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Preserving Value in M&A Transactions

THE INDEMNIFICATION CLAIM PROCESS

M&A transactions sometimes do not work out as expected due to misrepresentations or omissions made by the seller about the target company. This article explains how buyers can use the indemnification claim process in private M&A transactions to help preserve the value of their transactions.

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In a perfect world, every M&A transaction would be an unqualified success. However, the unfortunate reality is that some M&A transactions do not work out as expected. This may be due to misrepresentations or omissions made by the seller about the target company. In private M&A transactions, the buyer typically has a right to indemnification from the seller for losses it incurs as a result of the seller's breach of its representations and warranties in the purchase agreement.

Indemnification is important because it can enable the buyer to effectively adjust the purchase price that it pays for the target company, so that it more closely approximates its actual value. This article provides an overview of the indemnification claim process, including:

- How indemnification claims are initially identified.
- Potential limits on indemnification claims set out in the purchase agreement.
- Preparing and delivering the indemnification claim notice.
- The process for resolving indemnification claims.
- Satisfying amounts owed under indemnification claims.

For convenience, in this article the term:

- "Target" refers to the company being acquired.
- "Seller" refers to the target stockholders in a stock purchase or merger transaction or the seller in an asset purchase transaction, which are the parties generally providing indemnification to the buyer.
- "Representations" refers to the representations and warranties made by the seller in the purchase agreement.

Search Indemnification Clauses in Private M&A Agreements for an overview of indemnification clauses in private M&A purchase agreements, including ways to limit and enforce the indemnification obligation.

IDENTIFYING INDEMNIFICATION CLAIMS

Indemnification generally covers losses resulting from:

- Breaches of representations in the purchase agreement.
- Breaches of covenants in the purchase agreement.
- Excluded liabilities in asset purchase transactions.
- Specific target liabilities that the seller agrees to assume or retain (such as losses arising from a particular litigation matter).

Most indemnification claims made by buyers are based on breaches of the seller's representations. Some common issues, and the corresponding representations that are typically breached, include:

- Improper target accounting practices (potentially covered by the representations concerning financial statements).
- Undisclosed or inaccurately described actual or threatened litigation or other disputes (potentially covered by the representations concerning litigation).
- Issues with the target's contracts, including breach of contract allegations made by the target's customers, suppliers, or other contract counterparties (potentially covered by the representations concerning material contracts, no material adverse effect (MAE) since the most recent balance sheet date, and the target's relationships with its customers and suppliers).
- Violations of law by the target (potentially covered by the representations concerning compliance with law generally and compliance with specific regulations applicable to the target's business).
- Unpaid taxes (potentially covered by the representations concerning taxes and the tax indemnification provision in the purchase agreement).
- Employee benefit plan liabilities, including liabilities triggered by the sale of the target to the buyer (potentially covered by the representations concerning employee benefits matters, taxes, and compliance with law).
- Undisclosed labor and employment issues, including discrimination, harassment and wrongful termination claims, and WARN Act violations (potentially covered by the representations concerning labor and employment matters and compliance with law).
- Intellectual property (IP) issues, including infringement of the target's IP and improper maintenance of the target's registered IP (potentially covered by the representations concerning IP matters and the target's intangible assets).
- Environmental issues, including fines and penalties due to the target's failure to conduct its business in compliance with environmental laws and remediation obligations due to the release of hazardous substances (potentially covered by the representations concerning environmental matters and compliance with law).
- Issues with the target's tangible assets, including undisclosed liens and other encumbrances on title to the target's assets (potentially covered by the representations concerning the target's assets).
- Issues with the target's relationships with its key customers and suppliers, including undisclosed threats by key customers and suppliers to terminate their relationships with the target or otherwise adversely change their business relationships with the target (potentially covered by the representations concerning material contracts, no MAE since the most recent balance sheet date, and relationships with customers and suppliers).
- Undisclosed contracts and other arrangements between the target and related parties of the target or the seller (potentially covered by the representations concerning affiliated party transactions).

Many of these issues also constitute breaches of the "no undisclosed liabilities" and Rule 10b-5 representations.

A buyer becomes aware of these issues when:

- The buyer prepares its first audited financial statements including the target's financial results.
- The buyer prepares its first consolidated tax returns including the target.
- Regulators notify the buyer of violations of law by the target, which include pre-closing violations.
- Customers, suppliers, and other contract counterparties of the target assert breaches of their contracts with the target, which include pre-closing breaches.

- Target employees (who become employees of the buyer once the acquisition closes) disclose improper pre-closing seller practices to the buyer.

LIMITS ON INDEMNIFICATION CLAIMS

Once an issue that will be the subject of an indemnification claim arises and the relevant representations in the purchase agreement are identified, the next step is to analyze whether there are any limitations in the purchase agreement on the buyer's ability to make the indemnification claim, including limitations resulting from:

- Materiality, MAE, or knowledge qualifiers.
- Survival periods.
- The definition of indemnifiable "losses."
- Prior seller disclosures and buyer knowledge of the issue.
- Baskets and caps.

MATERIALITY, MAE, AND KNOWLEDGE QUALIFIERS

Materiality and MAE qualifiers can be used to limit:

- The seller's disclosure obligations to the buyer (for example, immaterial matters do not need to be included in the disclosure schedules).
- The ability of the buyer to make an indemnification claim.

Materiality is rarely defined in the purchase agreement with a specified dollar amount. The test for materiality is typically whether a reasonable buyer would consider the issue to be important in making its decision to acquire the target. There is no bright-line rule in applying this test, but comparing the dollar amount of the potential buyer losses from the issue to the purchase price paid by the buyer for the target can be instructive. In practice, buyers typically err on the side of caution and make an indemnification claim for all issues that arise, regardless of their magnitude, particularly if the indemnification basket has not yet been met.

An MAE qualifier sets an extremely high threshold for the buyer to make an indemnification claim. Only an issue having a very substantial impact on the target gives the buyer recourse against the seller.

Representations can also be qualified by knowledge (for example, "to the seller's knowledge, there is no litigation threatened against the target"). The knowledge standard may be actual knowledge or constructive knowledge (the seller knew or should have known). Sometimes only the knowledge of specified members of the target's senior management team and board of directors is imputed to the seller, making it irrelevant if other target employees knew about the issue.

If the relevant representation is qualified by knowledge and the standard is actual knowledge of specified target persons, to make an indemnification claim the buyer needs to find evidence (usually consisting of emails obtained by the buyer from the target's email server post-closing) that at least one of the specified target persons actually knew about the issue before closing. This can be difficult. A constructive knowledge standard is generally easier for buyers to satisfy because they can make an indemnification claim if they can show that, due to the type of

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issue and the specified target person's position within the target, the specified target person reasonably should have known about the issue.

SURVIVAL PERIODS

The purchase agreement typically includes specified survival periods for the seller's representations, which effectively act as the time limits after closing by which the buyer may make an indemnification claim against the seller relating to breaches of those representations. Survival periods can vary considerably, with a recent trend towards shorter survival periods. There is typically a general survival period for representations (which can range from 12 to 24 months after closing), subject to carve-outs for:

- Representations concerning environmental, employee benefits, tax, and certain other regulatory matters, which often survive until expiration of the underlying statutes of limitation.
- Fundamental representations, such as authority to enter into the transaction and clear title to stock or assets, which often survive indefinitely after closing.

Seller indemnification obligations relating to breaches of covenants, excluded liabilities, or other specific liabilities assumed or retained by the seller often survive indefinitely after closing. However, even if there is a survival period for these types of claims, it is often longer than for claims relating to breaches of representations.

If there is no survival period specified in the purchase agreement, the statute of limitations for breach of contract actions under the state law governing the purchase agreement acts as the deadline for indemnification claims. This statute of limitations varies from state to state, but five to seven years is typical.

In some transactions, a portion of the transaction consideration is placed into escrow with a third-party bank for a specified period of time after closing to secure the seller's indemnification obligations, which is referred to as the indemnification escrow. If the indemnification escrow is the buyer's sole remedy for satisfying the seller's indemnification obligations, the date on which the indemnification escrow is released to the seller effectively acts as the date by which the buyer must make an indemnification claim. Even in transactions in which the indemnification escrow is not the buyer's sole remedy, the buyer typically tries to make indemnification claims before the indemnification escrow is released to the seller because the indemnification escrow is a readily available source of funds to satisfy indemnification claims.

Search Escrow Agreement for a sample escrow agreement setting out the terms by which an escrow agent will hold and distribute the portion of the purchase price placed in escrow.

DEFINITION OF INDEMNIFIABLE LOSSES

The buyer is only entitled to be indemnified for damages resulting from a breach that fall within the definition of "losses" in the purchase agreement. Indemnifiable losses are typically defined extremely broadly in the purchase agreement and usually include the fees and expenses of the buyer's attorneys, accountants, and other advisors incurred in connection with the issue on which the indemnification claim is based. This contrasts with the general rule that, in the absence of an explicit provision entitling the prevailing party to attorneys' fees, those types of damages are not recoverable in a breach of contract action.

In some situations, calculating the buyer's indemnifiable losses is relatively simple. For example, it is easy to determine the buyer's damages from an undisclosed litigation against the target that is settled for a fixed cash payment or an undisclosed regulatory fine imposed on the target.

In other situations, the buyer's damages are less easily determinable. For example, where the target's financial statements were not prepared in accordance with GAAP (generally accepted accounting principles), which artificially inflates EBITDA, the buyer typically asserts that its damages are the product of the difference between the target's actual EBITDA and the EBITDA described in the non-GAAP target financial statements, multiplied by the EBITDA multiple used by the buyer in determining the purchase price that it paid for the target.

However, it may not be clear what EBITDA multiple to use when the transaction was the result of an auction process in which the buyer raised its bid several times to win the auction and, consequently, the implied EBITDA multiple changed over time.

Indemnifiable losses are typically defined extremely broadly in the purchase agreement and usually include the fees and expenses of the buyer's attorneys, accountants, and other advisors incurred in connection with the issue on which the indemnification claim is based.

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It also may be difficult to determine the buyer's damages relating to an undisclosed pre-closing breach by the target of one of its material contracts. For example:

- Are the buyer's damages just the amount necessary to settle the resulting breach of contract dispute with the contract counterparty?
- What if the contract was with a key target customer that terminated its relationship with the target in response to the breach?
- Should the buyer's damages include the lost profits that the target would have made under the contract, had the breach not occurred and the contract had been fully performed?
- Should lost profits over the life of the contract simply be totaled up or instead reflect the time value of money using a net present value calculation?
- Are the buyer's damages just the amount of those lost profits or should they be subjected to the EBITDA multiple used by the buyer in determining the purchase price that it paid for the target?

Language included in the purchase agreement can preclude the buyer from obtaining indemnification for losses determined using a multiple of EBITDA, revenues, or another financial measure, or other forms of consequential or indirect damages. These consequential damages waivers can be controversial, as the language is often included in the miscellaneous boilerplate provisions at the end of the purchase agreement and may not have been focused on or completely understood by the parties during negotiations.

Although purchase agreements sometimes include provisions reducing the buyer's indemnifiable losses by the amount of any tax benefits, insurance proceeds, and other third-party recoveries received by the buyer relating to the issue that is the subject of the indemnification claim, those amounts are frequently not known at the time the indemnification claim is made. As a result, the buyer typically does not take them into account when determining the amount of losses specified in the indemnification claim notice.

PRIOR SELLER DISCLOSURES TO THE BUYER

For an issue to constitute a breach of a representation that entitles the buyer to indemnification from the seller, the issue must not have been disclosed by the seller to the buyer in the purchase agreement or in the disclosure schedules to the purchase agreement. Sometimes disputes occur over whether a reference to an issue in the disclosure schedules was sufficiently detailed to have put the buyer on notice of the issue.

The disclosure schedules sometimes provide that disclosure of an issue in connection with any of the seller's representations also applies to other representations made by the seller in the purchase agreement, as long as it would be apparent to a reasonable buyer that the disclosure also applied to those other representations. Where that is the case, to confirm that an issue was not disclosed to the buyer and therefore can be the subject of an indemnification claim, the buyer must review the disclosure schedules in their entirety, rather than just the sections corresponding to the representations providing the basis of the indemnification claim.

The target's financial statements are typically attached to the section of the disclosure schedules corresponding to the target financial statements representations. As a result, accrual of a liability relating to an issue in the financial statements (if specific enough), or disclosure of an issue in the notes to the financial statements, may qualify as disclosure of the issue to the buyer, limiting the buyer's ability to make an indemnification claim against the seller relating to that issue.

Disclosures Outside of the Purchase Agreement

A substantial amount of information about the target is typically provided by the seller to the buyer in connection with its due diligence process, including information:

- Contained in the virtual data room created for the transaction.
- Supplied in response to supplemental due diligence requests from the buyer and its attorneys, accountants, investment bankers, and other representatives.
- Contained in the confidential information memorandum prepared by the target's investment bankers.
- Included in management presentations made by the target to bidders.

This information may or may not be taken into account for purposes of whether the buyer can make an indemnification claim against the seller relating to an issue.

The purchase agreement typically includes an "entire agreement" or merger provision, which states that all of the terms of the transaction are contained in the purchase agreement, superseding any other agreements and understandings among the parties. Some purchase agreements also include express non-reliance language, in which the parties agree that the only representations being made by the seller to the buyer in connection with the transaction are those contained in the purchase agreement and the buyer acknowledges that it is not relying on any other information about the target. However, some courts have limited the ability of the seller to avoid liability for misrepresentations made by them about the target in communications with the buyer outside the purchase agreement, despite entire agreement and non-reliance provisions in the purchase agreement.

Sandbagging

In some cases, the buyer makes an indemnification claim against the seller concerning an issue that it knew about before closing, which is referred to as sandbagging. Some courts have upheld the ability of the buyer to do so, which has led some sellers to seek to include anti-sandbagging provisions in purchase agreements that expressly bar the buyer from obtaining indemnification from the seller for issues that the buyer knew about before closing.

Conversely, some courts have barred buyers from making claims concerning issues they knew about before closing. This has led some buyers to seek to include pro-sandbagging provisions in purchase agreements that expressly reserve the buyer's right to make an indemnification claim against the seller concerning an issue it knew about before closing. Any sandbagging-related provisions in the purchase agreement need to be taken into account by the buyer when making an indemnification claim.

BASKETS AND CAPS

The purchase agreement typically limits the buyer's ability to obtain indemnification from the seller until its indemnifiable losses exceed a specified amount, which is referred to as the basket. The basket may be structured as a:

- **True deductible.** Here, the buyer must absorb otherwise indemnifiable losses below the specified amount and is only entitled to indemnification from the seller for losses in excess of that amount.
- **Threshold (or tipping basket).** Here, the buyer is merely required to delay making indemnification claims against the seller until it has incurred indemnifiable losses at least equal to the specified amount, but then is entitled to compensation from the seller for all of its indemnifiable losses.

In addition to an overall basket that applies to all indemnification claims made by the buyer, the purchase agreement may also provide for a mini-basket that applies on a claim-by-claim basis.

The purchase agreement typically caps the seller's total indemnification obligation to the buyer at a specified amount, based on the premise that sellers are often not willing to sell the target (thereby limiting their upside potential relating to the target) if they will be required to retain unlimited liability and downside exposure relating to the target's operations. Sellers also typically want some finality concerning the degree to which they could be required to return a portion of the purchase consideration to the buyer.

There is sometimes a de facto indemnification cap by virtue of the indemnification escrow being the buyer's sole remedy with respect to the seller's indemnification obligations.

There are typically carve-outs from the basket for buyer losses resulting from breaches of the seller's fundamental representations, excluded liabilities (in asset purchase transactions), any specific liabilities assumed or retained by the seller, and any fraud or intentional breach of the purchase agreement by the seller or the target. Similarly, there is typically a higher indemnification cap (usually the full purchase price) for these types of losses and a carve-out from the indemnification cap for buyer losses resulting from any fraud or intentional breach of the purchase agreement by the seller or the target.

As a result, when making an indemnification claim, the buyer needs to apply any relevant baskets and indemnification caps, taking into account any prior indemnification claims made against the seller.

Search Indemnification Clauses in Private M&A Agreements for more on baskets and caps.

PREPARING THE INDEMNIFICATION CLAIM NOTICE

Once the buyer has identified the breaches of representations or excluded liabilities on which the indemnification claim is based and applied any applicable baskets and indemnification caps, the next step is for the buyer to prepare and deliver the indemnification claim notice to the seller. The purchase agreement often specifies the information required to be included in the indemnification claim notice, typically providing that it must:

- Describe in reasonable detail the issue that is the subject of the indemnification claim.
- Specify the representations or excluded liabilities on which the indemnification claim is based.

Even if it is not required by the purchase agreement, it is advisable for the buyer to include this information in the indemnification claim notice. The buyer should also include language reserving its right to later provide additional information and make additional indemnification claims, as it learns more about the issue on which the indemnification claim is based.

For indemnification claims based on claims made by third parties, the purchase agreement typically requires the buyer to notify the seller of the third-party claim promptly after it becomes aware of the third-party claim and, in any event, soon enough to avoid prejudicing the seller's ability to assume and defend the third-party claim.

DESCRIBING THE INDEMNIFICATION CLAIM

Although a buyer may base an indemnification claim on the breach of only one of the seller's representations in the purchase agreement, buyers typically list in the indemnification claim notice all of the seller representations that are arguably breached by the issue on which the indemnification claim is based. There may be a strategic benefit for the buyer in characterizing an issue as a breach of certain representations rather than others. For example, when possible, the buyer is often better off alleging that an issue is a breach of a fundamental representation, rather than a non-fundamental representation, because the former is often not subject to a basket or an indemnification cap and generally has a longer survival period.

Similarly, it may be better for the buyer to characterize an issue that constitutes both a breach of the seller's tax, employee benefits, or environmental representations, as well as a breach of the seller's "no undisclosed liabilities" representation, as being the former because those representations typically have longer survival periods in which the buyer may make an indemnification claim. In asset purchase transactions, it is often better for the buyer to characterize an issue as an excluded liability, rather than as a breach of the seller's representations, because baskets generally do not apply to excluded liabilities and there is usually either no indemnification cap or a much higher indemnification cap on excluded liabilities.

Similarly, if the purchase agreement has a separate tax indemnification section, it may be better for the buyer, from both a procedural and substantive perspective, to use that provision for any tax-related issues for which it is seeking indemnification, rather than characterizing the issue as a breach of the seller's tax representations. This is the case because, under the tax indemnification provisions, the buyer may be able to control the Internal Revenue Service audit or other dispute with the taxing authority (rather than the seller being entitled to assume the buyer's defense) and the seller's indemnification obligations to the buyer may not be subject to the basket or indemnification cap.

In some cases, the buyer must make judgment calls in determining whether and how to include consequential and indirect damages in the indemnification claim amount, especially if the purchase agreement includes consequential damages waiver language.

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SUPPORTING DOCUMENTATION

The purchase agreement may require the buyer to accompany its indemnification claim notice with reasonable supporting documents concerning the issue on which the indemnification claim is based. For example, where the indemnification claim is based on an undisclosed target litigation, the buyer would be required to include copies of the complaint filed by the plaintiff in the litigation and other court documents. Even if the buyer is not required by the purchase agreement to supply supporting documents to the seller along with its indemnification claim notice, it may be advisable for the buyer to do so because:

- The seller will likely request those documents to evaluate the indemnification claim.
- Providing the supporting documents with the claim notice could help move the process along more quickly.

SPECIFYING LOSSES

The purchase agreement may require the buyer to specify in its indemnification claim notice, to the extent known, the amount of losses that it has incurred or expects to incur relating to the issue. To do so, the buyer needs to review the purchase agreement to determine what types of losses are indemnifiable. In some cases, the buyer must make judgment calls in determining whether and how to include consequential and indirect damages in the indemnification claim amount, especially if the purchase agreement includes consequential damages waiver language.

Even if the amount of losses incurred by the buyer appears to be certain, it may be advisable for the buyer to:

- State that the amount of losses specified in the indemnification claim notice is an estimate, which is subject to revision later as more information is learned about the issue on which the indemnification claim is based.
- Reserve its right to later revise the loss amount accordingly.

NOTICES TO OTHER PARTIES

In transactions with an indemnification escrow, the escrow agreement generally requires the buyer to provide the escrow agent with copies of any indemnification claim notices that it sends to the seller. Even if the escrow agreement does not include this requirement, doing so may be advisable for the buyer because it can help ensure that a portion of the indemnification escrow equal to the amount of claimed losses is reserved and not released to the seller while the indemnification claim is pending. For the same reason, in situations in which the amount of the buyer's losses resulting from an issue is not known with complete certainty, the buyer may want to include an estimated losses amount in the indemnification claim notice, particularly when the indemnification claim is being made shortly before the end of the escrow period.

If the buyer or seller has obtained representation and warranty insurance (R&W insurance) in connection with the transaction, it is typically required under the policy to provide the insurance carrier with copies of any indemnification claim notices concerning issues that could result in a claim under the insurance policy.

Search Representation and Warranty Insurance for M&A Transactions for more on R&W insurance, including key provisions and advice regarding insurer selection and the underwriting process.

RESOLVING THE INDEMNIFICATION CLAIM

The process for resolving an indemnification claim varies depending on whether it is based on either:

- A claim made by a third party (such as a counterparty to one of the target's contracts or a governmental entity with jurisdiction over the target) against the target or the buyer (a third-party claim).
- An issue with the target that was independently identified by the buyer (a direct claim).

THIRD-PARTY CLAIMS

For third-party claims in which monetary damages are sought, the seller (as the indemnifying party) typically has the right to assume the defense of the third-party claim from the buyer

(as the indemnified party) with an attorney reasonably acceptable to the buyer. In most cases, the seller must provide notice of this assumption to the buyer within a specified period of time after receiving notice of the third-party claim from the buyer. After the seller assumes the defense, the buyer generally has a right to participate in the defense at its own expense and, if the seller fails to diligently prosecute the defense of the third-party claim, the buyer can take over the defense.

The purchase agreement typically prohibits the seller from assuming the buyer's defense of a third-party claim if:

- A conflict of interest would result from the same attorney representing both the buyer and the seller in the matter.
- The third party seeks an injunction or other equitable relief against the buyer or the target.
- The third-party claim involves criminal allegations.

The buyer can sometimes negotiate provisions in the purchase agreement prohibiting the seller from assuming the buyer's defense in third-party claims brought by key suppliers or customers of the target. This is based on the concern that the seller may only be focused on resolving the third-party claim for the least amount of money, even if obtaining that resolution damages the target's business, which is now owned by the buyer.

The party defending the third-party claim (whether it is the buyer or the seller) typically must keep the other party informed of developments in the third-party claim, including providing the other party with copies of any litigation documents. The defending party also typically cannot settle the third-party claim without the other party's consent (which usually cannot be unreasonably withheld). The buyer should strictly comply with these provisions, as failing to do so may adversely affect its ability to obtain indemnification from the seller.

Some purchase agreements include additional or different restrictions on the ability of the seller to settle a third-party claim for which it has assumed the buyer's defense. For example, the purchase agreement may only permit the seller to settle a third-party claim if it provides for both a:

- Cash payment that is paid in full by the seller.
- Full release of the buyer.

Alternatively, in some cases, the seller is not required to obtain the buyer's consent to settle a third-party claim when both of these requirements have been satisfied.

In transactions in which the buyer or the seller has obtained R&W insurance, it is typically required to keep the insurance carrier reasonably informed about developments in any third-party claims that could result in a claim under the insurance policy.

DIRECT CLAIMS

For direct claims, the purchase agreement sometimes requires the seller (as the indemnifying party) to provide a written response to the buyer's indemnification claim notice, in which the seller responds to the buyer's allegations and provides any supporting documentation. The seller's response usually must be provided within a specified period of time after the seller receives the buyer's indemnification claim notice. If the seller fails to provide its response within that period, it is typically deemed to have conceded the claims made in the buyer's indemnification claim notice. Even if the purchase agreement does not include a "deemed concession" provision, the seller should promptly respond to the buyer's indemnification claim notice to avoid the argument that it has implicitly conceded the buyer's claims.

Some purchase agreements provide for a mandatory negotiation period in which the buyer and the seller must attempt to negotiate a good faith resolution of the indemnification claim before the buyer is allowed to commence litigation against the seller. Even where negotiation among the parties is not required by the purchase agreement, it typically occurs because the parties want to avoid incurring the time and expense associated with litigation. It may be advisable for the parties to expressly state, in any materials provided to the other side during negotiation of the indemnification claim, that these materials are being provided in connection with settlement negotiations and are subject to any resulting evidentiary privileges.

In transactions in which the buyer or the seller has obtained R&W insurance, it is typically required under the policy to provide the insurance carrier a copy of the seller's response to any buyer indemnification claim notice that may result in a claim under the insurance policy.

SATISFYING AMOUNTS OWED UNDER INDEMNIFICATION CLAIMS

The purchase agreement typically describes how amounts due to the buyer after the resolution of an indemnification claim are to be satisfied. The alternatives include:

- Satisfaction out of the indemnification escrow.
- Satisfaction out of the proceeds of a claim made against R&W insurance obtained by the buyer or the seller.
- Forfeiture of buyer stock issued to the seller as part of the transaction consideration.
- Set-off against the buyer's obligations under promissory notes issued to the seller as part of the transaction consideration.
- Set-off against any contingent obligations of the buyer to the seller (such as earn-outs).
- Payment by the seller to the buyer.

The purchase agreement typically specifies the order in which these methods of satisfaction are to be used.

Release of amounts from the indemnification escrow to satisfy amounts due to the buyer after resolution of an indemnification claim typically occurs pursuant to a joint written instruction executed by the buyer and the seller and delivered to the escrow agent. It may be advisable for the parties to follow up with a call to the escrow agent once the joint written instruction has been provided to:

- Confirm the escrow agent's receipt of the joint written instruction.
- Answer any questions that the escrow agent may have about the release of funds from the escrow.

In transactions in which the buyer or the seller has obtained R&W insurance, the parties need to comply with the procedures in the policy to obtain insurance proceeds regarding the breaches of representations that are the basis of the indemnification claim. Those procedures can vary considerably depending on particular terms and conditions of the R&W insurance policy.

In transactions in which forfeiture of shares of buyer stock issued to the seller as part of the transaction consideration is used to satisfy buyer indemnification claims, the purchase agreement typically has a methodology for valuing the buyer stock for that purpose. The alternatives can include:

- A floating value equal to the fair market value at the time of forfeiture.
- The greater of the then-current fair market value and a specified floor amount.
- The lesser of the then-current fair market value and a specified ceiling amount.
- A fixed value specified in the purchase agreement.

When an indemnification claim is satisfied through forfeiture of buyer stock, the buyer typically provides notice to the seller of the forfeiture that includes its calculation of the amount of shares forfeited using the methodology specified in the purchase agreement.

If there are multiple sellers required to directly satisfy indemnification obligations to the buyer, the purchase agreement typically specifies whether each seller is:

- **Jointly and severally liable.** In this case, each seller must pay the full amount to the buyer and then seek contribution from the other sellers for their allocable portions of the amount paid.
- **Severally, but not jointly liable.** In this case, each seller is only required to pay its allocable portion of the amount due to the buyer, usually based on its percentage ownership in the target.