

Indemnification in Uninsured M&A Deals

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Agenda

- Asset v. Equity Deals
- Making an Indemnification Claim
- Indemnity Contribution Agreements
- Small Fry Sellers
- Mitigation Obligations
- Shareholder Representatives
- Sandbagging

Asset v. Equity Deals: Key Differences in Indemnification Provisions

Asset Deals

- Indemnification for breaches of representations, subject to baskets/caps as agreed – **same**
- Indemnification for breaches of covenants, which can be negotiated to be subject to baskets/caps – **same**
- Buyer assumes specific post-closing liabilities as agreed, whereas pre-closing liabilities remain the responsibility of seller – **different**
- **Indemnification provisions for pre-closing liabilities can undercut carefully negotiated thresholds and limits**
 - Obligation to indemnify for pre-closing liabilities is not subject to baskets/caps that apply to reps
 - Buyer could make a case for wide swath of post-closing losses as constituting or resulting from pre-existing facts and circumstances
- On the buy side, exceptions to indemnification limits for pre-closing liabilities should be mirrored in escrow/holdback provisions
 - Provisions limiting buyer recourse to escrow/holdback should not apply to these claims

Equity Deals

- Indemnification for breaches of representations, subject to baskets/caps as agreed – **same**
- Indemnification for breaches of covenants, which can be negotiated to be subject to baskets/caps – **same**
- Pre-closing liabilities are generally encapsulated in representations, with recourse limited to breach of those specific representations – **different**
- Escrow can be used on sell side to limit indemnification obligations
 - If buyer's recourse is limited to amounts in the escrow, seller's liability will terminate once the escrow is exhausted (subject to negotiated exceptions, e.g., fraud)

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Making an Indemnification Claim Procedure

- Indemnification section should include procedural rules for handling third party claims:
 - Notice by indemnified party of claims
 - Post-closing limitations period
 - Right to control defense of claims
 - Right of other party to participate with own counsel
 - Right of other party to control subject to limitations
- Anatomy of potential dispute
 - Demand for indemnification/advancement
 - Pre-suit negotiations/mediation/resolution
 - Absent resolution, litigation/ADR on expedited basis or regular pace with motion to compel to secure/maintain advancement, declaration on enforceability of indemnification provision, and enforcement/application of indemnification
 - Most jurisdictions have mandatory indemnity disclosure requirements during the early stages of litigation. See, e.g., FRCP 26; TRCP 192

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Making an Indemnification Claim

Third-Party Claims: Assumption of the Defense

The Indemnifying Person may elect to defend through counsel of its own choosing (but reasonably satisfactory to the Indemnified Person) and at its own expense, the settlement or defense of any Third-Party Claim, but only if: (i) the Indemnifying Person notifies the Indemnified Person in writing of its intent to do so within thirty days (or sooner if the nature of the Third-Party Claim so requires) after receipt of the Notice of Claim; (ii) the Third-Party Claim involves only money damages and does not seek an injunction or other equitable relief; (iii) the Indemnifying Person conducts the defense of the Third-Party Claim actively; and (iv) the Indemnified Person shall have reasonably concluded, based on the advice of counsel, that: (x) there is no conflict of interest between the Indemnified Person and the Indemnifying Person in the conduct of such defense; and (y) all defenses available to the Indemnified Person are available to the Indemnifying Person

Buyers often negotiate for limitations on a Seller's ability to assume the defense

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Making an Indemnification Claim

Third-Party Claims: Assumption of the Defense

The Indemnifying Party may elect to defend through counsel of its own choosing (but reasonably satisfactory to the Indemnified Party) and at its own expense, the settlement or defense of any Third-Party Claim, but only if: ... (i) the Indemnifying Party confirms in writing that it is responsible for indemnifiable Losses arising from such Claim (subject to limitations set forth in this [Article XX](#)), (ii) the Indemnifying Party provides the Indemnified Party with evidence reasonably acceptable to the Indemnified Party that the Indemnifying Party has the financial resources to defend such Third Party Claim, (iii) settlement of, or an adverse judgment with respect to, the Third Party Claim is not reasonably likely to establish a precedential custom or practice adverse to the continuing business interests of the Indemnified Party ...

Additional limitations that Buyers may negotiate
on a Seller's ability to assume the defense

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