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M&A Contracts and the Role of Written Representations

Navigating Lead-Ins, Disclosures in Schedules, Qualifications and Exceptions, the "Bring-Down," and Interaction With Indemnifications

THURSDAY, JANUARY 10, 2013

1pm Eastern | 12pm Central | 11am Mountain | 10am Pacific

Today's faculty features:

Vincent R. Martorana, Counsel, **Reed Smith**, New York

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**M&A Contracts
and the
Role of Written Representations**

Presented by

Vincent R. Martorana

For

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Supplemental Materials

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Sample Definitions

“Material” and “Materially” - Two Samples:

Affects a Decision: “**Material**” and “**Materially**” refer[, with respect to a given Person,] to a level of significance that would have affected any decision of a reasonable person in [that Person’s]/[the Buyer’s] position regarding whether (a) to enter into this Agreement, (b) to consummate the Transactions, or (c) both.

Significant Enough to Warrant Attention: “**Material**” and “**Materially**” mean[, with respect to a given Person,] important enough to warrant attention from the perspective of a reasonable person in [that Person’s]/[the Buyer’s] position[, and such terms include a lesser level of significance than does the term “Material Adverse Change.”]

“Knowledge”: (a) an individual will be deemed to have “Knowledge” of a particular fact or matter only if such individual has actual knowledge of such fact or matter; and (b) an Entity will be deemed to have “Knowledge” of a particular fact or matter only if any individual [who is serving, or who has at any time served, as a director, officer, partner, executor or trustee of such Person (or in any similar capacity)]/[specified on Schedule [__]] has, or at any time had, Knowledge of such fact or matter. Except as set forth in the immediately foregoing sentence, a Person will be deemed to not have “Knowledge” of a particular fact or matter.

Materiality and Knowledge “Scrape” Considerations

1. Applicability.
 - a. Whether a rep is inaccurate
 - b. Whether an obligation has been breached
 - c. Whether any Losses have been sustained or incurred
 - d. The calculation of the amount of Losses that have been sustained or incurred
2. Terms to disregard.
 - a. “materiality”
 - b. “Material Adverse Effect”/“Material Adverse Change”
 - c. “Knowledge”
 - d. words of similar import
3. Seller might want the scrape to NOT apply to “core representations” and other items that are not subject to a deductible (because such items are not otherwise subject to a risk of double materiality).
4. Note that the “scrape” doesn’t make sense in all cases (e.g., a rep that no Material Adverse Change has occurred since a given date, 10b-5 rep, list of material items (such as material contracts)).

Drafting the Lead-in

- ☺ The Seller represents to the Buyer as follows:
- ☺ Each Seller represents to the Buyer as follows:
- ☺ The Sellers represent to the Buyer as follows:

- ☹ The Seller represents **and warrants** to the Buyer as follows:

- ☹ The Sellers **jointly and severally** represent to the Buyer as follows:
- ☹ The Seller **hereby** represents to the Buyer as follows:
- ☹ The Seller **is representing** to the Buyer as follows:
- ☹ The Seller **makes the following representations** to the Buyer:
- ☹ **In order to induce the Buyer to enter into this Agreement**, the Seller represents to the Buyer as follows:

CONCEPT MAP AND ANNOTATED DEFINITION: “MATERIAL ADVERSE CHANGE”

CONCEPT MAP: DEFINITION OF “MATERIAL ADVERSE CHANGE”

I. “Material Adverse Change” vs. “Material Adverse Effect”

“Material Adverse Change” sounds better than “Material Adverse Effect” in the context of an “absolute MAC/MAE” representation; it sounds odd to state that an “effect” has not happened since a given date. Both “Material Adverse Change” and “Material Adverse Effect” work well in the context of qualifying a representation. Therefore, the suggestion is to use “Material Adverse Change” rather than “Material Adverse Effect.”

II. Main portion of the definition

A. Lead-in. “any [m]/[M]aterially¹ adverse change to”²

¹ The following definition of “Material” is recommended:

“**Material**” and “**Materially**” refer, with respect to a given Person, to a level of significance that would have affected any decision of a reasonable person in that Person’s position regarding whether (a) to enter into this Agreement, (b) to consummate the Transactions, or (c) both.

² Whether the term “Material Adverse Effect” or “Material Adverse Change” is used, it probably makes sense to refer only to a “change” in the MAC definition and not to include “facts,” “circumstances,” or “conditions” in the definition, since the existence of “facts,” “circumstances,” or “conditions” does not necessarily mean that a “change” or “effect” has occurred. That being said, in the representations referencing MAC, a Buyer-favorable, but reasonably, formulation would be to also reference “any event or circumstance that, individually or in the aggregate, [could]/[would] [not] reasonably be expected to result in a MAC.”

The two types of representations in which a MAC reference can appear are the “absolute MAC rep” and in qualifications to other representations. Examples follow:

Since December 31, 2010, no Material Adverse Change, and no event or circumstance that (individually or in the aggregate) could reasonably be expected to result in a Material Adverse Change, has occurred.

The Seller is qualified to conduct business in each jurisdiction in which such qualification is required for the Seller to conduct the Business, except for such failures to qualify that (individually or in the aggregate) could not reasonably be expected to result in a Material Adverse Change.

Vincent R. Martorana**January****B. Core of the definition.**³

1. the assets, business, liabilities, results of operations, [prospects,]⁴ or [financial condition]/[condition (financial or otherwise)] of the [Seller]/[Seller Entities] [or] [the Business][, taken as a whole]⁵
2. the value of the [Purchased Assets]/[Business Assets]⁶[, taken as a whole]⁷
3. the ability of [the Seller]/[any Seller Entity] to perform [the Seller's]/[such Seller Entity's] obligations hereunder [or to consummate the Transactions[, in each case]] [on a timely basis]
4. Specific changes that the Buyer wants to ensure constitute a MAC

³ As evidenced in *Hexion Specialty Chemicals v. Huntsman Corporation* 2008 WL 4457544 (Del. Ch. September 2008), it is difficult for buyers to prove that a MAC has occurred. One of the key lessons from this case is that buyers should set out specific, objective tests for what constitutes an MAC. For example, if the buyer believes that the loss of a key customer would constitute an MAC, it should explicitly state that in the definition. However, it can be difficult to convince seller's counsel to deviate from the standard MAC definition. It is generally easier and more advisable for buyer's counsel to include these objective tests as a closing condition or a termination right. (From PLC)

⁴ Whether to include prospects in the MAC definition is often negotiated. The Buyer wants to include prospects in the definition (the future of the Business is a legitimate concern, given that the Buyer is acquiring the Business so as to operate it in the future). The Seller wants to exclude prospects from the definition (although the Seller is willing to stand behind how the Business is currently being operated, future operations are the Buyer's concern). More often than not, the seller wins this battle. (From *The Structure of M&A Contracts* by Ken Adams (2011), Section 2.101)

But if the Seller's representation regarding nonoccurrence of a MAC includes the phrase "or any event or circumstance that would reasonably be expected to result in a MAC," and if MAC qualifications in the Seller's representations are phrased using the formula "would [or would not] reasonably be expected to result in a MAC," that would afford the Buyer protection comparable to that afforded by including "prospects" in the MAC definition while avoiding the battle in the MAC definition. This approach has been referred to as incorporating prospects by the "back door." (From *The Structure of M&A Contracts* by Ken Adams (2011), Section 2.102)

⁵ Seller's counsel should try to add the phrase "taken as a whole" here so that the MAC definition only captures changes that have an impact on the Business as a whole (rather than a portion of the Business). The Seller does not want a MAC to be found if an event only Materially affects some of the assets used in the Business and has little effect on the condition of the Business as a whole.

⁶ If the MAC definition included in an asset purchase agreement, likely use the term "Purchased Assets"; if the MAC definition is included in a stock purchase agreement or a merger agreement, likely use the term "Business Assets" (if defined) or exclude.

⁷ See footnote above regarding the phrase "taken as a whole."

III. Carve-Outs**A. List of possible carve-outs.****1. More typical carve-outs.**

- a. [any change in general in the United States or foreign economies, securities markets, financial markets, currency markets, capital markets (including changes in interest rates or the availability of financing)]/[any change arising from changes in general business or economic conditions in any of the geographical areas in which [the Seller]/[any Seller Entity] conducts the Business]
- b. any event or circumstance that affects one or more of the industries in which the [Seller]/[Seller Entities] [or] [the Business][, taken as a whole,] operate[s]
- c. the Parties' entry into this Agreement, the announcement [or disclosure] of [this Agreement]/[any Transaction Document] or the Transaction [(including (i) the disclosure of the identity of the Buyer or any of the Buyer's Affiliates as being involved in the Transaction, (ii) any communication by the Buyer or any of the Buyer's Affiliates regarding the plan or intentions of the Buyer or any of the Buyer's Affiliates with respect to the conduct of the Business or relating to the Transactions, and (iii) the threatened or actual impact on relationships of any Company Entity with customers, vendors, suppliers, distributors, landlords, or employees (including the threatened or actual termination, suspension, modification, or reduction of such relationships))], or [any action required or [expressly]⁸ permitted [hereby]/[by any Transaction Document]]/[the performance or compliance with the terms of, or the taking of any action required by or related to, [this Agreement]/[any Transaction Document]
- d. any acts of war (whether or not declared), insurrection, sabotage, terrorism, or public enemy, or any national or international political or social conditions

⁸ Without "expressly," this could be interpreted as "not prohibited by this Agreement," which is much broader than an express permission under the Agreement.

2. More aggressive carve-outs.⁹
- a. a decline in the price, or a change in the trading volume, of the Company Common Stock on the [applicable stock exchange]
 - b. any acts taken, or failures to take action, or such other events or circumstances to which the Buyer has [expressly] consented
 - c. the Seller's failure[, in and of itself,] to meet internal or published projections, forecasts, or revenue or earning predictions with respect to the Business [or any other of the Seller's businesses, in each case] for any period[; except that the facts and circumstances underlying any such failure are not to be disregarded because of this clause [__] in determining whether a Material Adverse Change has occurred (though such facts and circumstances might be disregarded for because of the application of one or more other clauses of this definition)].
 - d. any event or circumstance of which the Buyer had Knowledge as of the Effective Date
 - e. any event or circumstance that, as of a given time of determination, no longer exists or the Seller has cured
 - f. any strike, lockout, labor dispute, riot, or civil commotion, embargo
 - g. any [adverse] changes in, or developments that are directly or indirectly attributable to, any Laws, any Orders, or any acts of any Governmental Entity
 - h. any change in [GAAP]/[IFRS], or in any interpretation thereof
 - i. any earthquake, hurricane, tornado, storm, flood, [fire]/[wildfire], or other natural disaster
 - j. any failure of technical facilities, or any failure or delay of transportation facilities
 - k. any operating losses of the Company and the Company Subsidiaries in the Ordinary Course of Business

⁹ To be very Seller-favorable, consider using concepts from the definition of "Force Majeure" in the carve-outs to the definition of "Material Adverse Effect."

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- l. any damage, destruction, impairment, or other loss of or with respect to any asset to the extent covered by insurance
 - m. any event or circumstance beyond the Seller's control
- B. Proving the applicability of a carve-out: The Buyer would want to place this burden on the Seller.
- C. Including not only the listed carve-outs, but also "events and circumstances relating to, arising out of, resulting from, or attributable to" any of the carve-outs.

IV. Carve-out to the Carve-outs: Disproportionality

- A. Events and circumstances are typically excluded as carve-outs if or to the extent that such events or circumstances disproportionately affect the Seller or the Business.
- B. "Unless" (Buyer-favorable) vs. "Except to the extent" (Seller-favorable)
- C. Relevant persons for comparison

ANNOTATED “MATERIAL ADVERSE CHANGE” DEFINITION

“**Material Adverse Change**” means any [m]/[M]aterially adverse change to (a) the assets, business, liabilities, results of operations,[prospects,] or [financial condition]/[condition (financial or otherwise)] of the [Seller]/[Seller Entities] [or] [the Business][, taken as a whole], (b) the value of the [Purchased Assets]/[Business Assets] [, taken as a whole], [or] (c) the ability of [the Seller]/[any Seller Entity] to perform [the Seller’s]/[such Seller Entity’s] obligations hereunder [or to consummate the Transactions[, in each case]] [on a timely basis][, but only if any such event or circumstance could reasonably be expected to have long-term effects on the Business]¹⁰[, or (d) [specific changes that the Buyer wants to ensure constitute a MAC]; except that each of the following events and circumstances [(and any event or circumstance directly or indirectly relating to, arising out of, resulting from, or attributable to any of the following events or circumstances)]¹¹ is deemed to not constitute, and is not to be taken into account in determining whether there has been or could be, a “Material Adverse Change” [to the extent that the Seller has reasonably demonstrated the occurrence or existence thereof]¹² [(except to the extent that)/[unless], in [each of the following cases]/[in the case of the immediately foregoing clauses [___], [___],..., and [___]], [the Buyer reasonably demonstrates that]¹³ such event or circumstance, as the case might be, disproportionately [and [m]/[M]aterially] affects [the Seller]/[Seller Entities] [or] [the Business][, taken as a whole,] in an adverse manner, as compared to [similarly situated businesses)]/[other participants in the industries in which the Business operates]/[competitors of the Business]]:

(i) [any change in general in the United States or foreign economies, securities markets, financial markets, currency markets, capital markets (including changes in interest rates or the availability of financing)]/[any change arising from changes in general business or economic conditions in any of the geographical areas in which [the Seller]/[any Seller Entity] conducts the Business];

(ii) any event or circumstance that affects one or more of the industries in which the [Seller]/[Seller Entities] [or] [the Business][, taken as a whole,] operate[s];

(iii) the Parties’ entry into this Agreement, the announcement [or disclosure] of [this Agreement]/[any Transaction Document] or the Transaction [(including (A) the disclosure of the identity of the Buyer or any of the Buyer’s Affiliates as being involved in the Transaction, (B) any communication by the Buyer or any of the Buyer’s Affiliates regarding the plan or intentions of the Buyer or any of the Buyer’s Affiliates with respect to the conduct of the Business or relating to the Transactions, and (C) the threatened or actual impact on relationships of any Company Entity with customers, vendors, suppliers,

¹⁰ Seller-favorable.

¹¹ Seller-favorable.

¹² Buyer-favorable.

¹³ Seller-favorable.

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distributors, landlords, or employees (including the threatened or actual termination, suspension, modification, or reduction of such relationships))), or [any action required or [expressly] permitted hereby]/[the performance or compliance with the terms of, or the taking of any action required by or related to, [this Agreement]/[any Transaction Document]];

(iv) any acts of war (whether or not declared), insurrection, sabotage, terrorism, or public enemy, or any national or international political or social conditions;

[(v) a decline in the price, or a change in the trading volume, of the Company Common Stock on the [applicable stock exchange];]

[(vi) any acts taken, or failures to take action, or such other events or circumstances to which the Buyer has [expressly] consented;]

[(vii) the Seller's failure[, in and of itself,] to meet internal or published projections, forecasts, or revenue or earning predictions with respect to the Business [or any other of the Seller's businesses, in each case] for any period[; except that the facts and circumstances underlying any such failure are not to be disregarded because of this clause (vii) in determining whether a Material Adverse Change has occurred (though such facts and circumstances might be disregarded for because of the application of one or more other clauses of this definition)];]

[(viii) any event or circumstance of which the Buyer had Knowledge as of the Effective Date;]

[(ix) any event or circumstance that, as of a given time of determination, no longer exists or the Seller has cured;]

[(x) any strike, lockout, labor dispute, riot, or civil commotion, embargo;]

[(xi) any [adverse] changes in, or developments that are directly or indirectly attributable to, any Laws, any Orders, or any acts of any Governmental Entity;]

[(xii) any change in [GAAP]/[IFRS], or in any interpretation thereof;]

[(xiii) any earthquake, hurricane, tornado, storm, flood, [fire]/[wildfire], or other natural disaster;]

[(xiv) any failure of technical facilities, or any failure or delay of transportation facilities;]

[(xv) any operating losses of the Company or the Company Subsidiaries in the Ordinary Course of Business;]

[(xvi) any damage, destruction, impairment, or other loss of or with respect to any asset to the extent covered by insurance;]

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[(xvii) [any events or circumstances that the Seller wants to ensure constitutes a carve-out]; or]

[(xviii) any event or circumstance beyond the Seller's control.]

Vincent R. Martorana

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Vincent R. Martorana, Counsel

Tel: +1 212 549 0418

Email: vmartorana@reedsmith.com

Vincent R. Martorana is Counsel in the Corporate & Securities Group with Reed Smith's New York office. His practice includes the representation of clients in domestic and cross-border mergers, stock and asset acquisitions and divestitures, joint ventures, strategic alliances, licensing arrangements, corporate restructurings, private equity investments, and securities offerings. He also regularly provides advice on corporate governance and state laws governing business entities (including Delaware and New York corporate, partnership, and limited liability company law). Vincent has represented a wide range of clients—from start-up and early-stage companies to well-established enterprises—in various industries, including technology, healthcare, pharmaceutical products, consumer products, and energy.

Vincent has extensive experience providing advice on contract drafting, analysis, and interpretation relating to disputes, settlements, and negotiated transactions. He has presented his continuing legal education contract-drafting courses for in-house legal departments and at various other venues, including Practising Law Institute, Strafford Webinars, The Business Development Academy, the National Academy of Continuing Legal Education, the American Bar Association, the New York State Bar Association, the New York City Bar Association, the New York County Lawyers Association, the Brooklyn Bar Association, the Suffolk County Bar Association, and the Westchester County Bar Association.

He is also the author of *Drafting Points* (www.draftingpoints.com), a blog that is dedicated to contract-drafting issues.

Vincent received a J.D. from the University of Chicago Law School and a B.S. in Economics (with concentrations in Finance and Operations & Information Management), *magna cum laude*, from the Wharton School at the University of Pennsylvania.