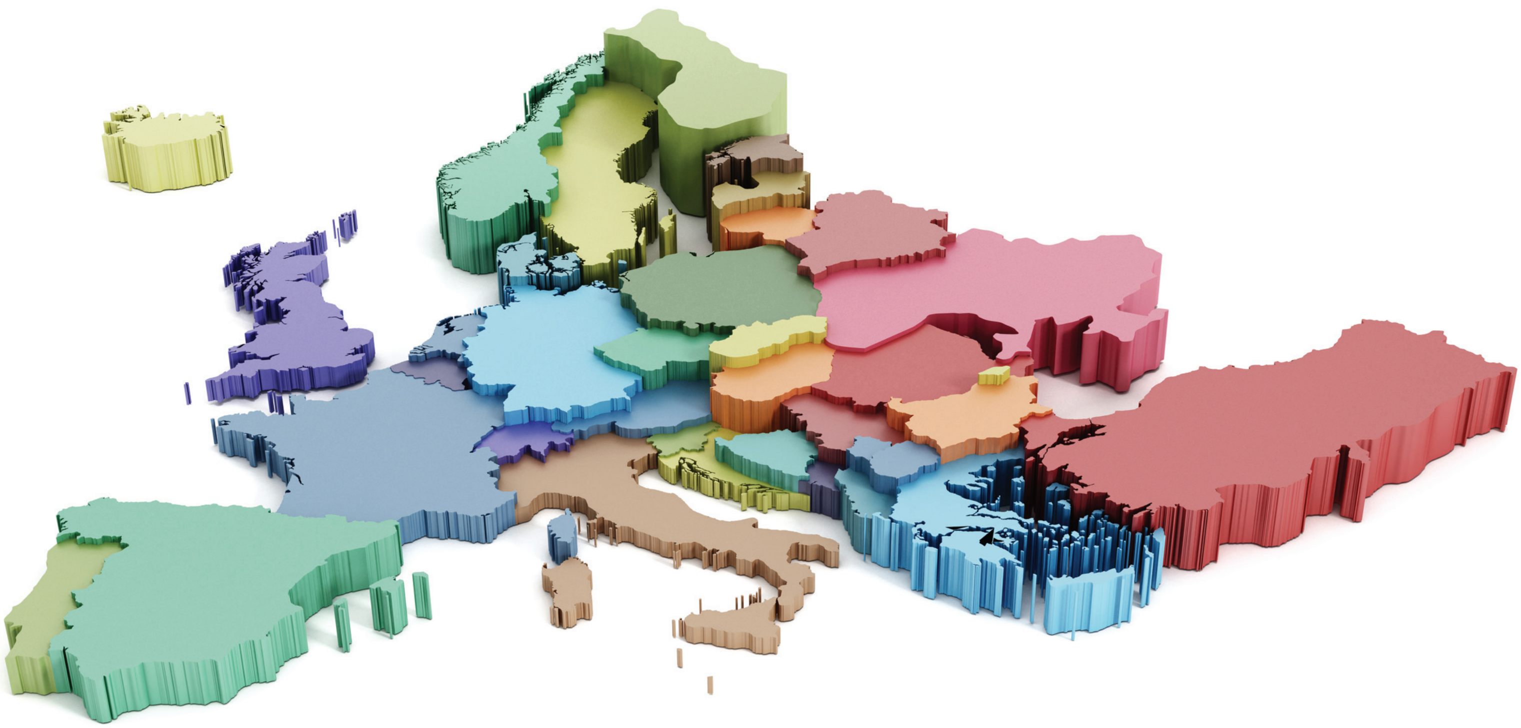

# IS FAIR DISCLOSURE "FAIR" IN EUROPEAN CROSS-BORDER M&A DEALS?

**Eric M. Fogel** SmithAmundsen LLC

We all know that M&A deals these days involve more cross-border deals and international issues. These cross-border transactions sometimes present different legal paradigms and practices. One of the more striking examples of a "paradigm shift" is the European concept of "fair disclosure" with respect to representations and warranties given by European sellers in M&A deals with American buyers.

Here is what I'm talking about. In a merger or acquisition, a buyer will ask a seller to make certain representations and warranties about the seller's legality, authorization, business, liabilities, etc. These representations run the gamut from due authorization by the Board, to environmental compliance, insurance coverage, retirement plan compliance, payment of all taxes, disclosure of material contracts and accuracy of financial statements.

In a typical American deal, the representations and warranties of a M&A agreement are a hotbed of negotiation. Buyers and sellers negotiate, sometimes fiercely, over disclosure, qualifiers (e.g., "to the best of our knowledge"), scope, and allocation of risk. If the seller wants any exceptions to the representations and warranties, the seller must disclose them on a Schedule. For example, a representation might read: "Except as disclosed on Schedule A, there is no material litigation that would affect the seller's business and prospects." If a liability, loss, or material impairment is not disclosed by the seller, the seller may incur the liability – regardless of whether the buyer knew about it, or should have known about it, as a result of reasonable due diligence.

Several European countries, including Switzerland, have a different paradigm. In this paradigm, if a potential liability was disclosed by the seller in some manner during the due diligence process, then the buyer would be put on notice, and any loss would not be counted against the seller unless a specific provision puts the risk of the liability in question on the seller. This shifts the burden and risk of loss to the buyer, and gets the seller off the hook.

Many M&A deals today utilize a virtual data room ("VDR") where the seller posts its financial statements, contracts, Board minutes, regulatory notices, and the like for inspection by the buyer and its advisors. In the American system, the VDR permits the buyer to "kick the tires," so to speak, and to ask due diligence questions. In the American system, if the seller makes an inaccurate representation, the liability rests with the seller, even if the buyer knew about it.

Here is an example. Let's say the seller uploads to the VDR a Confidentiality Agreement that the seller has with an important vendor. Buried in the document is a very onerous non-competition provision that would bar the buyer from selling goods in a particular market. Who bears the risk and loss of this restriction between the seller and the buyer? In the American system, the seller does, because the impairment would contradict a seller representation. In the European system, the buyer does, even if the non-compete provision makes the seller representation untrue, because the Confidentiality Agreement was "fairly" disclosed in the VDR and made available to the buyer and its advisors to read for themselves.

Typical "fair disclosure" language that a European seller would propose might read as follows:

> Any matter fairly disclosed in the Disclosure Schedules and VDR against specific representations and warranties of the Sellers is deemed to be disclosed generally for the purposes of this Agreement, and **Buyer shall have no claim under this Agreement or otherwise in respect of such matters or losses arising from them.**

When is a fact deemed to be "fairly disclosed?" Typical language that a European seller would propose might read as follows:

> A fact, matter or circumstance is fairly disclosed if sufficient information has been disclosed that the fact, matter or circumstance which might constitute a breach of a representation and warranty, **would be immediately obvious to a Buyer reasonably experienced in transactions of the nature of the transactions contemplated by this Agreement, with the assistance and expertise of its professional advisors.**

Note that this language puts the onus not only on the buyer, but on the buyer's advisors as well, including accountants, bankers and lawyers. The language basically creates a burden for the buyer and its advisors to read every single page in the VDR and elsewhere, lest they miss something. Many lawyers will strongly resist the inclusion of "advisors" as responsible parties for due diligence.

In Europe, instead of Disclosure Schedules to an M&A Agreement, there is a Disclosure Letter that generally accomplishes the same purpose, which is to list and detail exceptions to the representations. In Europe, many sellers will resist agreeing to warranties, as the word "warranty" connotes a legal guarantee. Hence, in European M&A agreements, you will see seller "representations", but not "representations and warranties," as you would in an American M&A deal. Typical Disclosure Letter language that a seller in a European M&A deal would propose might read as follows:

> Although the Sellers have attempted in the Disclosure Letter and VDR, for ease of reference, to make disclosure by specific reference to particular representations set forth in this Agreement, **each general and specific disclosure in the Disclosure Letter and VDR is to be treated as a disclosure against each and every representation to which it may reasonably be regarded as being relevant**.

Sometimes, the "fair disclosure" language can "push the envelope" in shifting risk to the buyer, as the following language demonstrates. In this language, the buyer is deemed to be put on notice about incomplete documents, if a buyer should have been able to figure out that an attachment was missing.

> Where brief particulars only of a matter are set out or referred to in the Disclosure Letter and VDR, or a document is referred to but not attached, or a reference is made to a particular part only of such a document, **full particulars of the matter and the full contents of the document are deemed to be disclosed and it is assumed that Buyer does not require any further particulars**.

So, which system is "fairer", the American or European system? In the American system, it falls on the seller's lawyers to protect the seller by insuring that the representations and warranties are as accurate and narrow as possible under the circumstances. An American seller is also responsible for providing complete and accurate Disclosure Schedules in order to make the representations and warranties that they qualify true. For example, a representation and warranty that "seller has no litigation except as listed on [the corresponding Schedule]," would need the corresponding Schedule to list all litigation in order to be true. In the European system, by contrast, it falls on the buyer's lawyers and other advisors to review every last bit of due diligence supplied by the seller to insure that the buyer is aware of all problems and potential liabilities. The question of comparative fairness depends on the answer to the question: Who is in the best position to know of potential losses and liabilities? Obviously, it's the seller who is selling its business. Yet, the European system shifts a tremendous burden and cost to the buyer, and on to the buyer's lawyers and other advisors, to seek and identify a seller's shortcomings.

Perhaps sellers in Europe have more market power, because companies there are held for longer periods of time, and it is more difficult to motivate sellers to sell. In any event, if you are an American businessperson or lawyer in the M&A game, be prepared for "paradigm shock" in negotiating the purchase of a European company.

*Eric M. Fogel is the chair of SmithAmundsen's Corporate Law Department. His practice concentrates on M&A, securities, private equity, venture capital and general corporate. To learn more about this topic or SmithAmundsen's corporate services, please contact Eric at efogel@salawus.com or 312.894.3325.*