

Tips for Enforcing Indemnification Provisions

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Your company has completed an acquisition of a strategic partner for a purchase price of \$40 million. In the representations and warranties in the acquisition agreement, the seller informed you that its financial statements were true and correct as of the date of the closing. Post-transaction you discover that the financial statements, as presented, were inaccurate and misleading. What recourse do you have? Typically, acquisition agreements (stock, asset purchase and merger agreements) contain indemnification provisions that provide contractual remedies for resolving post-transaction claims for breaches of representations and warranties, breaches of covenants and third-party claims. When determining whether or not to make an indemnification claim, you should consider the following:

Identify Time Periods for Asserting Indemnification Rights

The acquisition agreement will generally provide time periods within which to assert an indemnification claim. For most claims, the time period will expire between 12 and 24 months after the closing. Common exceptions include fundamental representations (authority to enter into the transaction, ownership of shares and organization and qualification) and specific representations regarding tax matters, environmental issues and intellectual property matters. You should evaluate your potential claims carefully to determine which specific representations and warranties (and the corresponding claims period) are applicable, so that you do not miss the applicable deadline for asserting.

Provide Notice in a Timely Fashion

A party asserting an indemnification claim must make sure to assert a claim within the specified time period. It is generally not necessary that the claim be resolved prior to the expiration of the applicable time period – in most cases, as long as the indemnification claim is timely asserted the ability of a party to assert the indemnification claims will be preserved until the claim has been finally resolved. While fraud or other intentionally misconduct on the part of the indemnifying party may serve to extend the applicable time period to bring a claim, it is important to comply with the specific terms of the acquisition agreement and provide timely and detailed notice of the claim to the indemnifying party.

Notify All Concerned Parties

The indemnification provisions will outline the steps necessary to properly assert a claim. One requirement will be to notify the proper parties. It is imperative to provide notice to all concerned parties. These may include some or all of the following: the indemnifying party, counsel to the indemnifying party, a stockholder representative and an escrow agent, if an escrow has been established. Putting an escrow agent on notice is critically important to avoid funds from being released that may be otherwise available to satisfy a claim in whole or in part.

Understand Limitations on Recovery

Many indemnification provisions provide limitations on the amount a party can recover for losses. Such provisions include deductibles and baskets (which serve as minimum dollar thresholds before which losses may not be recoverable). In addition, indemnification provisions commonly include caps on recovery. Similar to the survival provisions, there are generally

exceptions to limitations on recovery. For example, the ability to recover for breaches of fundamental representations and tax matters may be uncapped. Additionally, issues of particular importance such as environmental matters and breaches of particular laws may have specific caps that are higher than the general indemnification cap and such provisions may also exclude deductibles and baskets. Further, claims for losses based on fraud or other intentional misconduct may not be subject to applicable limitations. In crafting indemnification claims, all potential theories of recovery should be considered to maximize the potential claim.

Exclusive Remedy

In many instances acquisition agreements provide that the indemnification provisions serve as the sole and exclusive source of recovery in connection with post-transaction claims, other than for claims involving fraud or intentional misconduct. Absent a public policy argument against such a provision, the ability of a party to assert a common law claim for losses for post-transaction claims may be limited to the contract language set forth in the indemnification provision.

Scope of Damages

Definitions of losses and/or damages in indemnification provisions set forth the types of losses/damages that a party may recover against the indemnifying party. For example, losses/damages may include attorneys' fees and consequential or indirect damages (including losses related to lost profits and/or diminution in value losses) which may significantly expand the potential scope of recovery. Careful attention should be paid to these definitions when structuring a claim, in that the claim should be as broad as possible yet only include damages permitted under the terms of the acquisition agreement.

Claims Process/Dispute Resolution

A well-crafted indemnification provision outlines the steps necessary to assert and resolve an indemnification claim. The steps include asserting the claim, responding to same and the methodology for ultimately determining the merits of the claim. It is incumbent upon the parties asserting and defending a claim to make sure to follow the claims process to avoid missing a necessary deadline or otherwise risk properly pursuing or defending the claim.

For more information regarding enforcement of indemnification provisions please contact **John J. Tumilty** or **Joseph C. Marrow**.