Trending Topics in Indemnification

UT Mergers and Acquisitions Institute 2019

Moderator: Mark S. Solomon, Katten

Panelists:
Jennifer T. Wisinski, Haynes Boone
Alain A. Dermarkar, Jones Day
Jessica Pearlman, K&L Gates
William M. Monat, Willis Towers Watson

MATERIALITY SCRAPES

Materiality Scrapes

Today, most private M&A agreements include a "materiality scrape" in the indemnification provisions

Double Scrape:

- Post-closing, for purposes of determining (1) whether a ***breach*** of a representation or warranty has occurred **and** (2) the ***amount of liability*** for a breach of a representation and warranty, all materiality qualifiers are ignored

Single Scrape:

- Post-closing, for purposes of determining the ***amount of liability*** for a breach of a representation and warranty, all materiality qualifiers are ignored

Sample Clauses (double scrape):

"Materiality standards or qualifications by reference to the defined term 'Material Adverse Effect' in any representation or warranty shall not be taken into account in determining (i) whether an inaccuracy in such representation or warranty exists or (ii) the amount of any indemnifiable damages with respect to such inaccuracy."

"For all purposes of this Article X, the representations and warranties contained in this Agreement shall be deemed to have made without any qualifications or exceptions relating to or referencing the terms material,' 'in all material respects,' 'materiality' or 'Material Adverse Effect.'"

Negotiating Positions

Buyer Position:

- Should not be subject to “double materiality” resulting from basket/deductible or “triple materiality” from mini-basket
- Streamlines negotiating and reduces seller’s disclosure burden
- Reduces risk of post-closing dispute over what is “material”

Seller Position:

- Concern that buyer will force seller to close “into a breach” with liability
- Nickel and diming concern
- Potential increased disclosure burden
- Creates awkward situations

Drafting Considerations

Materiality scrapes can result in awkward readings of certain representations:

- representations that reference lists in schedules (Schedule X lists all “material” contracts; alternative is to include dollar thresholds instead of materiality threshold)
- Full disclosure or 10b-5 representation (materiality is at the essence of this representation)
- The MAE representation (won’t make sense without materiality)
- Financial statements representation

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