

Representations and Warranties

by Aaron Gerard Sankar and Annabel Kok Keng Yen

Although the due diligence process is intended to identify liabilities, and thus significantly reduce unknown risks in the target, a buyer would seek to obtain from the seller extensive representations and warranties. Representations and warranties are contained in the definitive agreement, thus binding on the seller, and would extend to matters that may not have surfaced during the due diligence process. These provisions further aim to confirm information that has been provided during the due diligence process, therefore serving as risk-shifting provisions entitling the buyer to seek damages in the event of inaccuracies.

Representations and warranties are therefore among the most extensively negotiated clauses of a definitive agreement in an M&A transaction.

Customary representations and warranties

Matters that a buyer would seek to cover by way of representations/warranties include:

- Title to subject shares/assets;
- Corporate organisational matters such as subsidiaries and associate companies;
- Authority of the seller to enter into the transaction;
- Financial matters (including that accounts are prepared and filed in accordance with applicable legal requirements and indebtedness);

- Contracts and other commercial matters;
- Regulatory compliance;
- Insurance; and
- Employee matters.

Disclosure schedules

While a buyer would seek to obtain extensive representations and warranties, a seller would naturally attempt to limit such representations and warranties, or seek to qualify them. A disclosure schedule/letter would thus be prepared for that purpose.

Disclosures, made against each applicable representation or warranty, seek to operate as exceptions or qualifications to such representations/warranties. Hence, a seller should place equal importance on the disclosures to avoid incomplete or inaccurate information being disclosed. In this regard, the seller should start preparing the disclosure schedule early and in tandem with the definitive agreement. It is also important to have key/senior persons from the seller's management to assist with the disclosure list preparation.

Limits on liability?

Representations and warranties are ordinarily underwritten by indemnification provisions, where the seller agrees to indemnify the buyer for losses suffered as a result of breaches of a representation/warranty. A seller may therefore introduce limits on its liability,¹ either generally or with reference to a matter in which the buyer had knowledge prior to entering into the definitive agreement.² These provisions are sometimes referred to as "anti-sandbagging" provisions. A buyer, on the other hand, would insist on the inclusion of "pro-sandbagging"

¹ It is common for both maximum and minimum amounts to be stipulated in the definitive agreement, the maximum typically not exceeding the purchase consideration, and the minimum to avoid *de minimis* claims

² For instance, matters that have surfaced during the due diligence exercise

provisions, i.e. an indemnity notwithstanding that the buyer has knowledge of a breach. When incorporating such clauses, it would be prudent to revisit the boilerplate “entire agreement” provision in the definitive agreement, as “entire agreement” clauses effectively curtail a party’s rights to rely on prior discussions or knowledge.³

Knowledge qualifiers

Additionally, sellers would seek to limit warranties (or certain warranties) with an appropriate knowledge qualifier. Typically, the warranty would be preceded by the words “to the best of the seller’s knowledge” or similar language. Such qualifiers are commonly applied to warranties relating to infringement of third-party rights in the conduct of the seller’s business and customer arrangements. It is advisable, however, for parties to specify in the definitive agreement whether knowledge refers to actual or constructive knowledge.⁴

Buyer warranties

While the scope of buyer representations and warranties is significantly less, it would be useful for a seller to incorporate warranties relating to the authority of the buyer to enter into the transaction and also to obtain indemnities for third-party claims that may be made against the seller (with regard to the target), post-completion.

Warranty and indemnity insurance

Warranty and indemnity (W&I) insurance has gained traction in M&A transactions, particularly in foreign jurisdictions. W&I insurance can be considered by both sellers and buyers to mitigate against liability arising from breaches of representations and warranties.

A buyer taking out W&I coverage would make a claim for losses arising from a seller’s breach directly against the W&I policy, without seeking recourse from the seller. Conversely, where a seller has obtained W&I coverage, it would seek reimbursement from the insurer for losses arising from warranty and indemnity claims by the buyer.

Conclusion

Representations and warranties are an integral part of the definitive agreement. As parties eagerly push forward to finalise and close transactions expeditiously, they may inadvertently leave unnoticed the specifics contained in the representations and warranties and disclosure schedule. As suggested above, parties should commence work on and review of the representations and warranties and disclosure schedule as early as possible, so that these documents reflect with precision the position of the target, and to avoid potential disputes post-completion.

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³ *Solid Investments Ltd v Alcatel-Lucent (M) Sdn Bhd (previously known as Alcatel Network Systems (M) Sdn Bhd)* [2014] 3 MLJ 785 (FC)

⁴ Meaning that the seller would be presumed to have made appropriate enquiries or investigations to determine if the warranty is accurate