MATERIAL ADVERSE CHANGE CLAUSES IN INDIA: DRAFTING FOR ENFORCEABILITY

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ABSTRACT

Material Adverse Change Clauses serve as an important contractual tool for allocating risk in mergers and acquisitions, particularly during the period between signing and closing. In India, however, the practical enforceability of such clauses is shaped by courts' cautious approach to contractual frustration under Section 56 of the Indian Contract Act,1872,[1] as well as by the regulatory scrutiny in public acquisition transactions. Indian courts have consistently held that mere commercial hardship, adverse market movements do not, by themselves, discharge contractual obligations; the change must be fundamental enough to destroy the foundation of the bargain or render performance impossible in a legal sense.[2] This article argues that while MAC clauses are not automatically invalid in India, invoking them successfully requires meeting a high threshold, which is precisely why they must be drafted with precision as to what triggers the clause and who bears the risk.

Keywords: Material Adverse Change Clauses, Indian M&A Transactions, Section 56, Indian Contract Act, doctrine of Frustration

[1] Indian Contract Act, No.9 of 1872, § 56.
[2] Satyabrata Ghose v. Mugneeram Bangur & Co., AIR 1954 SC 44 (India).

I. INTRODUCTION

In January 2022, Sony Pictures Networks India and Zee Entertainment Enterprises announced a proposed merger that drew significant attention in India's corporate and media sectors. By 2024, Sony reportedly withdrew from the transaction, with press reports said that the withdrawal was due to alleged material adverse changes in Zee's business.[3] The collapse of one of India's closely watched media transactions brought the Material Adverse Change Clause into unusual public focus in M&A practice.

A Material Adverse Change or a Material Adverse Effect clause is a contractual risk-allocation device commonly used in M&A transactions. Its function is to allocate between signing and closing the risk of a significant deterioration in the target company's business, financial condition, or prospects. If a MAC event occurs during the interim period, the acquirer may, depending on the wording of the contract, seek to terminate the transaction without being treated as a breach.

In India, however, MAC clauses are considerably harder to invoke successfully than their drafting might suggest. Indian Courts have generally assessed MAC-type arguments through the lens of frustration and impossibility under Section 56 of the Indian Contract Act,1872.[4] In Nirma Industries Ltd. v. SEBI and SEBI v. Akshaya Infrastructure Pvt Ltd., the Supreme Court took a strict view of open offer withdrawal and held that economic unattractiveness or commercial hardship is not enough.[5] The result is that MAC-type exit rights in India offer theoretical protection, but their successful invocation carries a high evidentiary burden.

II. THE FUNCTION AND STRUCTURE OF MAC CLAUSES

MAC clauses serve two related functions in M&A transactions. First, as a condition to closing, the transaction agreement often provides that the acquirer's obligation to complete the deal is subject to the absence of a Material Adverse Change between signing and closing. Second, as a representation and a warranty qualifier, the seller's statement about the target is often qualified by materiality or by a Material Adverse Change standard, thereby limiting exposure

[3] www.sonypicturesnetworks.com/news-details/0/630/issuance-of-termination-notice-for-the-merger-of-sony-pictures-networks-india-private-ltd-and-zee-entertainment-enterprises-ltd
[4] Indian Contract Act, No. 9 of 1872, § 56.
[5] Nirma Indus. Ltd. & Anr. v. Sec. & Exch. Bd. of India, (2013) 8 SCC 20 (India); Securities and Exchange Board of India v. Akshya Infrastructure Pvt. Ltd., (2014) 11 SCC 112 (India).

to changes that exceed a defined threshold of Significance.

The critical drafting battleground is the definition of 'Material Adverse Change'. A wide definition that includes any event that has or reasonably may be expected to have a material adverse effect on the business, financial condition and results of operation or prospects of the target company favours the acquirer, giving it maximum flexibility to exit if circumstances deteriorate. A narrow definition, with broad carve-out for general economic conditions, industry-wide downturns, change in law and market fluctuations, favours the seller, restricting the acquirer's ability to invoke the clause based on factors affecting all market participants.

US-influenced formulations have become more standard in common drafting practice in Indian M&A transactions, given the significant role played by US and international political equity and strategic investors in the Indian M&A market. These formulations usually include extensive seller-friendly carve-outs, contentious MAC materiality thresholds and, in some deals, objective financial benchmarks such as a specified percentage decline in revenue or EBITDA to define what counts as 'material'.

III. THE JUDICIAL APPROACH: IMPOSSIBILITY AS THE DE FACTO STANDARD

The Fundamental challenge in invoking a MAC clause before the Indian courts is that the judiciary has consistently treated MAC invocation as subject to the main standard of contract frustration under Section 56 of the Indian Contract Act, 1872. Section 56 provides that if the object of a contract becomes impossible or unlawful, the contract becomes void. The word 'impossible' in this context has been interpreted by the courts to mean legally or physically impossible and not just commercially burdensome or more difficult to perform.

In SEBI v. Akshaya Infrastructure Pvt. Ltd. (2014), while interpreting Regulation 27 of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997, the Supreme Court said that the withdrawal from an open offer could be permitted only in conditions of impossibility in performance.[6] The acquirer's assertion of a material adverse change in the target's circumstances, solely based on financial adversity, was held to be inadequate. The decision established the principle that indian courts will look beyond the contractual label

[6] Securities and Exchange Board of India v. Akshya Infrastructure Pvt. Ltd., (2014) 11 SCC 112 (India); SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997, Regulation 27(1)(d).

'MAC' and ask whether the underlying circumstances meet the impossibility standard.

This approach was strengthened in the context of COVID-19. In Haliburton Offshore Service Inc. v. Vedanta Limited (2020), the Delhi High Court rejected the argument that the pandemic rendered contractual performance impossible for Section 56, holding that the financial difficulty on account of the pandemic holding that financial difficulty, even in the context of unprecedented global disruption, does not constitute impossibility.[7] The Court's reasoning was clear: the contract was still capable of performance; it had just become more expensive or less commercially attractive. This is not the standard Section 56 requires.

The Practical implication of this jurisprudence is significant. Indian courts will read down a broadly drafted MAC clause covering any material adverse effect on the business or financial condition of the target against the standard of impossibility under Section 56. Unless the acquirer can demonstrate that the adverse change makes performance legally or physically impossible, a threshold that financial downturns, regulatory shifts, and even pandemics have been held not to meet, the MAC clause will not provide the exit it appears to offer.

IV. DRAFTING IMPLICATIONS: SPECIFICITY AS THE ANSWER

The judicial approach to MAC clauses in India has clear implications for how practitioners should draft and negotiate these provisions. A broad MAC clause as a matter of law offers little protection in an Indian court, as a general MAC clause will be measured against the impossibility standard irrespective of how it is drafted. In this author's view, specificity is the answer.

The parties should first avoid broad formulations and instead try to define MAC events with precision: specific financial threshold (decline in quarterly revenue of X percent, a decrease in net worth below Y rupees), specific operational triggers (loss of a specific material customer, revocation of a key license), or specific regulatory events (a change in applicable law that directly prohibits the transaction or materially increases its regulatory cost). The more specifically a MAC event is defined, the less room courts have to re-characterise its invocation as a frustration argument.

[7] Halliburton Offshore Servs. Inc. v. Vedanta Ltd., O.M.P. (I) (COMM) 3697/2020 (Delhi High Ct. May 29, 2020).

Second, carve-outs should be negotiated with equal care. Standard carve-outs for general economic conditions and industry-wide downturns are seller-friendly provisions that limit the acquirer's flexibility. Acquirers should resist overly broad carve-outs and, where carve-outs are accepted, ensure they include a 'disproportionate impact' so that even if a general economic downturn is carved out, the carve-out does not apply if the target is disproportionately affected relative to industry peers.

Third, parties should consider whether to include an express contractual standard for the MAC clause, separate from and more specific than the section 56 impossibility threshold. While Indian courts will ultimately apply their own standards in interpreting the clause, a carefully drafted provision that sets out a specific, measurable standard would give practitioners a stronger argument in favour of the parties' own risk allocation through the contract.

V. CONCLUSION

MAC clauses are indispensable to M&A transaction documents, but their practical utility in India is substantially constrained by the judiciary's alignment of MAC invocation with section 56's impossibility standard. Financial adversity, regulatory change, pandemic conditions, and even insolvency proceedings against the target have been held not to be sufficient to trigger the clause.

The lesson for practitioners is that a broadly drafted MAC clause provides less protection than it appears to offer. The SONY-ZEE collapse illustrates the commercial stakes involved in high-value transactions when MAC provisions are tested and also emphasises that the legal environment in India requires drafters to work harder through specific definitions, precise financial thresholds and carefully negotiated carve-outs to develop MAC provisions that will work as intended in the face of deteriorating circumstances. In Indian M&A, the MAC clause is not a general exit right; it is a precisely calibrated contractual mechanism that must be designed with an impossibility standard in mind from the outset.