CONTRACTUAL LIMITATIONS ON SELLER LIABILITY IN M&A AGREEMENTS

By

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8TH ANNUAL MERGERS AND ACQUISITIONS INSTITUTE

DALLAS, TX • OCTOBER 18, 2012

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ATTACHMENTS:

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I. PERSPECTIVE

Acquisition agreements for closely held businesses frequently incorporate well-defined risk shifting provisions. The buyer seeks to shift risks in the acquisition agreement to the seller through detailed representations, provisions that condition its obligation to close upon the correctness of those representations and provisions that obligate seller to indemnify buyer for losses buyer may suffer as a result of seller breaches and other events.[1] Typically these risk allocation provisions are heavily negotiated.

A contracting party that is dissatisfied with the deal embodied in a written agreement, however, often attempts to circumvent its provisions by premising tort-based fraud and negligent misrepresentation claims on the alleged inaccuracy of both purported pre-contractual representations and express, contractual warranties. The mere threat of a fraud or negligent misrepresentation claim can be used as a bargaining chip by a counterparty attempting to avoid the contractual deal that it made. Indeed, fraud and negligent misrepresentation claims have proven to be tough to define, easy to allege, hard to dismiss on a pre-discovery motion, difficult to disprove without expensive and lengthy litigation, and highly susceptible to the erroneous conclusions of judges and juries.

The seller can endeavor to reduce the risk of post-closing claims by the buyer through provisions in the acquisition agreement to the effect that the acquisition agreement is the exclusive agreement between the parties, that seller is not responsible for any statement not made within the four corners of the agreement[2] and the seller's responsibility for those statements is

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1 *See infra* Section IV. Indemnification Provisions.

2 *See infra* Section V. Entire Agreement.

contractually limited. This paper will endeavor to highlight these issues through a series of hypotheticals and discuss some recent cases that show how the issues are dealt with by some courts.

II. HYPOTHETICAL SITUATIONS

A. Hypothetical 1: Pre-Signing

- Seller conducts competitive auction to sell assets
- After receiving a non-binding indication of interest from Buyer 1, Seller sends an unsigned bid procedures letter to Buyer 1
- The bid procedures letter states that a bid will only be deemed to be accepted upon execution and delivery of the purchase agreement and contains "no legal obligation" language
- Buyer 1 submits a bid pursuant to the bid procedures letter, following which Seller calls Buyer 1 stating the parties have a "deal" and will work to sign a definitive purchase agreement
- Seller continues to market the assets and signs a purchase agreement with Buyer 2
- Buyer 1 sues Seller for fraud and negligent misrepresentation and Buyer 2 for tortious interference with contract

B. Hypothetical 2: Between Sign and Close

- Target conducts a competitive sale process and two buyers are interested
- Buyer 1 and Target sign a merger agreement (or, in a companion case, a letter of intent) with "no-shop" and "prompt notice" provisions
- Target continues to have strategic discussions and share confidential information with Buyer 2
- Buyer 2 makes a topping bid for Target
- Target terminates its signed merger agreement with Buyer 1, pursuant to the negotiated superior proposal termination right in the merger agreement, and signs a merger agreement with Buyer 2
- Buyer 1 sues Target for breach of the merger agreement

C. Hypothetical 3: Post-Closing

- Buyer and Seller sign a purchase agreement and close the acquisition

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First appeared as part of the conference materials for the
8th Annual Mergers and Acquisitions Institute session
"Developments in Seller Liability in M&A"