

Commentary Judgment call

Covering the bases

When it comes to making representations and warranties, timing can be everything *by Robert B. Little and Travis S. Souza*

REPRESENTATIONS AND WARRANTIES in acquisition agreements often form the basis for liability when a deal falters. While parties regularly negotiate the scope of the representations and warranties, including the inclusion of materiality and knowledge qualifiers, they typically pay less attention to a critical issue: When are the representations and warranties deemed to be made—at signing, at closing or continuously?

The timing of the representations and warranties is typically addressed in lead-in language to the representations section. This language can take many forms. The representations typically are deemed to be made at signing, but sometimes the parties provide that they are made at both signing and closing or, infrequently, continuously between signing and closing. Alternatively, the agreement may be silent as to timing, in which case the representations may be deemed to be made only at signing.

If the agreement ties the representations to a specified date, a party will be in breach only if its representation is untrue as of that date. However, if the agreement provides for continuous representations, the representations must be true at all times during the relevant period.

The timing of the representations can create profoundly different outcomes in the event of a breach, including with respect to the parties' ability to terminate the agreement, pursue damages or obtain post-closing indemnification. Consider a situation where the seller represents that, as of the date of the agreement, its equipment is in good condition in all material respects, and a major piece of the seller's equipment is seriously damaged after the agreement is signed and before closing. Because the damage did not exist at signing, the representation was accurate at that time.

One alternative the buyer may consider in light of the damaged equipment is termination of the agreement. Most termination provisions will allow termination if the other party breaches a representation (often subject to a materiality threshold) and the breach is not cured within a specified period. But in the damaged equipment example, was there even a breach? If the representations are made only at signing, the answer likely is

no. As a result, the buyer would need to see whether the damage resulted from a covenant breach that would allow the buyer to terminate.

If closing occurs, the buyer may seek post-closing recourse for the damage under the indemnification protections in the acquisition agreement. However, the buyer is likely to run into the same issue of whether the seller breached the representation. Rather than seek indemnification based on a breach of the representation due to the timing issue, the buyer may allege a breach of the seller's bring-down closing certificate, where the seller reaffirms the accuracy of its representations as of the closing (assuming the agreement permits indemnification for losses from breaches of the closing certificate). However, reliance on the closing certificate may be unsuccessful. Many closing certificates are subject to an overarching qualifier that the representations are true only to the extent that a breach would not materially impact, or result in a material adverse effect, the company being sold. Such a significant qualification of the representations may make proving a breach difficult.

Dealmakers should keep these considerations in mind when drafting acquisition agreements. Sellers, which are more likely to breach a representation, should seek to limit the timing of the representations to the signing date. Sellers can argue that buyers are protected from changes occurring post-signing by the interim covenants in the acquisition agreement and the bring-down certificate. Alternatively, the seller could agree to make the representations as of signing and as of closing, but not continuously during the interim period.

Under this formulation, a problem under the representations during the interim period would not give rise to a termination right and damage claim if the problem can be cured by closing, and the seller effectively has until the drop-dead date to cure the problem. If the seller is unable to cure and closing never happens, the representations are never made again as of closing, and there is no breach or liability.

Buyers, however, are typically best served by representations being made continuously or, to help ensure the availability of post-closing indemnification for breaches, both as of signing and closing. ■

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