

## The Definitive Agreement

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Finalisation of the definitive agreement is arguably the most important aspect in an M&A transaction. Depending on the structure adopted, a share transfer or an asset transfer agreement (or a combination of the two), would be entered into to comprehensively detail the terms of the transaction.

This article aims to set out the key provisions that a definitive agreement would ordinarily contain.

### Key terms

Irrespective of the deal structure, the definitive agreement should contain provisions dealing with:

- Definitions;
- Recitals (which set out briefly the background and subject matter of the deal);
- Consideration and payment;
- Mechanism for completion;
- Representations and warranties (please see “Representations and Warranties” on page 12);
- Consequences of breach; and
- Boilerplate provisions.

### (a) Consideration and payment

Purchase price/consideration clauses specify the sum that will be paid by the purchaser, the form of consideration and payment details. The most common forms of consideration are cash and shares (of the buyer), or a combination of both.

In the Malaysian context, where cash is the mode of consideration, payment of the purchase price is usually split into a payment of deposit<sup>1</sup> (on signing) and payment of the balance (on completion).

- (i) Cash consideration — adjustments and escrows

Frequently, parties would agree to post-completion adjustments to the purchase price, which is useful, as such a mechanism would take into account the performance of the company from the conclusion of the due diligence exercise to the time of completion/closing of the transaction. Additionally (or as an alternative), a purchaser may also seek a minimum profit guarantee of the target company from the outgoing shareholders.

When structuring larger transactions, parties may agree to provisions where a portion of the purchase price is held by the purchaser in escrow for a pre-

<sup>1</sup> Usually 10% of the total purchase consideration

determined period, to cover indemnities of the seller or specified liabilities in connection with the target.

(ii) Shares as consideration

The use of public listed shares as consideration is more common (due to liquidity), and is more often seen in reverse takeover exercises.<sup>2</sup>

(b) *Completion mechanism*

This part of the definitive agreement sets out timelines and mechanics for completion of the deal.

(i) Conditions precedent

Conditions precedent essentially relate to matters which are required to be fulfilled prior to completion. These conditions typically include:

- Approval from appropriate governmental authorities — for instance, certain industries require prior regulatory approval;<sup>3</sup>
- Third party approvals — some contracts of the target company may be subject to notification or prior approval requirements from third parties (such as suppliers, customers, financiers); and/or

- The buyer being satisfied with the outcome of the due diligence audit on the target.

The timeframe for these conditions to be fulfilled should be stipulated (while provisions relating to extensions of time or waivers of such conditions are also useful). It is customary for the deposit to be returned to the buyer should any of the conditions not be fulfilled within the stipulated timeframe.

(ii) Covenants pending completion

It is recommended that covenants of the seller pending completion be incorporated into the definitive agreement. For instance, the seller shall procure that that business of the target company is carried out in the ordinary course, and that the seller will not enter into any agreement to dispose of the target.

(iii) Completion

In addition to payment of balance purchase price (deducting deposit received), completion of a share sale transaction typically involves:

- Delivery by the seller to the buyer, share certificates and instruments of transfer;

<sup>2</sup> A reverse takeover allow private companies to effectively be listed, without undertaking an initial public offering exercise: see the requirements of a reverse takeover offer at Chapter 7 of the Equity Guidelines issued by Securities Commission Malaysia (dated 19 January 2017)

<sup>3</sup> For instance, approval by Bank Negara Malaysia is required for a change in control of licensed person under the Financial Services Act 2013

- Appointment of the buyer's nominees as directors to the board of the target company; and
- Resignation of existing directors (if these existing directors are nominees of the sellers) from the board of the target company.

Depending on the type of assets included in an asset sale transaction, completion of an asset sale agreement generally includes:

- Assignment/novation of contracts;
- Delivery by the seller to the buyer, assets included in the asset sale transaction, together with documents evidencing ownership of these assets; and /or
- Transfer of retained employees (please see "Sale of Shares or Business: What Happens to the Seller's Employees?" on page 16).

(c) *Consequences of breach*

Termination provisions in a definitive agreement set forth circumstances that allow parties to

terminate the agreement with (or without) notice. A timeframe is usually provided for the defaulting party to remedy a breach, failing which the non-defaulting party shall be entitled to claim damages for breach of the agreement.

Termination rights commonly include:

- (i) Termination where there has been a breach of obligations;
- (ii) Termination where there has been a breach of representations, warranties, or covenants prior to completion; and
- (iii) Termination for *force majeure*<sup>4</sup> events;

(d) *Boilerplate clauses*

While often overlooked, provisions relating to notices, governing law, dispute resolution, prior agreements, signing in counterparts, and so on — also known as "boilerplate" clauses — are of critical importance. These provisions would be referred to when alleged breaches occur or when there is a dispute. Parties therefore are exposed to risk where there is an over simplification or when attention is not paid to such provisions.

**Formalities for signing of definitive agreement**

Parties should also be mindful of formalities relating to execution of a definitive agreement, having regard to the requirements contained in the Companies Act 2016<sup>5</sup> and the company's constitution.

<sup>4</sup> An unexpected event that prevents someone from doing or completing something that he or she had agreed or officially planned to do, include both acts of nature (for instance flood or hurricane) and acts by people, see definition of *force majeure* by Black Law Dictionary (10th ed); see also s 57(2) of the Contracts Act 1950 on void agreements.

<sup>5</sup> See s 66 of the Companies Act 2016. The company shall authorise, via passing the necessary resolutions, the usage of common seal (if necessary), or authorisation of the relevant persons for execution of the agreements / instruments.

## Conclusion

The language and provisions contained in the definitive agreement would very likely influence the success of the transaction, and should therefore be approached clinically and meticulously so as to take into account the nature of the transaction and to achieve the intention of the parties.

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