

Demystifying Representations And Warranties In M&A Agreements: A Comprehensive Guide

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Few things are more significant than representations and warranties in the world of mergers and acquisitions (M&A). In an M&A transaction, both parties want to ensure that they are acquiring what they agreed on and that the company's statements are accurate. This is where representations and warranties in M&A Agreements come into play. Contractual assertions made by one party to another on the accuracy and reliability of specific transaction-related facts and conditions are referred to as representations and warranties. These may involve financial statements, tax compliance, legal compliance, intellectual property, contracts, environmental issues, and employee benefits, among other things.

Representations and warranties aim to allocate risk between the parties and to ensure that the buyer understands the company's assets and obligations. They reassure the buyer that the seller has given all relevant information and that there are no hidden risks or obligations that could reduce the company's worth. They not only protect the seller, but they also limit the buyer's ability to file claims against the seller after the transaction has concluded. However, there are also certain limitations of representations and warranties.

This article will comprehensively explain representations and warranties in mergers and acquisitions transactions in the following manner:

- Understanding Representations and Warranties in the Indian Context
- Importance of Representations and Warranties in M&A Agreements
- Key Provisions in Representations and Warranties
- Limitations and Qualifications to Representations and Warranties
- Best Practices for Negotiating Representations and Warranties

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- Limitations and Qualifications to Representations and Warranties
- Best Practices for Negotiating Representations and Warranties
- Conclusion
- FAQs
- What are representations and warranties in an M&A agreement?
- How do representations and warranties protect parties in an M&A transaction?
- What are some common limitations and qualifications to representations and warranties in M&A agreements?

Understanding Representations and Warranties in the Indian Context

The terms “representation” and “warranty” are not defined in Indian law under the Indian Contract Act[1]. The Sale of Goods Act (SOGA)[2], however, acknowledges and distinguishes these phrases in specific transactions involving commodities or services. SOGA defines a “warranty” as a condition that is incidental to the fundamental objective of the contract.

In the case of *All India General Insurance Co. Ltd. and Anr. v. S.P. Maheswari*[3], the Court observed the distinction between representation and warranty in insurance contracts. The primary contrast between representation and warranty, according to the court, is that responses to questions are normally viewed as representations rather than warranties unless the parties have agreed that they will serve as the basis of the contract. In the case of a representation, inaccuracy is a defense to a policy action, even if the error is minor and done in good faith. To cancel a policy based on a representation, the insurer must demonstrate that the statement is untrue and fraudulent, or that it was false and material to the risk.

The case *Life Insurance Company of India v. Permanent Lok Adalat and Anr.*[4] further recognized the distinction between representations and warranties. A breach of warranty gives rise to a claim for damages but does not give rise to the right to cancel the contract. But, in the instance of misrepresentation, the Indian Contract Act allows remedies.

Importance of Representations and Warranties in M&A Agreements

Representations and warranties are critical components of M&A agreements. They are critical in reducing risk, ensuring transparency, and developing buyer-seller confidence.

- Representations and warranties in an M&A agreement assist the buyer in understanding the company’s assets and liabilities and making educated decisions about the acquisition.
- They permit the allocation of risk among parties, with the vendor liable for any misrepresentations or inaccuracies.
- Breach of representations or warranties may entitle the buyer to compensation or other remedies, shielding them from risks or responsibilities that may arise after the transaction is completed.
- Representations and warranties can establish trust and a positive relationship between the buyer and the seller by displaying a commitment to openness and fairness.

Key Provisions in Representations and Warranties

The most commonly found M&A Agreement provisions for Representations and Warranties are:

- **Materiality:** The seller’s claims are limited to material facts or conditions.

Materiality can be defined in several ways, such as a monetary threshold or a percentage of revenue or assets.

- *Knowledge*: The seller is only liable for accurately representing facts or conditions about which it is aware. Actual knowledge, constructive knowledge, or knowledge that should have been attained with reasonable diligence are examples.
- *Survival Period*: The representations and warranties provision will also define how long the seller's statements will be valid after the transaction is completed. The survival period can range between 12 and 24 months depending on the nature of the statement and the transaction.
- *Indemnification*: These clauses obligate the seller to compensate the buyer for any losses incurred as a result of a breach of a representation or warranty. They include the scope of indemnification, the seller's responsibility limits, and the claim filing procedures.
- *Disclosure Schedules*: These schedules contain detailed information regarding the facts or circumstances covered by the representations and warranties.
- *Qualifications and exceptions*: The provisions of representations and warranties may incorporate numerous conditions and exclusions to the seller's promises.

Limitations and Qualifications to Representations and Warranties

Despite the importance of such clauses in an M&A Agreement, there are certain limitations of representations and warranties. For example, the seller's understanding and expertise of the company's affairs may be limited, which could lead to inadvertent misrepresentations. Furthermore, representations and warranties may be subject to various limits and exclusions, which might reduce their value.

Qualifications for representations and warranties are routinely utilized in M&A transactions, especially when sellers are unable to offer unqualified statements of truth. They alter or qualify the statement, typically referring to specific conditions that invalidate a representation or warranty.

Qualifications may be included in the representation and warranty text, a disclosure schedule, or a letter. These qualifications are negotiable and subject to revision, and they are required for accuracy and risk allocation. Qualifications include phrases like "*to the best of the vendor's knowledge*" and "*unless as specified in the disclosure schedule,*" etc.

Best Practices for Negotiating Representations and Warranties

Representations and warranties are frequently at the heart of M&A.

Implementing best practices for negotiating M&A Agreements safeguards all parties.

- Firstly, read and interpret the section on representations and warranties to identify any issues or coverage gaps.
- Second, ensure that the materiality requirement is appropriate for the transaction.
- Third, to minimize liability issues, specify the seller's knowledge.
- The indemnity clauses should protect the buyer while limiting the seller's liability.
- Any relevant information should be included in disclosure schedules.
- All representations and warranties should be qualified or eliminated to avoid confusion.

Following these best practices, parties can create representations and warranties in M&A Agreements that prevent and mitigate potential issues.

Conclusion

Representations and warranties are an essential component of any M&A transaction because they assure the buyer that the seller has disclosed all relevant information regarding the acquired business. Identifying materiality criteria, designating knowledge qualifiers, defining the survival period, drafting indemnity terms, preparing disclosure schedules, and outlining exceptions and qualifications are all best practices for negotiating M&A agreements and representations, and warranties. Following these recommended practices can help reduce risk and allow a smoother transaction for both parties. Buyers and sellers must engage with experienced legal counsel to draft and create representation and warranty provisions that satisfy their specific needs and expectations.

FAQs

What are representations and warranties in an M&A agreement?

Representations and warranties are assertions made by the vendor about the company being transferred in an M&A transaction. These statements are meant to inform the buyer about the target company's financial and legal status, operations, assets, liabilities, and contracts, as well as other material facts. Generally, representations are factual assertions, whereas warranties are contractual assurances that the vendor will indemnify the buyer if they are breached.

How do representations and warranties protect parties in an M&A transaction?

M&A Agreement provisions for representations and warranties protect the parties by specifying the seller's statements regarding the company being acquired and holding the seller accountable for any incorrect statements. While deciding whether to proceed with the acquisition, the buyer depends on these assertions. The seller has an incentive to provide accurate information as he may be held liable for any losses incurred by the buyer as a result of false or misleading statements. The provisions on representations and warranties establish a process for addressing representations and warranties in addition to providing a mechanism for resolving disputes and compensating the buyer in the case of a breach.

What are some common limitations and qualifications to representations and warranties in M&A agreements?

Materiality thresholds, knowledge qualifiers, survival periods, indemnification provisions, and disclosure schedules are common limitations and qualifications for representations and warranties in M&A agreements. Exclusions for known risks or liabilities, as well as exception disclosures, may also be provided.

[1] Indian Contract Act, 1872.

[2] The Sale of Goods Act, 1930.

[3] All India General Insurance Co. Ltd. and Anr. v. S.P. Maheswari, AIR 1960 Mad 484.

[4] Life Insurance Company of India v. Permanent Lok Adalat and Anr., C.W.P No. 9738 of 2007.

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