

When you sell a company you're on the hook for some stuff. In this section we're going to talk about representation, warranties and indemnification.

Clint: Let's start with representations and warranties. What are they, and why are they showing up in the LOI?

Brad: In an acquisition, you're going to make some reps and warranties. These reps and warranties are things that the company is saying are true about a variety of different things in the company. The reason they show up oftentimes in the LOI is because you're trying to define what you're going to rep to at a high level and which parts of the reps and warranties are ones that are going to be covered by an escrow, which we'll talk about in a separate section.

It is that versus which ones might be outside the escrow. Just trying to get a little definition is important. It's also a good way to tease out how the buyer is going to be thinking about the reps and warranties by forcing that discussion on the front end of the negotiation.

Clint: What are some examples of reps and warranties that might show up?

Brad: You're going to make the rep that you own all of your intellectual property. You're going to make the rep that the capital structure of the company is true. You're going to disclose any legal issues you have and you're going to make the rep that the only legal issues that you're aware of are the ones that you've disclosed.

It's things like that. You're going to make the representation that your employees have signed a confidentiality agreement. Some of the reps are very technical in nature. Some of them are very broad.

It used to be the case that reps and warranties would include things that were totally irrelevant to the companies, like that you didn't have any property that had any environmental issues. If you're a technology company and you rent all of your space and you don't actually produce anything that's a rep that doesn't make any sense.

You'll rep that you're in compliance with taxes and applicable laws and things like that.

Clint: What is an indemnification and how does that relate to reps and warranties?

Brad: The indemnification is the specific statement that if something is not true in your rep and warranty, you're taking responsibility for it. How the

indemnification language works often has a lot of importance in the context of any issue around the reps and warranties.

There's a big difference, for example, between having knowledge of something and not. If something exists and you had knowledge of it, but you don't have what's called a knowledge qualifier, the indemnification language will make a lot more difference.

If you have a knowledge qualifier the indemnification language might not matter at all. The linkage between this whole section, and what you're indemnifying and who is on the hook for what becomes quite important.

Clint: In your experience going through this in your companies, how much of this called pro-forma versus boy this is stuff you really need to pay attention to.

Brad: The vast majority of it is pro-forma in that it's in every transaction, but you have the situation where there's a spectrum. At one end of the spectrum would be reps and warranties that are incredibly light weight and seller friendly. In the other end would be reps and warranties that are incredibly heavy and buyer friendly.

On a one to ten spectrum, if they're balanced somewhere in the middle, it's probably fine. The problem comes, if you're the seller, where it's all the way at the end where they're very aggressive against you. In fact the buyer is asking you to rep stuff that you simply can't.

In addition, if you have any sort of complicated problems downstream, how the reps and warranties are written do play into whether you have any liability or not. That liability, as long as it's linked to just the escrow, is limited again to whatever the escrow amount is, but if it's not limited to the escrow, that liability can actually be quite significant. In some cases it's as much or more than the actual deal value.

While it's pretty standard stuff, getting the language right matters and making sure that you've limited your liability as much as you can to a defined amount for each of the reps and warranties that you're making.