

2023 Trends in Private Target M&A: Indemnification as an Exclusive Remedy

Market Trends: What You Need to Know

As reflected in the American Bar Association's Private Target Mergers and Acquisitions Deal Point Studies:

- Over the time period covered by the ten ABA studies (2005-2023), the inclusion of exclusivity of remedies (EOR) provisions has become commonplace: included within 76% to 97% of the reported agreements.
- “Fraud” is a common carve-out to EOR provisions, now present in about 90% of the reviewed agreements. In deals including fraud carve-outs, there is a steady trend to define fraud with some specificity. Commonly used definitions for fraud are “actual fraud,” “intentional fraud,” “actual knowledge of breach when made,” “express intention to deceive,” and “common law fraud.”
- Other carve-outs from EOR provisions are for “intentional misrepresentations,” seen in 43% of deals in the 2017 study before dipping to 20% in the 2019 study and further to 16% in the current 2023 study and prior 2021 study, and “equitable remedies,” which were present in 82% of the agreements reviewed in the 2023 study. Exclusions for “breaches of covenants” are present in a relatively small percentage (under 20%) of reported deals.

Introduction

Merger and acquisition purchase agreements generally include indemnification provisions, pursuant to which a given party (“indemnitor”) agrees to defend, hold harmless, and indemnify the other party or parties (“indemnitees”) from specified claims or damages. These typically include claims arising from a breach of the indemnitor's representations and warranties or covenants set forth in the purchase agreement, or with respect to other specific matters. Often the indemnification provisions are agreed to as between the parties as an exclusive remedy for asserting claims (also referred to as an “exclusivity of remedies” or “EOR” provision).

This article examines the use of EOR provisions in private company M&A transactions with reference to the ABA private target deal points studies.

Indemnification Provisions

As the name suggests, an EOR provision means that the right to indemnification provided under the M&A agreement is the parties' exclusive remedy for any breach of the representations, warranties, covenants, agreements, and obligations in the M&A agreement. Further, depending upon the scope of the EOR provision, it may also extend to other documents related to the M&A

transaction or as to the M&A transaction itself.

M&A indemnification provisions generally specify the rights of the parties regarding how claims are handled (e.g., timing, process, payment of claims, and limitations on liability). An EOR provision helps prevent plaintiffs from circumventing these carefully negotiated limitations by providing that the right of indemnification constitutes the only post-closing recourse available to either party and precludes the parties from seeking claims outside of the negotiated indemnification terms. As the studies show, EOR provisions are common in M&A purchase agreements, although they often include negotiated carve-outs that are usually narrow in scope.

A typical EOR provision may read:

The parties acknowledge and agree that their sole and exclusive remedy with respect to any and all claims (other than claims arising from fraud, criminal activity or willful misconduct on the part of a party hereto in connection with the transactions contemplated by this Agreement) for any breach of any representation, warranty, covenant, agreement or obligation set forth herein or otherwise relating to the subject matter of this Agreement, shall be pursuant to the indemnification provisions set forth in this Article []. In furtherance of the foregoing, each party hereby waives, to the fullest extent permitted under Law, any and all rights, claims and causes of action for any breach of any representation, warranty, covenant, agreement or obligation set forth herein or otherwise relating to the subject matter of this Agreement it may have against the other parties hereto and their Affiliates and each of their respective Representatives arising under or based upon any Law, except pursuant to the indemnification provisions set forth in this Article []. Nothing in this Section [] shall limit any Person's right to seek and obtain any equitable relief to which any Person shall be entitled or to seek any remedy on account of any party's fraudulent, criminal or intentional misconduct.

In some circumstances, a buyer may insist on indemnification as a non-exclusive remedy to preserve its ability to pursue other causes of actions. Although, as noted below, non-exclusive remedy provisions are relatively rare in practice, such a provision may read:

The indemnification rights of the parties to indemnification under this Agreement are independent of, and in addition to, such rights and remedies as the parties may have at Law or in equity or otherwise for any misrepresentation, breach of warranty or failure to fulfill any covenant, agreement or obligation hereunder on the part of any party hereto, including the right to seek specific performance, rescission or restitution, none of which rights or remedies shall be affected or diminished hereby.

It is worth noting that enforceability of EOR provisions generally is a matter of state law—and is beyond the scope of this article. EOR provisions should not be assumed to be fully enforceable, and practitioners should examine the laws of the relevant jurisdiction—for example, courts may be loathe to enforce EOR provisions in circumstances involving “fraud” or other types of misrepresentations. See, e.g., *ABRY Partners V, L.P. v. F&W Acquisition*, 891 A.2d 1032 (Del. Ch. 2006); *Livingston Livestock Exch. Inc. v. Hull State Bank*, 14 S.W.3d 849 (Tex. App. 2000); *Greenberg Traurig v. Moody*, 161 S.W.3d 56, 77-79 (Tex. App. 2005) (applying New York law).

The Buyer's Position

The Buyer's arguments for requesting a non-exclusive remedy provision (and resisting an EOR provision) may include:

EOR Provisions May Not Make the Buyer Whole. A buyer wants to preserve the flexibility to pursue claims of any type, whether based upon the indemnification provisions in the M&A agreement or otherwise. This could be important to the buyer because the remedies afforded to it under the indemnification provisions may be arguably inadequate given the potentially unique and unforeseen nature of harm that may be suffered. Put another way, a buyer may ask why it should waive remedies otherwise available to it under applicable law.

Fundamental Fairness. A buyer may also assert that a seller should not be permitted to immunize itself from certain tort or equitable claims premised on false representations of fact contained in the M&A agreement and that the parties acknowledge served as the factual basis on which they entered into the contract.

The Seller's Position

Sellers generally favor EOR provisions and often argue for inclusion for the following reasons:

Preserve the Benefit of the Bargain. In the absence of an EOR provision, a buyer might do an “end-run” around the carefully negotiated indemnification terms and conditions by changing the legal classification of a claim and thereby vitiating (or at least rendering less meaningful) the purpose of the indemnification provisions (particularly the caps, baskets, time limits, and procedural restrictions). In other words, why spend all of the time and effort negotiating detailed indemnification provisions if a buyer can avoid them based on the legal characterization it decides to place on the claim?

Common Market Practices. The 2023 ABA study of private company M&A deal points observed that almost 90% of reported M&A purchase agreements included EOR provisions. This result was consistent with the previous ABA studies (2005-2021) in which EOR provisions were included in between 76% and 97% of reviewed deals.

Common EOR Exceptions. Because EOR provisions often include carve-outs for fraud, equitable remedies, and (to a lesser extent) intentional breaches and/or willful misconduct, the seller may claim that the buyer's arguments regarding an EOR provision unfairly capturing claims not properly within a purchase agreement's indemnification provision are misplaced

Trends in Usage of EOR Provisions

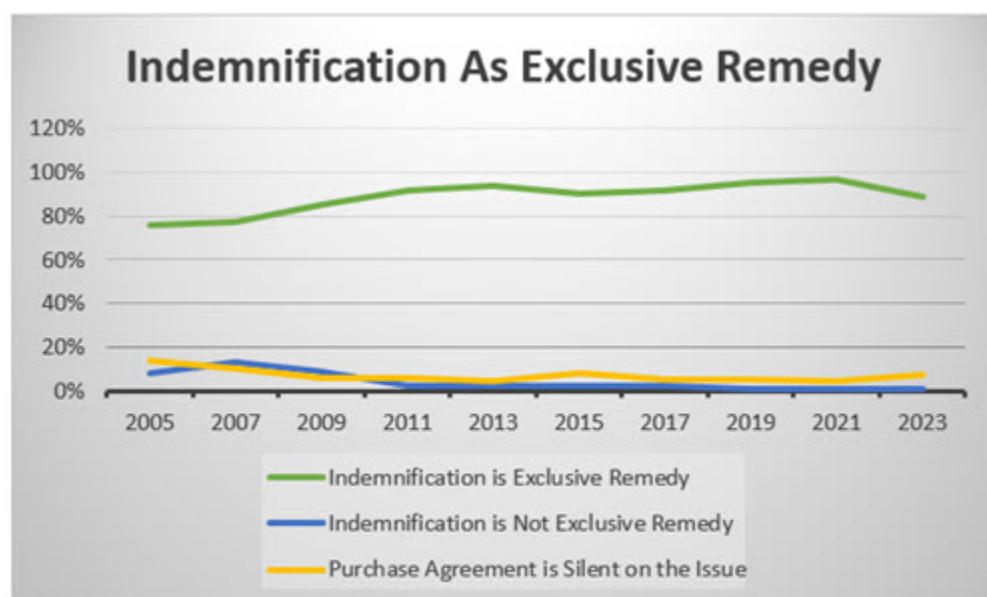
Every other year since 2005 the ABA has released its Private Target Mergers and Acquisitions Deal Points Studies. The ABA studies examine purchase agreements of publicly available

transactions involving private companies. These transactions range in size but are generally considered as within the “middle market” for M&A transactions; the transaction values of the 108 deals within the 2023 study ranged from \$30 to \$750 million.

Over the ten ABA studies (2005-2023), the inclusion of EOR provisions ranged from 76% to 97% of the reported agreements. Thus, not only are parties increasingly including EOR provisions in M&A purchase agreements, but the provision has become commonplace.

On the other hand, during the same time period, reported agreements including an express provision making indemnification a non-exclusive remedy ranged from 2% to 13%, with the last seven studies all seeing values of 1% or 2%. Some agreements reviewed in the ABA studies remained silent on the topic of exclusivity, with silence observed in between 4% and 14% of agreements.

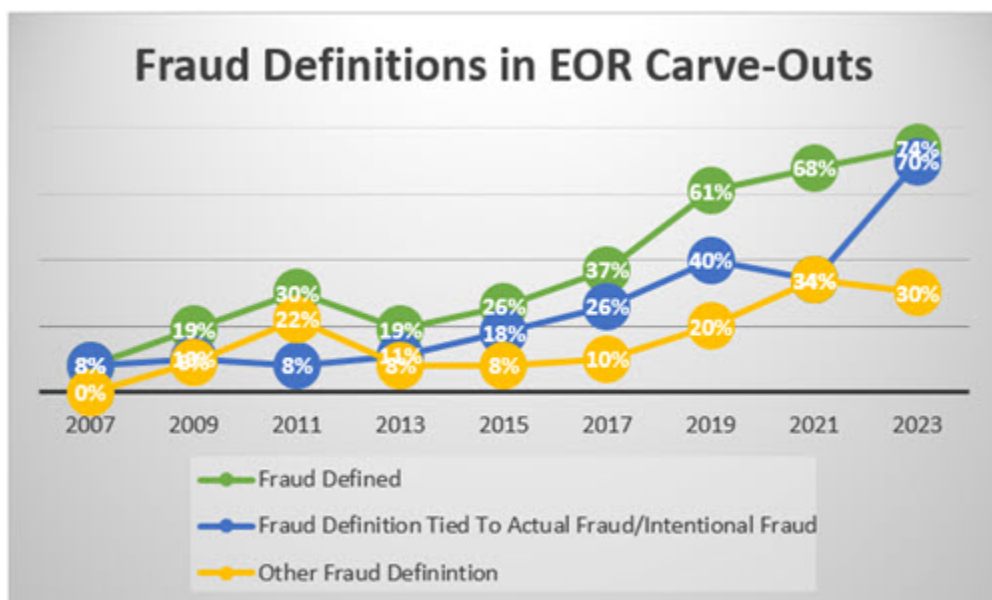
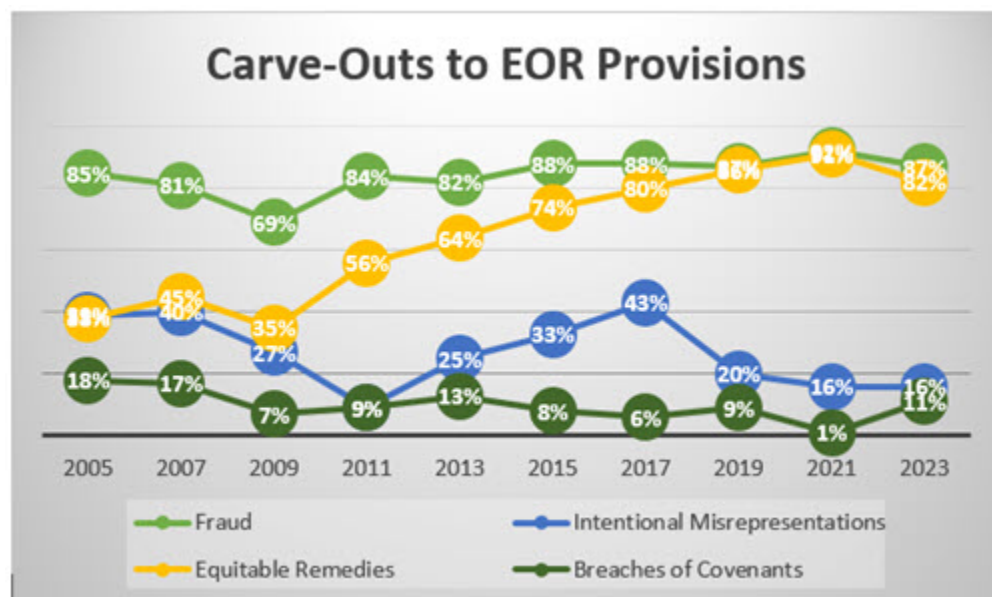
The charts below show the trend with respect to EOR provisions.



As discussed above, it is common for the parties to agree to carve-out certain exceptions to EOR provisions. According to the ABA studies, “fraud” is a common carve-out to EOR provisions, present in over 75% of the agreements reviewed in all of the ten ABA studies. In deals that include a fraud carve-out, there is a steady trend to define fraud with some specificity: in the most recent 2023 study, about 75% of the carve-outs specifically defined fraud, and 70% of those definitions were tied to “actual fraud” or “intentional fraud.”

Other carve-outs from EOR provisions are for “intentional misrepresentations,” seen in 43% of deals in the 2017 study before dipping to 20% in the 2019 study and further to 16% in the current 2023 and prior 2021 studies, and “equitable remedies,” which were present in 82% of the

agreements reviewed in the 2023 study. Exclusions for “breaches of covenants” are present in a relatively small percentage (under 20%) of reported deals.



Conclusion

EOR provisions have been and continue to be commonly used in M&A purchase agreements. At the same time, carving out fraud and equitable remedies as exceptions to an EOR provision are fairly common. Additionally, the ABA studies show that parties are increasingly defining the term fraud when it is included as a carve-out, and that definition is, in turn, increasing tied to actual or intentional fraud.

Although the inclusion of an EOR provision can provide certainty to a seller, it may constitute a

waiver of claims otherwise available to a buyer. Accordingly, the negotiated exceptions to an EOR provision are critical and counsel on both sides should consider these issues carefully when negotiating an M&A purchase agreement.

General Information

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