LEGAL-EASE

Buying or Selling Accounts

"Rep's and Warranties"

No, the "rep's" part does not refer to sales "representatives"! Outside of the actual business aspects of a deal (the purchase price, description of the accounts or other assets being sold, etc.) the "representations and warranties" the buyer asks the seller to give in connection with a transaction are the guts of the written sale agreement. These include simple, obvious things, such as that the seller actually owns the accounts it is purporting to sell, or that there aren't any liens against the assets that may present a problem for the buyer if they aren't paid off and removed before the transfer takes place.

Many of the lengthier reps and warranties are written in such technical language (so-called "legalese") that most laypersons are prone not to pay much attention to them. It's easier to ignore or skip over something that you don't understand, isn't it? And nine times out of ten, there will probably not be a problem.

The thing is that written agreements are not written for the nine times out of ten there isn't a problem; those deals could be done "on a handshake" without a written agreement at all. The whole point of having a written agreement is to address that very one deal in ten when a problem does arise, and it is, of course, impossible to predict in advance which deal that is going to be!

It is the function of the representations and warranties to try to anticipate the problems that might arise, and to allocate the risks between the buyer and seller as to who will be responsible for the (usually monetary) consequences of the problem if and when it does arise. For example, if there were a previously-undiscovered, and undisclosed, lien on the assets being transferred, and the seller had made a representation that there were no such liens, then it would be the seller's responsibility to either pay off the lien, make arrangements to have the lien removed, or pay damages to the buyer to allow him to pay off the lienholder and free up the assets from the cloud on his title.

While that example seems obvious and objectively "fair," there are lots of other representations and warranties that cover much more esoteric issues, and where the fair resolution may not be so obvious. These can be written many different ways, and correspondingly shade the risk between buyer and seller in ways that may seem unimportant at the time, but depending on the exact nature of that pesky problem that occurs later, may be critical in determining who pays, or doesn't, after the deal is done. This is what lawsuits are made of. And when all is said and done, the resolution of a dispute may cost far more than what the deal was worth in the first place. An experienced, competent lawyer can negotiate language changes to modify the reps and warranties in ways that might be more favorable to the client when the unexpected arises. Or, at least, the lawyer can advise the client of the possibilities based on the language of the text, so that the client can make an intelligent decision whether the risk is worth taking to get the deal done.

I am in the process of advising a seller in another industry. Because he knew the opposing lawyer personally, and this lawyer had been, prior to his retirement, the General Counsel of one of the largest, public companies in the industry, my client assumed he would not only be an expert in the field, but also present a balanced, "fair" agreement. He urged me (as more of my clients than I care to count do!) not to spend "too much" time on the agreement and get the deal done as quickly as possible. When I reviewed the draft, it was obvious that it was a form this lawyer had used for much, much larger transactions than this one. It included reps and warranties about the financial statements that my client couldn't possibly verify using his simple accounting software, required an "opinion of counsel" on my part that would cost my client a couple of thousand dollars worth of my time to prepare, and, among other things, required my client to give a representation and warranty that he had all legal rights to all the "intellectual property" of his company. Well, it just so happens my client has been doing business under a "dba" specifically because there is another company operating under the same name that may very well have superior rights to the name than my client. As I advised the client, he actually would have been better off doing the deal on a handshake, and not having a written agreement at all!

Lucky for my client that he trusted me to take the time I urged him to allow me – both to look over the agreement carefully, and then to convince the lawyer that this particular deal did not justify what would have been called for under the initial draft he had prepared. A drastically revised, simplified draft is now on its way.

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