ZEE AND SONY MERGER: ANALYZING FORCE MAJEURE AND MATERIAL ADVERSE CLAUSE IN VOLATILE LANDSCAPE

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Backdrop

One of the biggest mergers deals in entertainment sector is on the tables which will render the merged entity (Sony Group Corp. + Zee Entertainment Enterprises) being India's second largest entertainment network, with the presence of 75 channels and a total revenue of 1.8 billion US dollars, making it a substantial participant in the sector. Zee has troubled history in raising money for its expansionist aspiration in the sector as well as Sony had a rocky ride since losing the broadcasting rights for Indian Premier League (IPL), thus a successful merger will be a win-win propositions for both the companies leading to combing of synergies. As per the settled terms of agreement, the composition in the merged entity will be 52.93% of Sony and remaining 47.07% of Zee, along with Sony bailing out money for the debt incurred by subsidiaries of latter and Mr. Punit Goel (present MD & CEO of Zee Group) will retain his current position in the merged entity.

The Indian media house has faced the heat of the India's Securities and Capital Markets Regulator, Securities and Exchange Board of India **(SEBI)** in pretext of purported violations of SEBI (Prohibition of Insider Trading) Regulations, 2015 and subsequently the regulator has initiated suit in accordance with Section 15(2) of SEBI Act. Moreover, this legal drama comes amidst SEBI has already barred Mr. Punit Goel from serving in any directorial or executive position of any publicly listed entities in pretext of allegations that he abused his position inside the firm and siphoned off 200 cr. INR for squaring off loans of related companies of Essel group (subsidiary of Zee Media Corporation managed by kins of Goel family) as well as decline in 5% shares. These aforesaid latest developments have worked as perfect roadblocks for proposed deal and speculations are there that Sony may call off the deal or frustrate the contract by triggering 'Force Majeure' and 'Material Adverse Clause'. The writer attempts to shed light on these clauses of Indian Contract law along with examining the legal precedents.

Doctrine of Frustration vis-à-vis Force Majeure

Any contract per se follows the fundamental tenet of 'Pact Sunt Servanda' and any party diverting from this can be held liable for breach. But the contract is not said to be breached if some unforeseeable or unanticipated change which is material to the contract takes place. This leads to trigger of doctrine of frustration per Section 56 of Indian Contract Act, 1872 which explicitly states that a party can bypass its contractual duties if it becomes difficult or impractical for it to fulfil its obligation.

The Hon'ble Supreme Court held in *Satyabrata Ghose v. Mugneeram Bangur and Company & Anr*, the word "impossible" in Section 56 shall not be interpreted in literal sense but in practical one. The scope can extend to supervening illegality or impossibility. Therefore, even if it is not an absolute impossibility, but the contract has undergone substantial changes that the parties did not anticipate at the beginning of the agreement, it would still come under the ambit of this section. Such event or occurrence can arise in any manner like destruction of any vital asset which forms an essential part for performance of a contract; any change in law which has rendered the performance unlawful or illegal or such circumstances have arisen which has led to change in state of things that has altered the performance without any fault on part of any party. In catena of cases, a tripartite test is mentioned for invoking this section, (a) contract performance has become impossible, (b) such impossibility has not arisen due to any anticipated or pre-mediated event and (c) such frustration is not deliberate or shouldn't be misused.

Whereas, Force Majeure clause shall be invoked if an occurrence or event subsequent to contract occurs which could not have predicted or controlled by the parties of different ends of the table, the ultimately renders the performance impossible or impracticable .While the clauses, 'frustration of contract' and 'force majeure' are frequently used interchangeably, they differ in a number of ways as while force majeure must be specifically stated in a contract in order to be triggered, frustration may be invoked by any party without any explicit mention per se. Moreover, to take plea of frustration there is requirement of high degree of proof unlike force majeure as well as the former simply release all parties from their duties automatically unlike the latter.

The Hon'ble Supreme Court decision in Energy Watchdog v. Central Electricity Regulatory Commission & Ors. established the force majeure doctrine in India. It outlined the guidelines for triggering this clause (a) the rationale behind this clause is that for entities cannot be held

accountable for failing to fulfil their contractual commitments if any such event which results in circumstances which are outside the reasonable control of an entities occur (b) performance of such contract due to such occurrence has become illegal or impossible; (c) such occurrence must be unavoidable by the parties even after taking all reasonable precautions within their power and lastly all mitigation endeavors should have been exhausted.

But the nebulous cloud which has shadowed invocation of these clauses is commercial hardships cannot be the reason for their trigger. Some settled interpretations are provided by cases of foreign jurisdiction. The 2013 ruling in Grupo Hotelero Urvasco SA v. Carey Value Added SL case, adjudicated that the "change" in question had to be significant and not just a minor adjustment to the loan. The Hon'ble Federal Court of Australia ruled in Canberra Advance Bank Ltd. v. Benny that altering cash flow estimates do not result in a MAC to the borrower's or target company's "business, inventory, or economic condition." Lastly, The Hon'ble Delaware Court maintained high criteria of materiality in Hexion Specialty Chemicals, Inc. v. Huntsman Corp and held the latter's underwhelming performance across a number of business areas and increase in debt was not sufficiently significant and was a too limited of a shift to be deemed unfavourable.

Material Adverse Clause (MAC)

Material Adverse Clause refers to any event, change, occurrence, formation, circumstance, or consequence which either individually or taken in tandem as an aggregate, resulted in and could reasonably be expected to cause such substantial change in terms of EBDITA or on revenue, assets, rights, duties, obligations or financial condition that directly influences the current state or position of an entity. It is based on the principle "rebus sic stantibus" ("things being as they are") and is a deviation from the tenet of "pacta sunt servanda" in order to modify or alter what has been agreed between the parties.

The Alberta Court of Appeal, in Marathon Canada Ltd. v. Enron Canada Corp., gave the foremost interpretation of this clause and gave the entity right to walk away by stating that MAC shall be defined as any occurrence, fact, circumstance, or development that is significantly detrimental to (a) the corporation's business, operation result's, financial condition, or assets, or (b) the vendor's ability to complete the transactions envisioned by this agreement. In Akorn Inc. v. Fresenius Kabi AG & Ors, the Hon'ble Delaware court, pointed out that one of the most crucial factors to take into account, would be whether there has been a negative development in the target's company that has an impact on the target's long-term

earning capability over a commercially acceptable period which one would expect to be assessed in years rather than months. Finally, the court determined in IBP, Inc. v. Tyson Foods, Inc. that a change might be considered significant and detrimental or adverse if it "essentially undermines the target entity's earning potential in a durationally relevant manner."

Conclusion

Practice of invocation of the contractual provisions like Force Majeure and MAC are not new in Indian Market. Recently, Skoda Auto Volkswagen India invoked Force Majeure clause in its circular dated February 22, 2023 addressing it's Indian supplier in pretext of its inability to produce micro-processor chips or semi-conductors citing the reason of the crisis ridden automobile industry in production of manufacturing parts.

The walk off of Sony from the proposed merger won't come as a shocker as the latest events or occurrences can very well lead to trigger of doctrine of frustration or force majeure clause in lieu of MAC. But subsequent to call off of the deal, if Zee drags Sony in a court room battle, major impediment Sony has to face will be (a) establishing events that led to MAC (b) such events did not existed at time of formation of deal (not anticipated or pre-mediated); (c) such occurrence or events were so material and not trivial to said deal and primarily the reason to trigger such clause is not mere commercial hardship. Only time will tell, what future upholds for the proposed merger which currently seems to be on the fence.