

CFA Society Sri Lanka
From Concepts to Closing: Mergers &
Acquisitions Essential Course

Legal Perspectives – Sale & Purchase Agreements



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Key documentation in a M&A transaction

Term Sheet (binding/non-binding)

MOUs (binding/non-binding)

Share Purchase Agreement (a.k.a. Share Sale Agreement or Share Sale & Purchase Agreement)

Corporate approvals – board + shareholder resolutions

Shareholders' Agreement

Transfer documentation –

- Unlisted - share transfer forms [instrument of transfer – s73 CA 2007] (unlisted)
- Listed (CSE) - Buy & Sell Orders.



Term Sheets

Purpose

Outlines key commercial and legal terms of the deal.

Key terms

Commercial: Parties, price, number of shares/% of shareholding

Legal: CP (DD, regulatory approvals), timelines, confidentiality, liability caps, cost allocation, deal exclusivity, dispute resolution.

Role

- Provides transaction framework and alignment for definitive agreements (SPA/SHA)
- Enhances deal efficiency, reduces negotiation disputes and costs
- Offers confidence to incur pre-transaction costs (advisory, due diligence)

Can be binding, non-binding or mixed (i.e., binding on key terms).



Share Purchase Agreement

- **This is the standard written agreement/contract which governs the sale and transfer of shares in a company.**
- Sets out the detailed T&C on which the sale & purchase of the shares will occur.
- It is however not a title document, nor does it effect the transfer of title.

For:

- *Unlisted companies (private/public) that would be through the execution and delivery of share transfer forms (as per the relevant articles of association and the CA 2007).*
- *CSE listed companies: generally, through a 'crossing' under the Trading Rules of the CSE (via the submission of buy & sell orders to the broker).*

Key [standard] provisions of a SPA

Parties

Background/recitals

Details of shares to be transferred & purchase price (or determination methodology)

Conditions Precedent (CP)

Interim management covenants

Completion matters

Conditions Subsequent (CS)/Post-closing adjustments (NWC adjustments etc.)

Reps & warranties

Indemnities & limitation of liability clauses

Confidentiality

Restrictive covenants (vendor non-competes etc.)

Termination rights

Boilerplates – assignment rights, third party, notices/communication, publicity, further assurances etc.

Governing law & dispute resolution (litigation, arbitration, hybrid ADR arrangements etc.)

Key concepts

Conditions Precedent (CP)

Contractual provisions that must be fulfilled, waived or satisfied before parties are obliged to proceed to complete/close the transaction – i.e., buy and sell the relevant shares.

Examples

Satisfactory completion of due diligence activities (financial/tax/legal), governmental/regulatory or other 3rd party approvals (e.g., BOI, CBSL – banks/LFCs, IRC SL, clearance of any liabilities/disputes corporate restructuring activities etc.

Usually time-bound through a ‘Long Stop Date’, additional restrictions on exit rights/consequences may also be imposed.

Key Concepts (cont..)

Representations & Warranties

- A **'representation'** is a statement or assertion of past or existing fact made by one party to the other.
 - E.g., “The entire share capital of the Company consists of 100 ordinary shares, all of which are legally and beneficially owned by the Seller”. “The company does not have any ongoing litigation.”
 - A **'warranty'** is a contractual promise or assurance made by a party (usually a seller-party) regarding the target company or its assets, liabilities and/or operations, or otherwise connected with the proposed transaction (and usually 'forward looking' up to completion).
 - E.g., “On completion, the shares will be sold and transferred to the Buyer free of any encumbrances whatsoever.”
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- Distinction has now been blurred in SPAs (and are usually collectively referred to as 'Reps & Warranties' / 'Warranties' etc).
 - SPAs focus on consequences - cure or termination rights, damages etc. **Note:** Usually qualified by disclosures – express, findings of the due diligence exercises, public registry contents (NIPO, ROC, land registries) etc.

Key Concepts (cont..)

Covenants and Undertakings

Covenant

An express promise or obligation set out in the SPA imposing either a positive obligation (i.e., to do something) or a negative obligation (to refrain from doing something).

Undertakings are similar to covenants, as they also relate to promises to fulfil certain obligations. Generally, they are tied to a particular standalone action or outcome and have specific deliverables (and may be linked to the CP/CS or completion matters).

Practical note: Terms are used synonymously or collectively, in SPAs.

Indemnities and limitations on liability



Generally, parties have the legal right to seek damages, for breach of contract. This is a ‘common law’ remedy.



Contractual damages are however subject to various limitations, including:

Remoteness / Causality / Mitigation

The Seller may also seek to limit the remedies (and the quantum of liability) for contractual damages, by way of ‘limitation of liability’ and ‘sole & exclusive’ remedy clauses.



An ‘**indemnity**’ is an express contractual promise to compensate one party for a particular loss or liability. It does not necessarily have to flow from a breach by the indemnifying party of the contract (SPA) but is intended to insulate the indemnified party against a direct or indirect financial loss. It is not subject to the limitation rules applicable for contractual damages, as the terms and parameters of indemnification would be set out in the relevant clauses in the SPA (and may even cover third-party claims).

Indemnities (cont...)

EXAMPLE INDEMNITY CLAUSE

“The Seller agrees to indemnify and keep indemnified the Buyer from and against any and all losses, liabilities, costs, expenses, claims, actions, or damages (including reasonable legal fees) which the Buyer or the Target Company may incur, suffer, or be liable for arising from or in connection with:

- 1.1 any breach of any warranty, representation, or covenant made by the Seller under this Agreement;*
- 1.2 any and all tax liabilities, fines, or penalties of the Target Company relating to periods prior to the Completion Date, except to the extent they are fully provided for in the Accounts;*
- 1.3 any claim, demand, or proceeding made by a third party against the Buyer or the Target Company in respect of any act, omission, or liability of the Seller or the Target Company occurring prior to the Completion Date; and*
- 1.4 any undisclosed liabilities or obligations of the Target Company existing as of the Completion Date, other than those expressly disclosed in the Disclosure Letter.”*

Indemnities (cont...)

Limitations on liability are contractually included in a SPA to minimise a party's (usually the seller/seller-parties') exposure to claims for damages/indemnification.

Time bars

These generally contractually replace the standard prescription period (imposed under the Prescription Ordinance). Will vary based on the type of claims. For example (for pre-completion liabilities):

Fundamental warranties (title to shares etc.) - might be uncapped.

Tax warranties – period for tax claims to be made by the relevant authorities (IRD).

Other reps & warranties – 6 to 24 months.

Quantum limitations

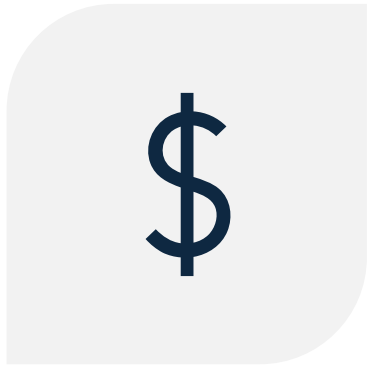
Will be as negotiated. Usually up to 100% for fundamental warranties (capacity, title etc.) and tax indemnities, and generally ranges from 10%-25% for other claims.

May also be unlimited for specific indemnities covering disclosed liabilities. Post-completion matters: Restrictive covenants (Non-compete/non-solicit) etc. – may be uncapped.

De minimis thresholds and basket amounts (tipping/deductible).

Carve outs maybe included for matters covered by the target company's insurance policies. Also: R&W liability insurance.

Practical protection against liabilities



HOLDBACK ARRANGEMENTS

A MECHANISM WHERE A PORTION OF THE PURCHASE PRICE IS WITHHELD BY THE BUYER FOR A SPECIFIED PERIOD AFTER THE TRANSACTION'S COMPLETION TO ADDRESS POTENTIAL RISKS, LIABILITIES, OR CONTINGENCIES.



ESCROW ARRANGEMENTS

INVOLVES A PORTION OF THE PURCHASE CONSIDERATION BEING HELD BY AN INDEPENDENT THIRD-PARTY, SUCH AS A BANK OR OTHER SERVICE PROVIDER KNOWN AS AN 'ESCROW AGENT' (MAY ALSO BE A LAW FIRM/LAWYER).



CORPORATE/THIRD-PARTY GUARANTEES

USUALLY SOUGHT FROM ULTIMATE PARENT COMPANIES/ASSET-RICH AFFILIATES, TO COVER THE RISKS EMANATING FROM SPVS AS SELLERS ETC.

Purchase price mechanisms

Locked Box: purchase price mechanism in M&A transactions where the purchase price is fixed based on the target company's financial position as of a specific date (the "locked-box date"), prior to signing the SPA. After the locked-box date, the seller typically covenants that no value will "leak" from the company (e.g., no dividends, payments to shareholders, or related-party transactions) except for permitted leakage.

Completion Accounts mechanism: Adjusts the purchase price based on the financial position of the target company as at the closing date. The parties agree on a provisional purchase price at signing, which is subject to adjustment based on a set of financial statements (the "completion accounts") prepared after the closing date. Usually adjustments focus on key metrics like NWC, net debt and cash & cash-equivalents. Common in US-centric deals.


Earn out: ties a portion of the purchase price to the future performance of the target company over a specified period. E.g., meeting certain pre-agreed revenue, EBIDTA or customer retention targets.

Price Adjustment clauses: mid-way point between Locked Box and Completion Account mechanisms, which involve certain limited adjustments based on specific events/milestones. E.g., adjustments for failing to collect certain AR within a specified period. Usually, they relate to payment outflows rather than returns from the seller.

Purchase price mechanisms (cont...)

Additional considerations

- Limitations on cross-border transactions due to exchange control restrictions.
- Listed company share transactions (price constraints) –
 - **Crossings** – price band of a maximum 5% negative variance from the Closing Price.
 - **Regular trades** – manual entry & matching of ‘buy’ and ‘sell’ orders. CSE ‘administrative’ price band of 20% of Closing Price for liquid shares and 25% for illiquid shares.
- Mandatory offer obligations under s31 of the Takeovers & Mergers Code.



Negotiation dynamics in SPAs and the role of legal & other advisers

- Appoint competent, experienced & specialist legal counsel. Transaction/M&A lawyers.
- Important that legal, tax & financial teams are appointed early on and coordinate/communicate well.
- TS/high-level MOU is highly recommended to set overall framework/parameters.
- Purchaser usually prepares the first draft of the SPA – market practice.
- Identify and focus on key aspects, material risks and issues – look for a win-win outcome.
- If stalemate between legal advisers, it is important for key decision makers from the buy/sell-sides to seek to mediate and consider a mutually acceptable compromise.

Examples of disputes/issues arising from SPAs





Questions?