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MERGERS & ACQUISITIONS

Some practices still vary between U.S.

Positions differ on, e.g., fraud exceptions and material adverse change.

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AS MERGERS AND acquisitions become increasingly international, historic differences between U.K. and U.S. practice are diminishing. The differences that remain result both from legal considerations and from custom and practice.

In the United Kingdom, sellers commonly object to calling the warranties "representations." Some consider this to minimize the risk of tortious claims and the possibility of rescission under the Misrepresentation Act 1967. However, it is hard to see how a mere label can have any bearing on whether the statement is a representation for purposes of that act. So an express provision must be included if tortious claims and rescission are to be excluded.

While it is customary in the United States to characterize the statements about the target as both representations and warranties, the remedies available to the buyer will depend, in part, on whether certain remedies, such as tortious remedies for misrepresentation, have been contractually excluded and, in part, on the extent of the buyer's knowledge and reliance on the statement.

In both jurisdictions, sellers invariably will seek to include in the agreement an "entire agreement clause" and a "nonreliance statement" to ensure that they cannot be found liable for representations and/or warranties not incorporated in the written agreement.

If a buyer can demonstrate that it was actually induced by a precontractual statement outside of the written agreement to enter into the bargain, it may have the ability to challenge the entire agreement clause and nonreliance statement.

In the English cases of *Thomas Witter Ltd. v. TBP Industries Ltd.*, [1996] 2 All ER 573, and *E.A. Grimstead & Son Ltd. v. McGarrigan*, [1999] WL 852482, the court held that an "entire agreement" clause will not alone exclude remedies for precontractual misrepresentations, and a nonreliance statement can be challenged if in fact the buyer relied on a precontractual statement. Although a nonreliance statement could operate in certain circumstances as an evidential estoppel, if a seller wishes to avoid such claims it will be necessary to include an express provision to that effect in the agreement.

U.S. state courts are split on whether precontractual representations can form the basis of a claim in tort when the written agreement contained an entire agreement clause and/or nonreliance statement.

New York courts may bar both fraudulent and nonfraudulent misrepresentation claims when the contract contains a specific statement of nonreliance on the very representations that are later claimed to have been fraudulently made. *Danann Realty v. Harris*, 184 N.Y.2d 599 (1959).

The courts of some other states have taken a different approach and, much like the English courts, have decided that a nonreliance statement does not automatically preclude a finding that the buyer did in fact rely on a representation that was not included in the agreement, even in cases not involving fraud. Many of these cases, however, seem to rely on specific facts and circumstances in determining whether a nonreliance statement should shield the seller from liability.

Any attempt to exclude or limit liability in an English law-governed agreement must be reasonable if it is to be effective. In the *Witter* case, the court held that it was never reasonable to attempt to exclude liability for fraudulent misrepresentation. Accordingly, under English law, an exclusion clause that omits an exception for fraud is unenforceable, even if fraud is not present. *ABRY Partners V L.P. v. F&W Acquisition LLC*, No. 1756-N (Del. Ch. 2006), shows that a U.S. court is not as likely to declare an entire agreement clause unenforceable simply because it does not have a fraud exception. Generally, the U.S. approach is to look to the facts of the case and enforce the provision if the matter does not involve fraud.

Disclosure issues

In the United Kingdom, disclosures against warranties are typically contained in a separate disclosure letter, rather than in schedules to the agreement, as is sometimes the case in the United States. The disclosure letter usually contains "general" disclosures (for example, matters that appear in public records), which qualify all warranties, and "specific" disclosures, which, although usually cross-referenced to specific warranties in the agreement, are often treated as effective disclosures in relation to all warranties.

U.S. convention has been for the buyer to allow specific disclosures only in respect of each warranty and representation against which

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disclosure is being made. Since the case of *IBP Inc. v. Tyson Foods Inc.* (Del. Ch. June 15, 2001), express provisions to that effect are all the more important. In *Tyson*, the court found that certain disclosures qualified all of the representations in the agreement, even though the buyer failed to appreciate the extent of the implications of the disclosure for other warranties and representations.

Under English law, to be effective, a disclosure must be "fair," i.e., a seller is normally required to disclose "facts and circumstances sufficient in detail to identify the nature and scope of the matter disclosed and to enable the purchaser to form a view whether to exercise any of the rights conferred on him by the contract." *Edward Prentice v. Scottish Power,* [1997] 2 BCLC 264. Merely making known the means of knowledge or reference to a source of information that may enable the buyer to work out certain facts and conclusions may not itself be sufficient.

However, this position must be measured against the requirement of the agreement in question and the particular circumstances of the case. *In MAN v.Freightliner Ltd.*, [2005] EWHC 2347 (Comm), the court indicated in dicta that it could give effect to a disclosure clause providing that inferences capable of being drawn from disclosed documents would be deemed to be generally disclosed. In the light of this, it is becoming increasingly common for buyers to include a concept of "fair disclosure" in their agreements pursuant to which a disclosure, in order to be effective, must contain such information as would enable a reasonable buyer to make a reasonably informed assessment of the matters, facts and circumstances giving rise to the inconsistency with the warranties and their implications.

English law requires a fraud exception.

In the United Kingdom, if a buyer had actual knowledge prior to execution of the agreement of facts that are inconsistent with a warranty when given, that buyer may be precluded from raising a successful claim for breach of such warranty, even if that matter was not disclosed to the buyer. In the United States, state laws differ on this question, and even within jurisdictions, such as New York, the situation is confused. In some states, there is a requirement that the buyer show reliance upon a particular contractual representation or warranty made by the seller in order to sustain its contractual claim. Other states hold that a buyer claiming a breach of a contractual representation or warranty need only show that there was in fact an untrue statement and that the buyer's knowledge will not generally preclude such a claim.

In the U.K. case *Eurocopy PLC v. Teesdale*, [1992] BCLC 1067, the agreement contained the usual provision that the warranties were given subject only to the matters set out in the disclosure letter but that no other information of which the buyer had knowledge would preclude the buyer from claiming breach of warranty. Although only an interlocutory application, this case casts doubt on the viability of such provisions. The court's decisions suggested that a buyer may not be able to rely on such a clause when it has actual knowledge of facts not disclosed in the disclosure letter. Comments by way of dicta in *Infiniteland v. Artisan Contracting Ltd.*, [2005] EWCA Civ. 758, bolster the view that a buyer will be prevented from relying upon such provisions if it has actual knowledge. The court found that the buyer's actual knowledge would defeat any claim for breach of warranty but constructive knowledge would not.

The position of the U.S. states on the issue of buyer knowledge varies. In *Ziff Davis*, 75 N.Y.2d 496 (1990), the New York court held that "the critical question is not whether the buyer believed in the truth of the warranted information,...but whether [it] believed [it] was purchasing the [seller's] promise" as to the truth of the statement. The Ziff Davis case was subsequently distinguished, however, in *Galli v. Metz,* 973 F.2d 145 (2d Cir. 1992), and *Rogath v. Siebenman*, 129 F.3d 261 (2d Cir. 1997), where the courts focused on the fact that the buyer learned about the misrepresentation from the seller and could not be said to have negotiated the seller's promise that the fact was true, and waived the breach by closing with such knowledge. Both cases also involved situations in which the buyer obtained the knowledge prior to signing and there was no express reservation of rights prior to closing. The courts of other states have held that a buyer's knowledge of an inconsistency with a warranty will preclude a claim for breach of that warranty.

In the United States, the practice is invariably to require warranties and representations to be repeated at closing, and usually the accuracy of warranties/representations at closing is a condition of closing. In the United Kingdom, while it is not uncommon for warranties to be repeated at closing, sellers will seek to resist that principle and at worst argue for repetition of only those warranties over which they have direct control.

In addition, in the United Kingdom, it remains unusual for the accuracy of all warranties at closing to be a precondition of closing. In some U.K. deals, the buyer may have the right to terminate as a result of a material breach of the warranties given at signing and, in some cases, as repeated at closing.

Material adverse change

In the United States, buyers frequently seek to include a material adverse change (MAC) clause, whether expressed as a condition or as a termination right. A MAC clause gives the buyer the right to refuse to close if an event occurs between signing and closing that has an effect on the target that is material and adverse.

The law relating to MAC clauses is fact- and language-specific. In the *Tyson Foods* case, the court held that the broadly drafted MAC clause was a capricious provision that put the seller at risk for a variety of uncontrollable factors and took the view that such a provision should operate only to protect a buyer from the occurrence of unknown events that substantially threaten the overall long-term earnings potential of the target.

MAC clauses that take the form of a general condition to closing are not commonplace in the United Kingdom. If a MAC clause is incorporated in a U.K. agreement, it is more likely that it will take the form of a termination right capable of being exercised when the seller caused or allowed an event that is materially inconsistent with the warranties.

The only significant case is *Levinson v. Farin*, [1977] 2 All ER 1149. In the absence of a definition of "material," the court indicated that a reduction in the net asset value of the target in the region of 20% would be seen as material for purposes of such a clause. In relation to public takeovers, the U.K. Takeover Panel, which governs the rules on the acquisition of U.K. public companies, has ruled on this subject. Although not a court, it may offer some indication of the attitude of English courts toward MAC clauses. WPP Group PLC's August 2001 offer for Tempus Group PLC contained a MAC clause that took the form of a condition to the offer. WPP argued that, following the terrorist attacks of Sept. 11, 2001, a material adverse change had occurred. The Takeover Panel found that 9/11, while exceptional, unforeseeable and a contributor to the decline that had already affected the advertising industry, did not undermine the rationale for the terms and the price of WPP's offer. It thus ruled that the MAC condition could not be invoked, stating that "meeting [the materiality] test requires an adverse change of very considerable significance striking at the heart of the purpose of the transaction."

Although market practice in the United Kingdom and the United States is becoming increasingly aligned, important distinctions do remain. The U.S. and English courts have adopted differing approaches to the interpretation and enforcement of certain provisions of acquisition agreements that have important implications for the allocation of risk. These differences need to be borne in mind by the parties to any trans-Atlantic transaction. NLJ