

Document 6

Endgame Provisions in Acquisition Agreements

The conditions article and the termination article in an acquisition agreement are inextricably intertwined. The conditions article lists each condition that must be satisfied or waived before a party has an obligation to perform the agreement's subject matter performance provision. These conditions can be divided into three categories.

1. Conditions requiring that representations and warranties be true.
2. Conditions requiring that covenants be performed.
3. Conditions unrelated to either representations and warranties or to covenants.

The failure to satisfy or waive one or more of these conditions creates the grounds for terminating an acquisition agreement. But the conditions article only creates conditions. It does not contractually turn the failure to satisfy or waive a condition into a ground for termination, nor does the conditions article state the consequences of termination. Instead, the termination article does both these things.

The termination article typically consists of the following sections.

1. Grounds for termination.
2. Contractual monetary consequences of receipt of notice of termination.
3. Other contractual consequences of receipt of notice of termination.
4. Effective date of termination.
5. Consequences of termination—survival of common law rights and remedies and survival of specific contract provisions.
6. Dispute resolution provisions.

The *Grounds for Termination* section gives a party the discretionary authority to notify the other party that it has grounds for termination if one or more of the conditions to its obligation to close has not been satisfied or waived. Parties colloquially refer to this notice as a **termination notice** or **notice of termination**. But the notice alone may or may not terminate the agreement. Instead, it notifies the other party that the first party is exercising its right to terminate. Termination may or may not occur immediately. The effective date of termination depends on the ground for termination.

An acquisition agreement has the same number of grounds for termination as it has conditions to closing, and the agreement enumerates each ground for termination in its own subsection. Therefore, a one-to-one correlation exists between the conditions to a party's obligation to perform and the reasons a party may terminate a contract.¹ A ground for termination subsection does not restate the language of a condition, but instead cross-references the subsection stating the condition. So, for example, assume Section 6.2 states that performance of all covenants to be performed on or before closing is a closing condition. Therefore, in the section stating the grounds for termination, the ground for termination is the failure to satisfy or waive the condition stated in Section 6.2. It's indirect, but the way it's done. If the condition were restated, the drafter would have to be extraordinarily careful to say the same thing the same way. A divergence between the condition and the ground for termination would invite litigation. The cross-reference obviates the problem.

1. The one-to-one correlation disappears if the contract states that the parties may terminate the agreement at any time.

7.1 Termination by the Seller.

- (a) **Grounds for Termination.** The Seller may notify the Buyer that it has grounds for this Agreement's termination if any one or more of the following events has occurred on or before the Closing Date:
 - (i) **Misrepresentations and Breaches of Warranty.** The condition stated in Section 5.1 has not been satisfied or waived. (*Section 5.1 states the condition that the representations and warranties must have been true on the signing date and must also be true on the closing date.*)
 - (ii) **Breach of Covenants.** The condition stated in Section 5.2 has not been satisfied or waived. (*Section 5.2 states the condition that all covenants must have been performed on or before the closing date.*)

Depending on the business deal, receipt of the notice of termination may trigger contractual obligations, monetary obligations, or rights. The section dealing with these terms should precede the *Effective Date of Termination* section to reflect the chronological sequence of events.

If receipt of the notice of termination triggers a contractual obligation, include a section with a title that describes the required performance; for example, *Required Purchase of Unsold Licensed Products*.

If a party must pay money, include a section, *Payment Obligations*. The payment could be a return of funds or it could be liquidated damages. In either event, it should explicitly address all the *who*, *what*, and *when* questions attendant to the payment of money. If the payment constitutes liquidated damages, the provision should state that the payment is the exclusive remedy. You must, of course, check applicable law so that the provision has the best chance of being enforceable.

If the notice of termination triggers the right to retain money, include a section *Right to Retain [insert descriptive name]*. If the right to retain money constitutes liquidated damages, the provision should state that the retention of the money is the exclusive remedy, again, if that is the business deal.

The section *Effective Date of Termination* states the date when an agreement terminates. The date depends on whether the termination process includes an obligation to be performed or money to be paid. If no payment or performance is required, then termination is effective on a party's receipt of the notice of termination. If a payment or performance is required, the effective date of termination is the date the payment is received or the obligation performed. This postponement ensures that all of the agreement's provisions apply during the period between the receipt of the notice of termination and the receipt of the payment or performance. These provisions would include the dispute resolution provisions, such as governing law, choice of forum, and waiver of the right to a jury trial.

Finally, the agreement must address the consequences of its termination. The aptly named section, *Consequences of Termination*, takes the laboring oar. Generally, the salient issue in this section is whether the terminating party has the common law right to sue for damages. It would have that right if the other party had made a misrepresentation, breached a warranty, or breached a covenant. To memorialize these rights, the section states that on termination, neither party has any rights or obligations, *except for Party A's rights and Party B's obligations arising from any misrepresentation, breach of warranty, or breach of covenant*. When these rights

and obligations are preserved, they are said to **survive** the agreement's termination. (In a real-world, sophisticated acquisition, these rights and obligations would probably not survive because a negotiated, contractual indemnity would be the exclusive remedy.) No rights or obligations survive if the breaching party paid liquidated damages because if they did, the terminating party could receive double damages.

Specific contract provisions sometimes also survive termination. For example, the parties might want the confidentiality provision to survive the contract's termination. If a provision is to survive, the contract must explicitly state that it does.

If the ground for termination is not a misrepresentation, breach of warranty, or breach of covenant, no rights or obligations survive because damages only arise from misrepresentations and breaches. For example, the agreement might include a condition that seller's counsel must have delivered its opinion to the buyer. As discussed, the agreement would include a correlative ground for termination if the opinion were not delivered. If a party were to terminate the contract because the opinion was not delivered, the only remedy would be the common law walk-away right. The agreement would state that on termination under Section X, neither party has any rights or obligations.

Dispute resolution provisions are key to any contract's endgame provisions, but a detailed discussion is beyond the scope of this book.

Beginning on page 532 is an exemplar of a conditions article in an acquisition agreement.

Beginning on page 534 is an exemplar of termination provisions in an acquisition agreement. Finally, beginning on page 537 is a drafting exercise.

1. Only the conditions to closing are in this article. The failure to satisfy a condition and its consequences are stated in the termination article.

2. This introductory sentence follows the article heading, but is unnumbered.

3. Which cross-reference is better? Condition requires that the representations and warranties be accurate as of two dates. Why should the buyer care if the reps were inaccurate on signing, so long as they are accurate on closing?

4. The bracketed language is only appropriate if the contract contemplated a change in the facts underlying the representations and warranties. Look at each representation and warranty and see if the parties expect that the underlying facts will change. Typically, these facts do not change with respect to the buyer.

5. Why would this condition not refer to the article that contains the buyer's covenants between signing and closing? Why does this condition refer to covenants to be performed *on the Closing Date*?

6. Why is the certificate necessary?

7. Here is the same language that was the subject of Annotation 4. This language is needed more frequently with respect to the seller's representations and warranties. During the gap period, facts relating to a seller's business may well change.

Conditions in an Acquisition Agreement¹

Article 6 — Conditions to the Seller's Obligation to Perform

The Seller is obligated to consummate the transactions that this Agreement contemplates only if each of the following conditions has been satisfied or waived on or before the Closing Date.²

6.1 The Buyer's Representations and Warranties. The Buyer's representations and warranties stated [in this Agreement][in Article 4]³ must have been true on the date this Agreement was executed and delivered, and they must be true on and as of the Closing Date as if they were made on that date[, except as affected by transactions that this Agreement contemplates.]⁴

6.2 The Buyer's Covenants. The Buyer must have performed all of its covenants to be performed on or before the Closing Date.⁵

6.3 The Buyer's Closing Certificate. The Buyer must have delivered a certificate to the Seller, signed by its Executive Vice President, certifying as to the truth of the statements in Sections 6.1 and 6.2.⁶

Article 7 — Conditions to the Buyer's Obligation to Perform

The Buyer is obligated to consummate the transactions that this Agreement contemplates only if each of the following conditions has been satisfied or waived on or before the Closing Date:

7.1 The Seller's Representations and Warranties. The Seller's representations and warranties stated [in this Agreement] [in Article 3] must have been true on the date this Agreement was executed and delivered, and they must be true on and as of the Closing Date as if they were made on that date[, except as affected by transactions that this Agreement contemplates.]⁷

7.2 The Seller's Covenants. The Seller must have performed all of its covenants to be performed on or before the Closing Date.

7.3 The Seller's Closing Certificate. The Seller must have delivered a certificate to the Buyer, signed by its President, certifying as to the truth of the statements in Sections 7.1 and 7.2.

7.4 Consents. All of the Consents listed in Schedule X.X must have been obtained.⁸

8. Why would Section 7.4 be necessary as a business and legal matter to protect a buyer? Assume the seller promised that, during the gap period, it would use commercially reasonable efforts to obtain all consents.

1. These provisions tie into the preceding conditions articles.

2. This provision does not need to be more detailed because the parties will enter into an agreement concerning the termination. Technically, the provision is not even required because the parties may always amend or terminate their agreement. Parties tend to include it because it reflects their understanding.

3. The grounds for termination are created by cross-reference to the sections stating the conditions. Each condition has its own ground for termination. The headings make it easier for the reader to understand the ground for termination.

4. Subsection (b) addresses whether money is paid or retained or if a contractual performance is required. If a party has a payment obligation, how could it be legally characterized, and what are the business and drafting consequences? The alternative to this provision is that a party might be entitled to retain funds. That right should be stated explicitly to avoid any dispute as to the right to those funds.

5. Draft provisions that specify the other acts necessary to transfer the funds. Don't use general language.

6. Why is *entitled* used and not the discretionary language *may*?

Termination Provisions in an Acquisition Agreement¹

Article 8 — Termination

8.1 Written Agreement. The parties may terminate this Agreement at any time by written agreement.²

8.2 Termination by the Seller.

(a) **Grounds for Termination.** The Seller may notify the Buyer that it has grounds for this Agreement's termination if any one or more of the following events has occurred on or before the Closing Date:

- (i) **Misrepresentations and Breaches of Warranty.**³ The condition stated in Section 6.1 has not been satisfied or waived.
- (ii) **Breach of Covenants.** The condition stated in Section 6.2 has not been satisfied or waived.
- (iii) **The Buyer's Closing Certificate.** The condition stated in Section 6.3 has not been satisfied or waived.

(b) **[Payment Obligations.]**⁴ If the Buyer receives a notice of termination under Section 8.2(a), it shall pay the Seller \$X no later than three days after its receipt of the notice of termination. To effect this payment, X shall

- (i) wire transfer \$X of funds immediately available in Chicago, Illinois no later than three days after its receipt of the notice of termination; and
- (ii) do any other act necessary to the transfer the funds.⁵

or

(b) **[Right to Retain]** *[Insert defined term that identifies the money — for example, the Y Payment.]* If the Buyer receives a notice of termination under Section 8.2, it is entitled to retain the [Y Payment].⁶

(c) **Effective Date of Termination.** If the Seller sends a notice of termination of this Agreement under Section 8.2(a), the termination is effective when [the Buyer receives the Seller's notice of

termination] [the Seller receives the payment required by Section 8.2(b)].⁷

- (d) **Consequences of Termination.** On termination of this Agreement under Section 8.2, neither party has any further rights or obligations under this Agreement[, *except for the Seller's rights and the Buyer's obligations arising from any one or more of the Buyer's misrepresentations, breach of warranty, or breach of covenant*].⁸

7. Why do the termination dates differ?

8. What determines whether the bracketed language is included?

Write in the appropriate contract language for each of the following provisions, using the conditions on pages 536-537 to determine grounds for termination.

8.3 Termination by the Buyer.

- (a) **Grounds for Termination.** The Buyer may send the Seller a notice stating that it has grounds to terminate this Agreement if any one or more of the following events has occurred on or before the Closing Date:

- (i) **Misrepresentations and Breaches of Warranty.**

- (ii) **Breach of Covenants.**

- (iii) **The Seller's Closing Certificate.**

- (iv) **Failure to Obtain Consents.**

(b) **Contract Obligation/Payment Obligations/Right to Retain.**

[Assume for this exercise that neither party has a payment or performance obligation.]

(c) **Effective Date of Termination.** If the Buyer terminates this Agreement under Section 8.3(a), the termination is effective when

(d) **Consequences of Termination.**

- (i) **Termination under Section 8.3(a)(i), (ii), and (iii).** On termination of this Agreement under any one or more of Sections 8.3(a)(i), (ii), and (iii),

- (ii) **Termination under Section 8.3(a)(iv).** On termination of this Agreement under Section 8.3(a)(iv),

8.4 Survival of Confidentiality Provisions. Despite any termination of this Agreement under Section 8.2 or 8.3, the parties' obligations under Article 9 — Confidentiality survive to the extent stated in that Article.