Key Provisions to Include in a Merger Agreement
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According to the Companies Act, of 2013, a merger refers to an agreement that is made for the purpose of uniting two existing business companies into one single new company. In a merger, two companies join their hands to unite their resources, facilities, infrastructure, and manpower to carry out their business activities as one entity/company. There may be different types of mergers depending upon the consensus between both parties which may include – vertical mergers, horizontal mergers, roll-up mergers, conglomerate mergers, etc.

A merger agreement refers to an agreement entered by two companies intending to merge by stating their rights, interests, liabilities, and other pertinent details like indemnification, purchase price, representations and warranties, termination clause, and other considerations. A well-drafted merger agreement enables the merging companies to be acquainted with their rights, liabilities, and duties and has a thorough idea about every detail pertaining to the merger. Moreover, it serves as a guard of rights in event of any conflict or confusion between the companies and adds the element of enforceability to the merger.

A well-drafted merger agreement not only reduces the chances of a dispute or conflict between the two entities but also serves as a process management function to ensure a smooth takeover or consolidation.

Structure Of A Merger Agreement

In addition to fulfilling the essential elements of a contract under the Indian Contract Act, of 1872, every contract should also meet the demands of the project and cater to the needs for which the contract or agreement is being created.

The structure of a merger agreement should be properly drafted and key details pertaining to the nuances of the agreement should be entered as elements of the agreement so that a clear and concise overview of the agreement between the companies can be obtained before the actual merger or final takeover.

Various critical provisions of a merger agreement that must be included in a merger agreement to render it effective and avoid any future conflict are as follows:

1. Purchase Price: The purchase price, in the context of a merger agreement, refers to the amount of money that one company must pay to the other company based on its valuation and market equity to merge with it into a single business entity. Arriving at the purchase price of a company involves many factors. Firstly, the companies must agree on the market valuation of each other. The purchase price in every merger transaction is determined by various factors such as the base purchase price along with cash, indebtedness, assets, and the value per share of the company.
2. Representations and Warranties: In every merger operation, both companies undertake various risks associated with the transaction. For instance, the risk may involve any hidden ongoing litigations, taxation disputes, discrepancies in inventory and asset evaluations, and many other disclosures. In the event of any falsified information or any risk that may arise, both parties are required to make a representation to mitigate the risk and indemnify the party which has suffered a loss due to their action. For instance, if a company certifies that there was no pending litigation against the company at the time of the merger and any litigation that was pending at that time may arise in the future, the defaulting party is liable to pay indemnification to the other party in the form of representations and warranties.
3. Indemnification: Every merger agreement must provide for monetary indemnification in event of a breach of any covenant, misdescription of facts and vital information, fraudulent information, etc. The parties in a merger may agree to a specific quantified monetary amount as indemnification for the breach including a ceiling for a higher limit of the same. Moreover, the parties may also agree to the method of indemnification which may be in form of deductions, set-offs, direct payments, etc. There may also be guarantors for the parties which may certify their liability in event of a breach of indemnification by the party concerned.
4. Termination: Termination is one of the most essential elements of every merger agreement which gives the power to the parties to call off the deal in the event of various situations. There may be different reasons for which any merger may be terminated such as – mutual consent of the parties to the contract, contractual breach by either party, time-bound termination, or termination due to any unforeseen circumstance. The merger agreement can be terminated with cause only due to any material breach by either party or due to any terms specified in the agreement whereas the termination may take place without cause in event of a time-bound contract or mutual agreement of parties. A termination clause in a merger agreement gives power to both parties to exit the agreement and merger without any legal trouble or litigations. The only burden of proof is upon the parties to prove that the elements of the agreement were either not met or violated by the parties in response to which the agreement was terminated.
5. Other relevant considerations: Apart from the above elements of a merger

agreement, there may be other relevant considerations that must form a part of the merger agreement. For instance, a non-compete clause forms an important element of every merger agreement which states that the parties merging into a single entity must not compete with the new entity so formed in terms of business in the name of the old entity. Generally, non-compete clauses are added for a period of up to 36 months where the merger pertains to the transfer of goodwill or essential business knowledge of the parties. Another important element of a merger agreement is a non – solicitation clause which states that in event of closing or demerger of the companies, both the companies will refrain or abstain from any business activity in competition with the entity or soliciting the acquired clientele base of each other. This enables both companies to enjoy security and confidence while dealing with each other in a business environment.

Conclusion

A merger agreement is the backbone of every merger transaction between two companies because it carries the power to decide the fate of both companies coming together in a merger to carry out business activities. Due to the vital legal importance and enforceability of a merger agreement, it is important to get it drafted and determined by a legal counsel or consultant. Since a merger involves many stakeholders other than the two companies including the shareholders, employees, investors, and members of the company, every effort should be done to minimize the scope of errors and conflicts in a merger.

In the event of a merger, a legal counsel can carry out due diligence of both companies and identify the areas which may cause future litigation and help to mitigate them. Moreover, a legal consultant may also help to protect the interests of either party in event of an unforeseen circumstance and lead to a valid and dispute-free merger.

FAQs

What is a merger agreement, and why is it essential for businesses involved in an acquisition?

A merger agreement is an agreement that is drawn between two companies that intend to come together to carry out business as a single entity. It is essential as it lists the rights and liabilities of both companies.

How is the purchase price typically calculated in a merger agreement, and what factors may impact it?

The purchase price in every merger transaction is determined by various factors such as base purchase price along with cash, indebtedness, assets, and value per share of the company.

What are some common issues that arise during the negotiation of a merger agreement, and how can legal counsel help businesses navigate these challenges?

There are various issues that arise during a merger agreement and its negotiation such as price consideration issues, share valuation issues, representation and warranty issues, escrow/holdback issues, etc. A legal counsel can apply the existing laws of the country along with relevant judicial precedents to enable a smooth transition for both companies.

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