
In analyzing the MAEs, we first focused on language that expressly captures a global pandemic like COVID-19. To ensure that we capture all (or nearly all) of the language relevant to COVID-19, we assembled a list of the terms most similar to the words “disease” and “pandemic” from three data sources: (i) WordNet, a large lexical database of English maintained by language experts; (ii) GloVe, a representation of ordinary English language; (iii) Contracts-word2vec, a language model based on roughly half a million agreements submitted to the SEC by publicly registered companies. We then verified the results by hand. The resulting vocabulary includes terms specific to the outbreak of a contagious disease, such as “pandemic,” “epidemic,” and “public health.” But our list also includes broader, more general terms such as “act of god” and “force majeure”—gray area terms that do not explicitly cover pandemics but one might imagine arguments going either way. The [complete list](#) includes a total of 50 key terms. Within our data set, 15 of these terms appear with positive frequency, as reflected in the figure below. The figure further subdivides between (i) general terms (pictured in red), that arguably carve out a variety of

² As referenced above, FactSet lists over 300 transactions that are pending as of March 2020, representing around \$550 billion in value. There can be considerable latency in the public disclosure of these deals, however (particularly for companies not traded in the US), which reduces the number of pending deals with observable contractual terms.

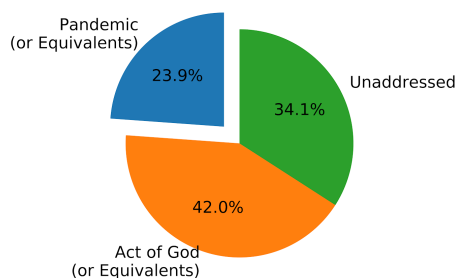
force majeure events including pandemics; and (ii) specific terms (pictured in blue) that explicitly invoke the term “pandemic” or its semantic equivalents.



Applying this list to our MAE data, our key finding is that—like the LVMH/Tiffany agreement discussed above—*less than one out of eight MAE provisions in our data set explicitly carve out pandemics from force majeure events*. Indeed, as the left-hand panel of the figure below shows, the majority of definitional carve-outs—a little more than half—*do not even address a pandemic (or pandemic-like) outbreak—either with explicit terms or with “catch-all” terms (such as “Act of God”, “Calamity”, or “Force Majeure”)* that arguably have sufficient breadth and scope to do so. Of the remainder that arguably address COVID19, the trigger usually comes through the broad, catch-all provisions (36.2%) rather than through an explicit phrase related to pandemics (12%). That said, as the right-hand panel of the figure illustrates, pending deals appear to skew much more discernibly towards carve-outs (of both species): Nearly 24% of pending deals carve out pandemic (or pandemic-like) contingencies explicitly, and 42% contain the more general “act of god” carve-out language.

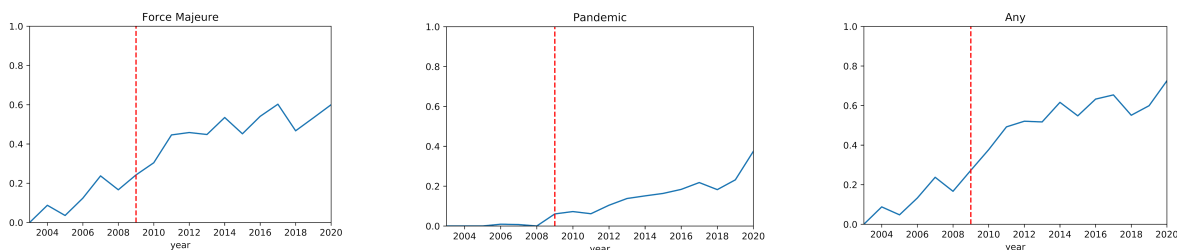


Panel A. Full Data Set (2003-Pres.)



Panel B. Pending Deals (as of 3/26/2020)

Digging a little deeper, it becomes evident that the shift in carve-outs is actually part of a longer-term sea change whose seeds were sown over a decade ago. The time series charts below track the year-by-year prevalence of general carve-outs (left panel), pandemic-specific carve-outs (center panel), and their union (right panel) since 2003. General *force majeure* carve-outs became significantly more prevalent around 2009 – coinciding with the emergence from the great recession (well, [at least the last one](#)). But note that pandemic-specific carve-outs also started to go viral at around the same time (having been virtually non-existent prior to 2009). Although global economic conditions had much to do with the rapid adoption of general *force majeure* language, the pandemic-specific trend was more likely a byproduct of the contemporaneous H1N1 crisis that [unfolded during the spring of 2009](#). And this fraction continued to rise through the two waves of the [MERS crisis \(first in 2012 and then again in 2015\)](#). By 2019, *fully 23% of deals specifically carved out pandemics from coverage in the MAE*.



A. General Carve-Outs

B. Pandemic-Explicit Carve-Outs

C. General or Explicit Carve-Outs

It is worth reiterating that when an MAE provision features language bearing on a pandemic (via either explicit or general terms), our data suggest that it invariably enters through a *carve out* to the MAE (the holes in the cheese) rather than through an affirmative provision (the cheese itself). Consequently, when present, such provisions would appear to push pandemic-related risks onto the buyer (and away from the seller). A typical example of an explicit pandemic-like provision is the private equity acquisition of the telecom company ComScope in 2010. That provision reads (in relevant part):

"Company Material Adverse Effect" means a change, event or occurrence that has a material adverse effect on the financial condition, business or results of operations of the Company and its Subsidiaries taken as a whole; provided, however, that none of the following, and no changes, events or occurrences, individually or in the aggregate, to the extent arising out of, resulting from or attributable to any of the following shall constitute or be taken into account in determining whether a Company Material Adverse Effect has occurred or may, would or could occur:

...

(3) epidemics, pandemics, earthquakes, hurricanes, tornados or other natural disasters

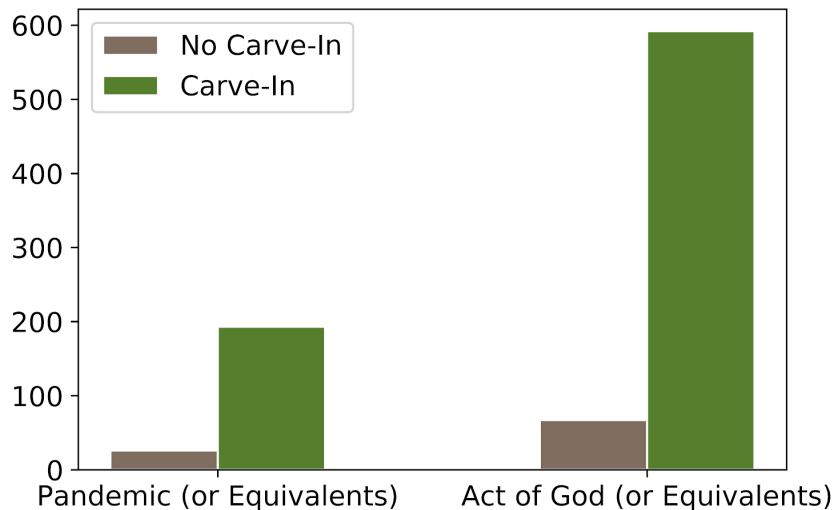
...

provided, further, that, with respect to [clause (3) above, *inter alia*], such changes, events or occurrences do not materially and disproportionately adversely affect the Company

and its Subsidiaries, taken as a whole, compared to other companies operating in the industries in which the Company and its Subsidiaries operate.

This clause is a good indication of the typical location of an explicit provision (in the carved-out Swiss-cheese holes in the MAE). But it *also* exposes the fact that carve-outs can come with a significant lawyerly grain of salt: After expressly carving out contingency from the definition of an MAE, the ComScope provision proceeds to *carve it right back in if the pandemic affects the seller disproportionately*, relative to a benchmark of other competitors in the industry.

Carve-ins like the one above are far from aberrational. Indeed, a significant fraction of MAEs that purportedly exempt a laundry list of enumerated risks *carve back in* aspects of those same risks through similar “disproportional effects” qualifiers (whereby an excluded contingency still counts as a *force majeure* if the target suffers hardships that are disproportionate to some class of peers). The figure below demonstrates that ComScope deal’s language is far from anomalous, by assessing prevalence with which MAE terms that invoke a general or specific carve-out then include a “disproportional effects” modifier after the carve-out.³ Note that the strong tendency towards carve-ins for disproportional effects appears to hold even when the carve-out uses more general provisions (right-hand panel), focusing on broad *act of god* contingencies (rather than pandemics in particular). Our preliminary analysis suggests, moreover, that disproportionate-effects carve-ins appear with roughly the same frequency (or perhaps a little higher) in pending deals. Thus, while carve-outs have no doubt become more prevalent over time, a portion of their impact has been blunted mechanically by carve-ins that are typically riding shotgun.



Disproportional Effects Carve-In

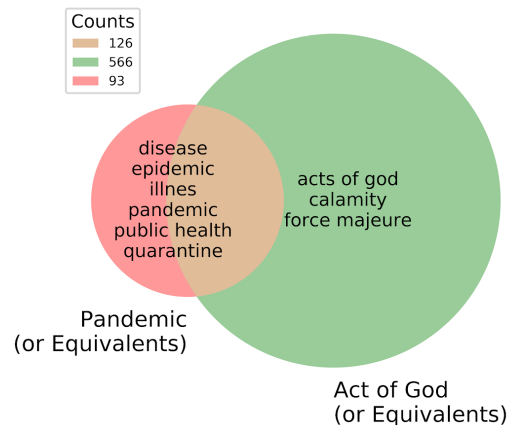
³ The results reported on here do not reflect a tedious hand-verification that the disproportional-effects language modifies the pandemic/act-of-god carve-out (rather than some other carve-out), we have performed this tedious verification on a sub-sample and the results of the two approaches are substantively identical.

(2003-Pres.)

The upshot of this observation is that, for most deals, the question of whether COVID-19 triggers the MAE clause may turn further on a finely-grained analysis of how the pandemic has affected a company vis-à-vis its peers. For targets that are *especially* susceptible to pandemic risks relative to others in the industry, then, the “disproportional effects” carve-in may shift risk right back to the seller.

A second pressing question is whether the more general language carving out acts of god and force majeure events from the MAE definition should be read to apply to COVID-19 in the first place. In other words, should one of these general terms be interpreted as a semantic substitute for an explicit term that invokes pandemics? One way to get at that question is to look at the text of the MAE definitions themselves—and in particular the frequency with which we observe pandemic-specific language enumerated as an example of an act of god or force majeure event versus a stand-alone phenomenon. The figure below displays the relative degree to which explicit and catch-all language are used as complements versus substitutes.

Venn Diagram of Target MACs Addressing Coronavirus



Overlap in General and Specific Terms (2003-Pres.)

As the figure demonstrates, when specific language is invoked, it tends to be split evenly between (a) being an enumerated example of a general *force majeure* provision (57% of the time); and (b) standing alone without also invoking the more general language (43% of the time). Although this result may be consistent with a variety of interpretive theories, it does seem inconsistent with some of them. For example, it would seem to cast doubt on the argument that general *force majeure* language can **never** be interpreted as reading on pandemic risks, since a large fraction of MAE provisions make the connection explicitly. But it also casts some doubt on the opposite proposition that general language **always** captures specific pandemic risks: indeed, in our reading, the vast majority of provisions with general language tend to enumerate a variety of *different* specific contingencies (such as weather, climate change, terrorism, and the like), perhaps making it telling that the pandemic language is *not* included as an enumerated example.

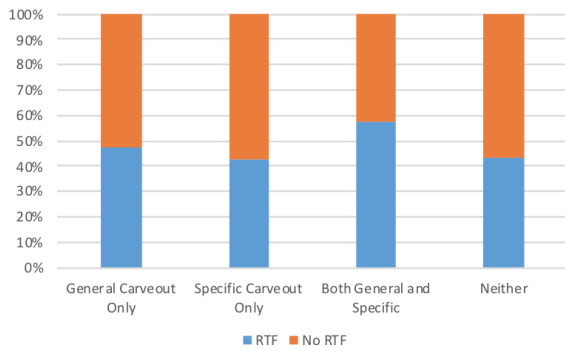
Although it is easy to get caught up in the quantitative structure of MAE provisions to the exclusion of other considerations, it is important not to lose sight of the broader institutional setting that frames these disputes. Some relevant considerations include the following:

- *Judicial Reticence.* By any account, common-law courts aren't pushovers when it comes to nullifying contractual obligations. Contract law has long resisted the temptation to rescue a regretful party once foundational risk allocation decisions seem locked in. This canonical attribute of contract law carries over to M&A, too: for at least two decades, Delaware courts [have consistently held](#) that buyers wishing to bail out of a deal "[ought to have to make a strong showing to invoke a Material Adverse Effect](#)".
- *Burdens of Proof.* Consistent with the foregoing view, MAEs are [generally interpreted by courts](#) to constitute *conditions subsequent* to the obligation to close (rather than as *conditions precedent*, as many often mis-label them). The key upshot of this designation is that the initial burden of proof to invoke an MAE rests squarely on the shoulders of the party alleging excuse (almost always the buyer). And if the underlying evidentiary case is unclear, or if competing arguments produce an approximate stalemate on the merits, then the case is resolved in favor of the party seeking enforcement of the contract (usually the seller).
- *Durational Significance.* One of the few consistent lodestars in existing MAE jurisprudence is that the target's unanticipated hardship [must be durationally significant, and not merely a hiccup in revenues or earnings over a quarter or two](#). But the economic dislocation caused by COVID-19 is so fresh and unfamiliar that reliable forecasts of long-term implications are largely impossible. (The [historic and careening volatility in the financial markets](#) of late ably attests to this fact.) And thus, [as of this writing](#) at least, many buyers are likely to find themselves unable to scare up the evidence needed to carry their burden of proving a durationally significant adverse effect in the post-COVID world. (Though tourism-intensive industries may have the best shot).
- *Precedential Tea Leaves.* Finally, as we noted in our prior post, the time span of our original data set also coincided with an era in which *no Delaware opinion had ever found an MAE to have been triggered*. Like [many other hot streaks](#), however, this one eventually came to an end in the fall of 2018, with the Chancery Court's [Akorn v. Fresenius](#) opinion. The precedent has no doubt bolstered the confidence of rueful buyers in pending deals who are now contemplating invoking their MAEs. (And we note in passing that the MAE in *Akorn* specifically carved out pandemics, subjecting the exclusion to a "disproportionate effects" carve-in.) Nevertheless, it is important to understand that while *Akorn* no doubt sent a message that the ["MAC is Back"](#) as a front-line issue for M&A doctrine, the underlying facts of the case diverge considerably from current circumstances (involving highly target-specific issues pertaining to regulatory clearance and outright regulatory fraud).

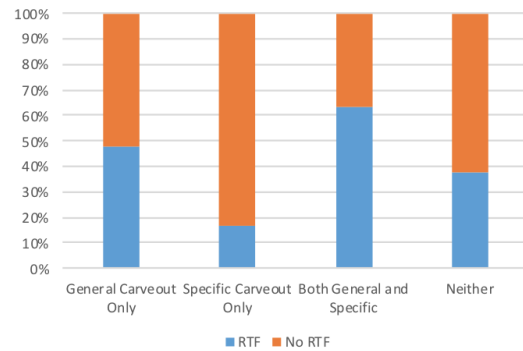
In the light of above points, we conjecture that the average M&A buyer will face a heavy slog in asserting that COVID-19 represents a deal-killing *force majeure*, even when the MAE contains no carve outs for pandemics (general or specific). The odds grow longer still, of course, in the presence of such carve-outs.

So this must imply that savvy acquirors need to abandon all plans to declare an MAE, right? *Not so fast*: notwithstanding the uphill battle (and long odds) faced by buyers asserting MAEs, we can think of several reasons why rational and sophisticated parties might still pursue this strategy:

- First, pressing the MAE issue can buy precious time for the acquirer. Although MAE litigation moves substantially faster in Delaware Chancery Court than does commercial litigation in other venues, the process is still far from instantaneous. Moreover, the [temporary closure of courthouses in Delaware](#) and [potential delays in litigation schedules](#) due to the outbreak may well lead to unusually protracted timelines. That, in turn, could afford buyers an opportunity to amass additional evidence about the durational significance of the COVID-19 crisis (while preserving the option to abandon the strategy down the road).
- Second, even if the current saga proves to be short-lived, [it is already raising fears of a medium-term liquidity crunch](#). The potential delaying effect of an MAE kerfuffle can also be a hidden source of liquidity for cash buyers, at least until the current market tumult resolves and greater sense of order returns to capital markets.
- Finally, invoking the MAE may be part of a larger portfolio of strategies that buyers might deploy in attempting to walk from – or potentially restructure – a signed deal. Several other strategies suggest themselves too, including asserting the failure of other closing conditions (related to, *inter alia*, financing, regulatory clearance, solvency, and tax status). Moreover, in many deals acquirors could conceivably threaten a backup strategy of using a “reverse termination fee” (“RTF”) to permit them to exit a deal in exchange for paying what amounts to liquidated damages to break away. The figures below plot the prevalence of reverse termination fees as a function of each type of MAE carve-out, concentrating on both all deals in our data set (left panel) and pending deals (right panel). As illustrated in the figures, RTFs appear to be most common in deals where there are both general and specific carve-outs – *i.e.*, those deals that would (all else held constant) be least amenable to granting *force majeure* walking rights. Moreover, the deals that have neither general nor specific carve-outs for pandemic risks tend on the whole to be more likely to offer RTFs to compensate.

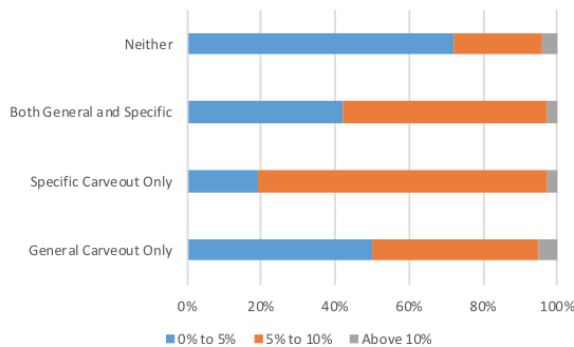


A. Prevalence of RTFs by Carve-Out Type (2003-Pres)

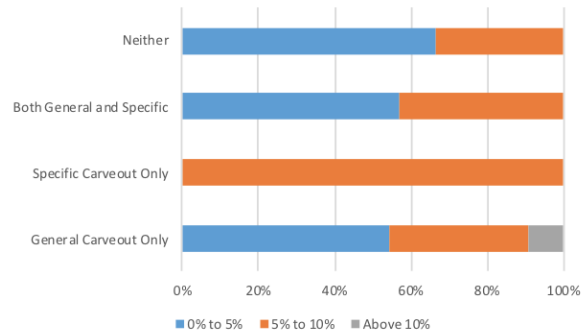


B. Prevalence of RTFs by Carve-Out Type (Pending Deals; 3/2020)

For the deals that include RTFs, one can drill further to assess the relative *size* of the RTF (as a percentage of the transaction value) by carve-out type. As the figures below demonstrate, RTFs tend to be the lowest when there is *neither* a general nor a specific carve out. Recall that this same group as a whole was relatively less likely to have an RTF to begin with. On the whole, then, RTFs and MAEs tend to operate as weak substitutes for one another; but there is still ample room for many buyers to use them together as part of a multi-pronged approach to busting up a deal (or, more likely, to get it restructured).



A. Size of RTF by Carve-Out Type (2003-Pres.)



B. Size of RTF by Carve-Out Type (Pending Deals; 3/2020)

We close by reminding readers of two additional points. First, M&A is but one domain where *force majeure* provisions are ubiquitous). One can also find them in financing contracts, supply contracts, consumer contracts, employment contracts and many others. In these other settings, another factor may play a critical role as well: the presence of a long-term relationship, in which both parties may interact over the course of months, years, or even decades. In such contexts, non-legal considerations may be as important (if not more so) than legal ones. Thus, even if a party believes that it may have the *legal* ability to walk away from a deal on the basis of an

MAE, doing so may sabotage a long-term business relationship that is far more valuable in the long run.

Second, it is important to remember that this area of law remains – much like *force majeure* terms themselves – relatively opaque and open to competing arguments. We doubt that this core feature (or is it a bug?) will resolve itself any time soon. In the meantime, much may be left up to courts and lawyers to work out, if (as we expect) buyers begin to assert walking rights on the basis of a less-than-clear MAE. And that observation brings us to a final prediction, which our analysis permits us to state with some degree of confidence: If you are an M&A litigator on either side of the courtroom aisle (and you remain healthy over the next few months), your timing couldn't be better.