DECODING THE TWITTER V. ELON MUSK FEUD - WHAT IS THE "MATERIAL ADVERSE EFFECT" CLAUSE AND WHAT IS ITS IMPACT ON M&A DEALS?

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Mergers and Acquisitions ("**M&A**") are strategic business collaborations that form an indispensable part of the corporate world. Parties have to mutually consent upon key terms and considerations regarding the target's business before closing the deal. Legally speaking, the ongoing dispute between Twitter and Elon Musk ("**Musk**") in the Delaware Chancery Court has given prominence to the contractual nuances prevalent in M&A deals with special attention on the Material Adverse Effect ("**MAE**") clause. Typically, acquisition agreements include clauses which safeguard the interests of the contracting parties. One such clause is MAE, which is a ground for the acquirer to terminate a transaction on the occurrence of a materially adverse event that puts the acquirer's commercial interest in jeopardy.

Generally, a MAE clause envisages broad circumstances or events, whose adverse consequences make the transaction untenable. These may include events that have a materially adverse impact on the target business itself, or the ability of the parties to perform their obligations and consummate the transaction, or the ability of the acquirer to carry on the target's business post-acquisition. MAE clauses are heavily negotiated and differ depending on the facts and industry requirements of each deal. While acquirers seek to retain broad definitions, sellers seek to include qualitative and quantitative constraints to protect their own interests.

In the ongoing Twitter v. Musk feud, the following developments have taken place:
(1) Musk has terminated the merger agreement to acquire Twitter by claiming that Twitter has made materially inaccurate representations (especially in relation to fake Twitter accounts), which allegedly result in a materially adverse event triggering the MAE clause.
(2) Twitter, on its part, has denied Musk's claims of misrepresentation and challenged the termination. Twitter has alleged that Musk is seeking to walk away from the transaction due to a market downturn and subsequent fall in the stock price. Twitter has relied on the qualitative thresholds in the MAE clause to argue that a market downturn does not trigger the MAE clause.

In India, there is a scarcity of judicial decisions on the enforceability of MAE clauses, especially as many such disputes end up in arbitrations which are confidential in nature and not in public courts of law. However, the provisions of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 ("**Takeover Code**") provide some guidance in the form of Regulation 23 which provides statutory grounds for withdrawal of a takeover offer. Accordingly, an offer for takeover can be withdrawn if a condition mentioned in the acquisition agreement attracting the obligation to make the open offer is not met for reasons outside the reasonable control of the acquirer. A similar provision in the predecessor to the Takeover Code i.e., SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997, has been interpreted by the Indian judiciary to be restricted

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only to instances of legal and natural impossibility. Poor financial performance of the target entity is, typically, not permitted as a legitimate ground for invoking this provision.

The Takeover Code, however, applies only to listed companies. For private or unlisted public companies in India, there are no guiding statutory provisions. Hence, everything boils down to negotiations and the contractual understanding between the parties.

American jurisprudence, however, provides some legal literature on this subject. In *Re IBP, Inc. Shareholders Litigation v. Tyson Foods, Inc.*, the broadly worded MAE clause included events affecting the financial condition, business, assets, liabilities and results of operations of the target and its subsidiaries taken as a whole. The Delaware court interpreted this clause to mean a substantial threat to the overall long-term earning potential of the acquirer and not just applicable to mere short-term setbacks. The court also relied on past negotiations and conduct of the acquirer in its interpretation of the clause. In *Akorn, Inc. v. Fresenius Kabi*, the Delaware court permitted the termination as the acquirer had complied with all its obligations and its conduct showed an intent to close the deal. In this case, the court also introduced a test of quantitative and qualitative materiality to invoke the MAE clause to safeguard the seller.

M&A deals in India are at an all-time high, especially in the startup space which is attracting the interest of well-established conglomerates too. While regulatory, legislative and even judicial guidance is scare domestically, there are some lessons to be learned from this foreign dispute. Even as proceedings are *sub judice*, certain key aspects should be kept in mind by parties to a M&A deal: (1) MAE clauses should be drafted with care to accurately capture the commercial intent of the parties. Boilerplate MAE clauses should be avoided. (2) Termination may only be permitted if the MAE has a substantial impact on the transaction. General stock market downturns may not save the day. (3) Further, the conduct of the parties between signing and closing can play a key role in determining if a MAE clause is being invoked unreasonably. It is also suggested that parties should be proactive and get their existing arrangements legally reviewed for risk mitigation.

In conclusion, this dispute has highlighted the importance of efficient contracting, especially to resolve future conflicts when the parties may no longer be on the same page. Lastly, we can expect the Delaware court to give a precedent-setting judgement, which will have the potential to change the course of future M&A deals in India and the world over.

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