

The background of the slide is a photograph of an oil field at sunset. Several pumpjacks are visible, their silhouettes against a sky with soft, orange and blue light. The pumpjacks are yellow and black. The overall scene is industrial and serene.

INDEMNITIES AND DAMAGES

A Bit Of Planning Can Go A Long
Way

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September 28, 2016



First: The Misunderstanding of Contract Damages
Then: Indemnity 101 (Mostly Third Party Indemnity)
Then: Inter-Party Indemnity
Last: Related Issues

FIRST: THE MISUNDERSTANDING OF CONTRACT DAMAGES

- Compensatory
- Actual
- Direct
- Indirect
- Incidental
- Nominal
- Lost Profits
- Liquidated
- Expectation
- Benefit of the Bargain

- General
- Special
- Exemplary
- Punitive
- Foreseeable
- Consequential
- Extraordinary
- Rescission
- Restitution
- Specific Performance

WHAT CAN BE RECOVERED (AS DAMAGES)

- For Breach of Contract, assuming no damage-limiting agreement, a party may recover its ACTUAL DAMAGES
- ACTUAL DAMAGES include DIRECT DAMAGES, INCIDENTAL DAMAGES, and CONSEQUENTIAL DAMAGES
- All Breach of Contract damages must be foreseeable!

CONFUSION AS TO BASIC CONCEPTS = BAD CONTRACTS

- Worth Repeating: ALL CONTRACT DAMAGES MUST BE FORESEEABLE
- DIRECT DAMAGES are those damages which naturally and necessarily flow from a wrongful act, are so usual an accompaniment of the kind of breach alleged that the mere allegation of the breach gives sufficient notice, and are conclusively presumed to have been foreseen or contemplated by the party as a consequence of his breach.
- CONSEQUENTIAL DAMAGES are those damages which, though they do not always or even usually flow from the breach of contract, are, at the time of making the contract, recognized by the parties as those which in the particular case may result from a breach.
- Lost profits are not always CONSEQUENTIAL DAMAGES
- Punitive (or "exemplary" or "extraordinary") damages are not contract damages – EVER

CONSEQUENTIAL DAMAGES

It's Pretty Simple: No One Knows What They Are

“[N]either in Michigan nor elsewhere does the term ‘consequential damages’ have a clearly established meaning.”

Applied Data Processing, Inc. v. Burroughs Corp., 394 F. Supp. 504, 508 (D. Conn. 1975)

The meaning of indirect and consequential losses “is a question on which it is difficult to obtain much assistance from authority or dictionary definitions.”

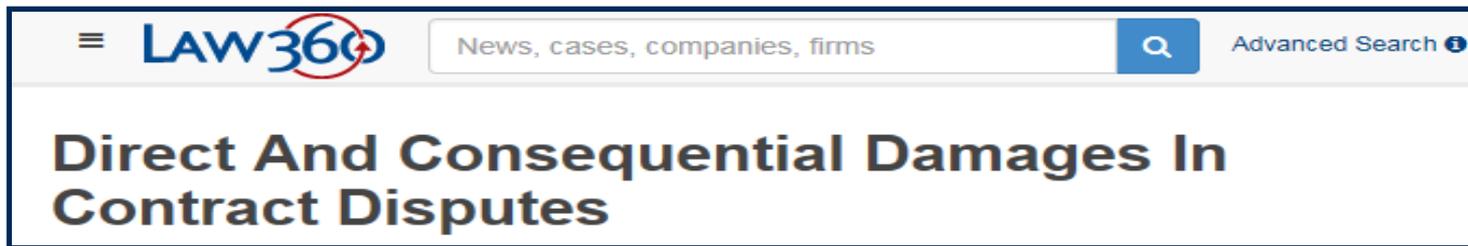
Caledonia N. Sea Ltd. v. London Bridge Eng'g Ltd., [2000] S.L.T. 1123, 1207 (Sess.).

“No one knows what consequential damages are or may be, at least not with predictability or uniformity.”

Gregory K. Morgan & Albert E. Phillips, *Design Professional Contract Risk Allocation: The Impact of Waivers of Consequential Damages and Other Limitations of Liabilities on Traditional Owner Rights and Remedies*, 33 J.C. & U.L. 1, 13 (2006).

CONSEQUENTIAL DAMAGES

It's Pretty Simple: No One Knows What They Are



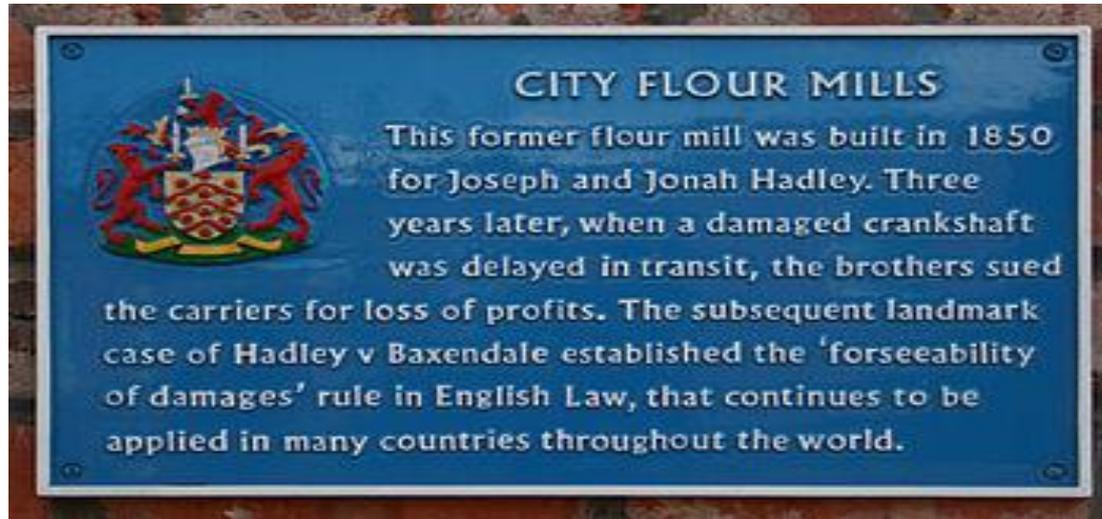
The screenshot shows the LAW360 website interface. At the top left is the LAW360 logo with a red circle around the '360'. To its right is a search bar containing the text 'News, cases, companies, firms' and a magnifying glass icon. Further right is an 'Advanced Search' link with a small information icon. Below the search bar, the main heading of the article is displayed in large, bold, black text: 'Direct And Consequential Damages In Contract Disputes'.

These cases illustrate again the importance of properly drafted limitation-of-liability contractual clauses. But even this precaution has its limits. Texas case law shows that direct damages alone can be substantial depending on the facts of the case. Damages that are usually classified as consequential can sometimes be treated as direct damages depending on the contract's language. Counsel should mind these dangers as they draft their contracts.

 *Huh?*

CONSEQUENTIAL DAMAGES

It's Still *A Hadley v. Baxendale* World



CONSEQUENTIAL DAMAGES

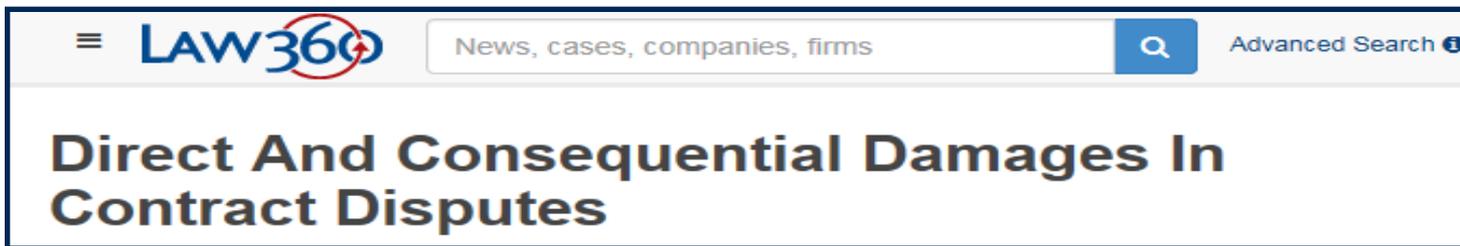
It's Still A *Hadley v. Baxendale* World

- The two branches of Hadley: DIRECT DAMAGES and CONSEQUENTIAL DAMAGES
- DIRECT DAMAGES are “those which may fairly and reasonably be considered as arising naturally from the breach” of any similar contract (as said in Hadley, “in the great multitude of such cases”) and which do not arise from any special circumstances applicable to the non-breaching party
- and
- CONSEQUENTIAL DAMAGES are “those damages which, though they do not always or even usually flow from the breach of contract, are, at the time of making the contract, recognized by the parties as those which in the particular case may result from a breach”



BRACEWELL

THE CHALLENGING CASE OF LOST PROFITS



≡ LAW360 News, cases, companies, firms Advanced Search ⓘ

Direct And Consequential Damages In Contract Disputes

Lost profits, lost sales, incidental damages and most other damages are consequential damages. Cagle, supra, at 665–68. Lost profits on the contract itself, as in Hess Die Mold, are direct damages. Cherokee County Cogeneration Partners LP v. Dynegy Mktg. & Trade, Dynegy GP Inc., 305 S.W.3d 309, 314 (Tex. App.—Houston [14th Dist.] 2009, no pet.). Lost profits on other contracts, but that result from the breach, are consequential damages. Id.

 ***What?***

THE CHALLENGING CASE OF LOST PROFITS

- KEY CONCEPTS
- It is **ABSOLUTELY COMPLETELY AND TOTALLY FALSE** that Lost Profits are always CONSEQUENTIAL DAMAGES
- Lost Profits are often DIRECT DAMAGES (think about construction contracts)
- Not knowing when Lost Profits are DIRECT or CONSEQUENTIAL leads to unexpected and disappointing results
- Courts and Arbitrators will screw this up too
- Lawyers muddle concepts like “diminution in value damages” and “any damages based on multiples of earnings” with CONSEQUENTIAL DAMAGES all the time – and they are wrong, all the time.

THE CHALLENGING CASE OF LOST PROFITS

- WHY DOES ANY OF THIS MATTER?
- WE ALWAYS ALWAYS ALWAYS EXCLUDE CONSEQUENTIAL DAMAGES!!!
- “Consequential damages waivers protect me from lost profits claims!”
 - NOPE: “the great multitude of” similar contracts
- “We both waive consequential damages; everyone wins!”
 - WELL, SOMEONE DOES: But what is the basis of the bargain?
- “I exclude consequential damages and lost profits from every contract!”
 - GOOD, DEEP THINKING: But what are you buying?

DIMINUTION IN VALUE

- References to damages for “Diminution in Value” sometimes appear in provisions limiting damages
- Practitioners often neglect and/or misunderstand these words
 - If included in Seller’s first draft, Buyer assumes this is customary and immaterial
 - If omitted, Seller assumes this is already covered by waivers of “special” or “consequential” damages or “lost profits”
 - None of this is correct
- DAMAGES FOR “DIMINUTION IN VALUE” (1) ARE “DIRECT” DAMAGES, (2) ARE NOT “SPECIAL” OR “CONSEQUENTIAL DAMAGES” AND (3) ARE NOT DAMAGES FOR “LOST PROFITS”
- Without the ability to recover for the diminished value of the acquired business, Buyer may be without a remedy for many/most breaches

DIMINUTION IN VALUE

POWERS V. STANLEY BLACK & DECKER INC. (SDNY 2015)

- SB&D acquired Powers Fasteners in May 2012. At closing, \$16.5M was escrowed to support selling stockholders' indemnification obligations
- After closing, SB&D argued that sellers had breached certain representations and refused to release the escrowed funds
- Claim: sellers failed to disclose litigation regarding the imposition of anti-dumping duties on Chinese-made products that acquired business was importing into Canada
 - SB&D sought damages for the diminished value of the acquired business as a result of its exports being subject to anti-dumping duties
 - Sellers countered that recovery of this type of damages was foreclosed by the damages limitations in the purchase agreement, which prohibited recovery of “any lost profits, consequential damages, punitive damages or opportunity costs...”

DIMINUTION IN VALUE

POWERS V. STANLEY BLACK & DECKER INC. (SDNY 2015)

- Court sides with SB&D:
 - Under NY law, there are two general types of damages available for breach of contract: “(1) general or market damages and (2) special or consequential damages.”
 - Diminution in value damages are general damages; waiver of damages in the Purchase Agreement foreclosed only consequential damages
 - Where “a party purchased a company on the basis of inaccurate warranties, the injured party is normally ‘entitled to the benefit of its bargain, measured as the difference between the value of [the company] as warranted by [sellers] and its true value at the time of the transaction”
 - SB&D can recover its losses: “but for the [sellers’] misrepresentations, it would have spent materially less” for PFI

DIMINUTION IN VALUE

POWERS V. STANLEY BLACK & DECKER INC. (SDNY 2015)

- Court was dismissive of sellers “lost profits” argument:
 - Sellers “do not seriously argue that the diminution of value damages sought by SB&D are “lost profits” (recall that “lost profits” had been excluded)
 - “Diminution of value, a backward-looking measure of damages, is fundamentally different from lost profits, a forward-looking measure.”

DIMINUTION IN VALUE DRAFTING TIPS

- Assume that damages for diminution in value will be available unless expressly excluded
- Buyers should be extremely reluctant to include “diminution in value” in excluded losses provisions
 - If included (in the damages waiver), buyer should be completely aware of what is being waived
 - Concerns from sellers about allowing recovery on the basis of revenue multiples can be addressed with specific, narrow language

DRAFTING – A FEW FINAL, OBVIOUS THOUGHTS

- Make sure you are getting what you want (remember the basis of the bargain)
- Make sure the words you use match the assurances you want
- Rescission/Restitution/Specific Performance are equitable remedies that exist outside the damage waiver (unless put inside)
- Pay attention to the indemnity language: conflicts between indemnity for "all losses" and damage waiver

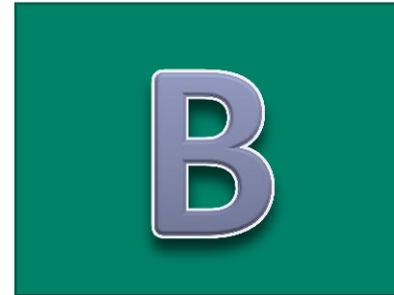
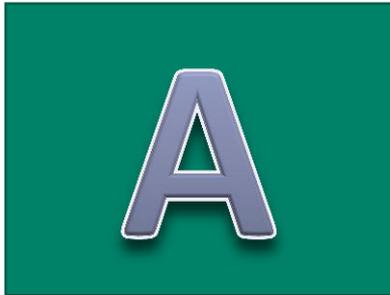
The background of the slide is a photograph of several oil pumpjacks in an industrial setting. The scene is captured at sunset, with the sun low on the horizon, creating a warm, golden glow and silhouetting the machinery. A large, semi-transparent geometric overlay, composed of overlapping blue and green shapes, is positioned in the center-right of the image. The word "INDEMNITIES" is printed in white, uppercase letters within this overlay.

INDEMNITIES

BRACEWELL

FIRST THINGS FIRST:

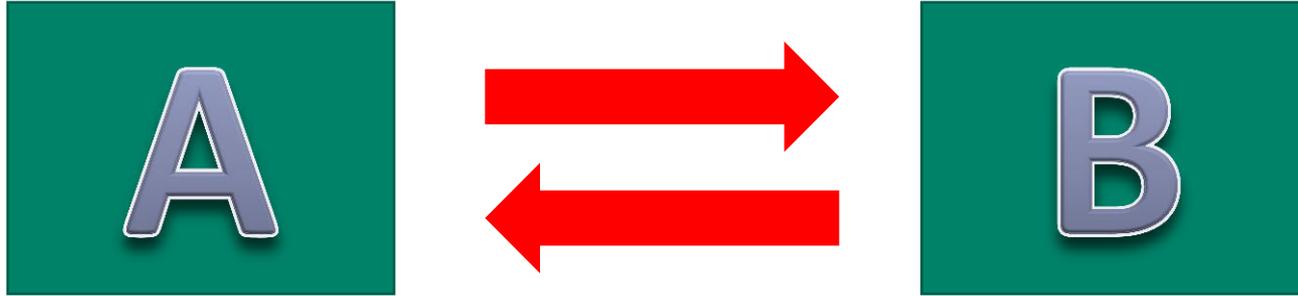
What is third party indemnity?



INDEMNITY 101

- In Basic Legal Terms –
- **FIRST CONCEPT:** Party A indemnifies Party B against CERTAIN claims, losses, and damages.
- **SECOND CONCEPT:** What “claims, losses, or damages”?
 - Death or injury to Party A’s employees
 - Losses of or damages to Party A or its property
 - Pollution emanating from Party A’s property
 - Inter-Party claims
- **THIRD CONCEPT:** All notwithstanding that Party B’s negligence may have caused or contributed...

INDEMNITY 101



It's Simple! Party A will cover losses to its people and property no matter the cause, and B does the same.

BUT....

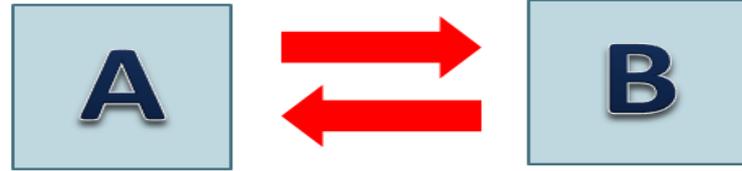
Who, exactly, is A?

AND What do we mean “no matter the cause”?

AND Can we even agree to that?

AND Why would we?

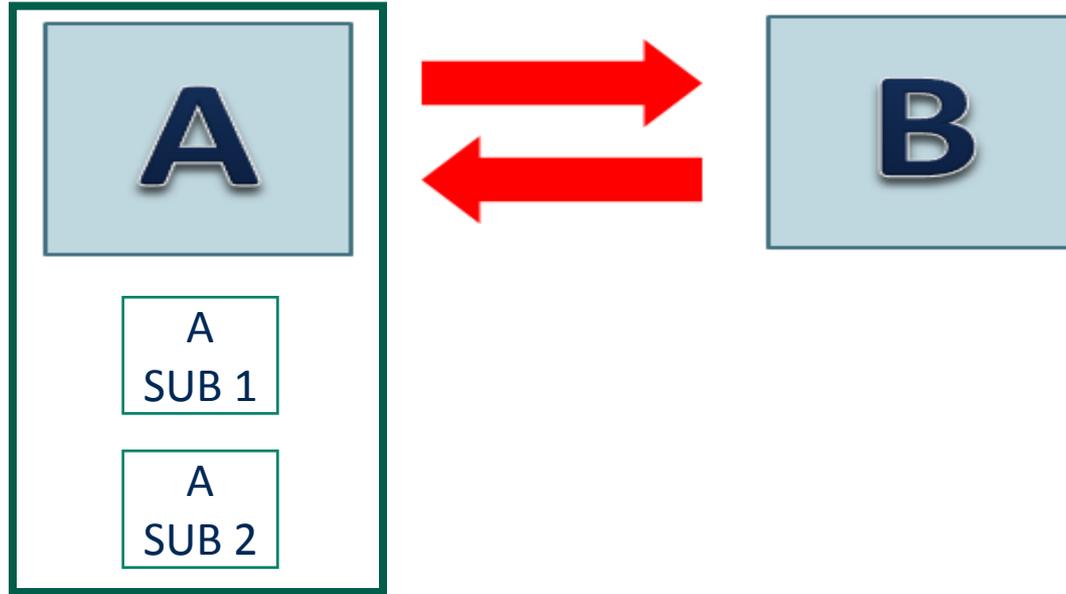
Why would we?



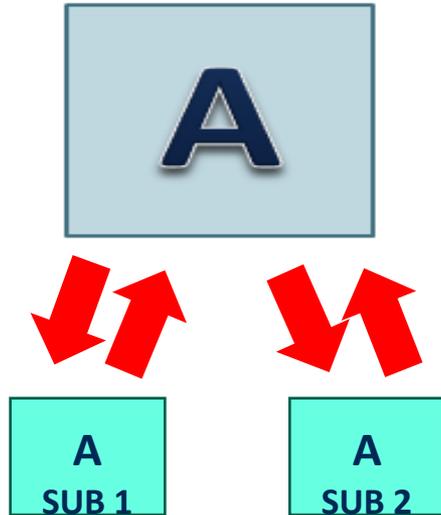
- To allocate risk, usually based on an ownership and employment
 - But can be based on other factors!
- To avoid ambiguity regarding responsibility for liability
- To place liability in the hands of the party in the best position to handle the situation
- To avoid disputes regarding responsibility for liabilities
- To simplify insurance obligations

INDEMNITY 101

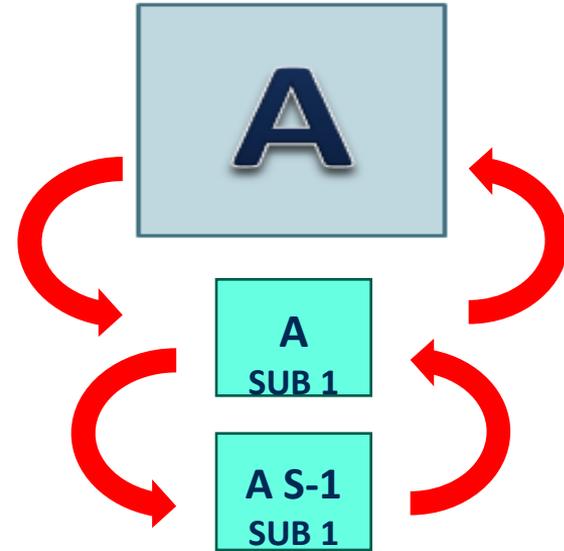
Who is A (or B)?



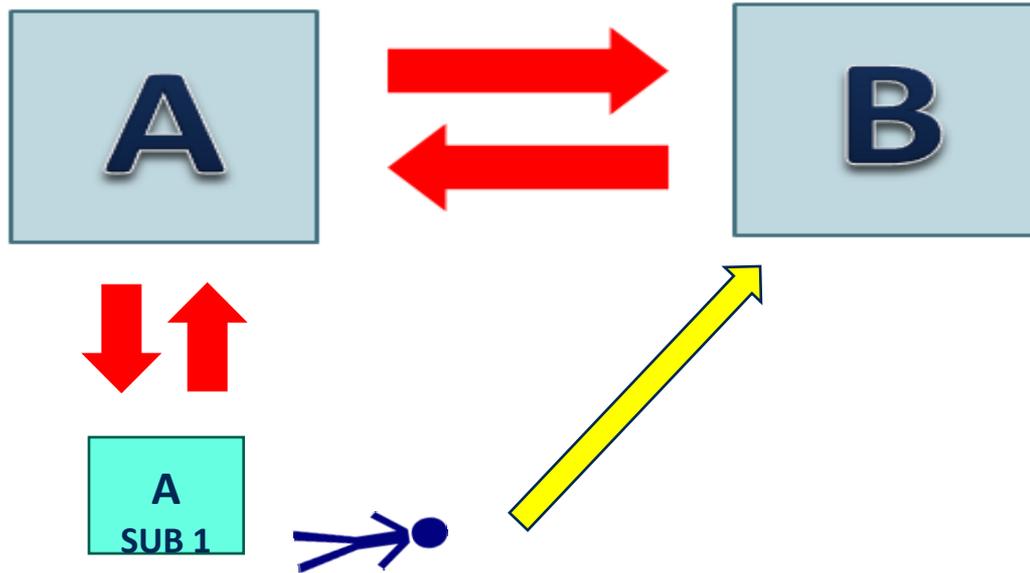
THE IMPORTANCE OF PASS-THROUGH INDEMNITIES



OR,
PERHAPS

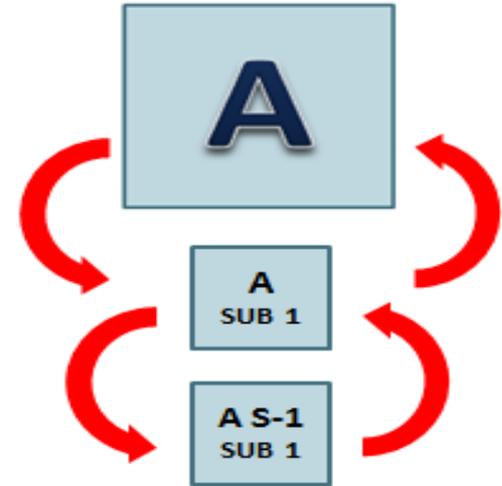
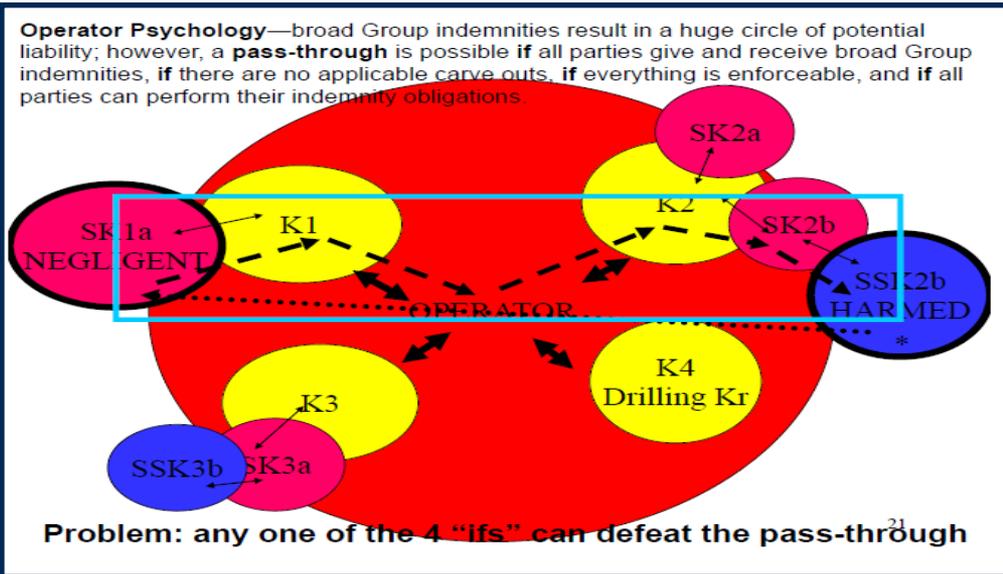


THE IMPORTANCE OF PASS-THROUGH INDEMNITIES ("KNOCK FOR KNOCK")



“KNOCK FOR KNOCK” INDEMNITIES

Look, It's Easy!



INDEMNITIES FOR THIRD PARTY CLAIMS

- Whether an indemnity provision in a contract will be enforceable for the indemnitee’s own negligence (i.e., as is the case in a “knock for knock” indemnity) is determined—in large part—by the language of the contract.
- Three drafting tips:
 - Indemnification provision covering own negligence must be “clear and unequivocal”
 - Indemnification provision must be conspicuous
 - Choose the governing law carefully

INDEMNITIES FOR THIRD PARTY CLAIMS

- Interplay between Indemnification Clauses and Insurance Clauses:
- The extent to which the scope of a party's insurance coverage is determined by the scope of that party's indemnification is an undecided issue in many courts, including the Fifth Circuit and Texas courts
- Undecided issue is the extent to which umbrella insurance policies “stand alone” or are to be interpreted in the context of other agreements (i.e., a drilling contract)
 - In other words, can your policies increase your obligation to provide indemnity
- CGL policies will generally cover contractually-assumed risks

LIMITS ON INDEMNITIES IN OILFIELD

- Other Factors To Consider In Certain Jurisdictions:
- US Maritime Law: Indemnification clauses cannot extend to punitive damages or civil penalties
- Louisiana Anti-Indemnity Law: Indemnification by counter party against your own negligence is not always enforceable (subject to “Marcel exception”)
- Texas Oilfield Anti-Indemnity Act: Limits ability to indemnify a person for his or her own negligence
- US Federal Law (Longshoremen and Harbor Workers’ Compensation Act): Prohibits certain indemnity agreements between a “vessel” and the employer of a maritime employee

AND THEN, MACONDO

This:



And Also This:



LESSONS FROM MACONDO

- Compensatory Damages for Gross Negligence: Enforceable
- Must be expressly included in indemnification clause
- Policy in favor of indemnification for gross negligence strengthened in knock for knock indemnification clauses:
 - Reciprocal agreements create incentive for each party to avoid grossly negligent conduct
 - The Drilling Contract allocated risk for grossly negligent behavior to both BP (below the waterline) and Transocean (above the waterline)
- “Freedom of contract” policy weighs in favor of allowing a party to be indemnified for its own gross negligence, if such a right is expressly stated in the agreement.
- Indemnification clauses merely shift the risk of payment—they do not leave an injured party without recourse



LESSONS FROM MACONDO



- Punitive Damages for Gross Negligence: Unenforceable
- No matter the contract language, one party cannot require another party to indemnify it for punitive damages resulting from its own gross negligence
- “The public policy purpose behind permitting [punitive] damages is to punish the defendant for egregious conduct, teaching him not to do it again, and to deter others from engaging in similar behavior No clearer example of a situation which would subvert the purposes of awarding punitive damages can be imagined than to permit such indemnification. To require a party, without recompense, to shoulder the burden of egregious conduct by another and hence permit that other to avoid punitive damage liability would make a mockery of the very concept.”

LESSONS FROM MACONDO



- Civil Penalties Under OPA/CWA: Unenforceable
- Primary objectives of these civil penalties are to punish and deter future pollution and penalty is “tailored” to the specific defendant
- The punitive nature of this penalty “would be undermined if a penalty tailored to discharge X is contractually shifted to Y.”

LESSONS FROM MACONDO



- Removal Costs Under OPA/CWA: Enforceable
- “Removal costs,” which are intended to restore the status quo, are remedial in nature and indemnification for these costs is enforceable
- PRIMARY DISTINCTION: Remedial Cost v. Punitive Penalty
- “[U]nlike a penalty that is primarily designed to deter certain conduct and punish the wrongdoer, it does not contravene public policy if removal costs are shifted by contract.”

LESSONS FROM MACONDO



- Indemnification where indemnitee breaches contract:
- Enforceable, but a fact-specific inquiry
- “[A] breach of contract can, in some circumstances, invalidate an indemnity clause.”
- “[A]n act on the part of an indemnitee which materially increases the risk or prejudices the right of the indemnitor will discharge the indemnitor to the extent that he has been damaged as a result of that act.”
- BUT—not every breach of contract or act increasing the indemnitor’s risk will void the indemnity
- Louisiana Court declined to decide whether Transocean breached the agreement, and if so, whether such a breach would absolve BP of its indemnification obligations

LESSONS FROM MACONDO

- Costs and attorneys’ fees proving right to indemnification:
- Enforceable, but only if clearly specified in contract
- “Parties can expressly agree that the expense of proving indemnification is within the scope of indemnity.”
- BUT— “[u]nder a general indemnity agreement . . . , the indemnitee enjoys no right to recover its legal fees incurred in establishing its right to indemnification.”
- Court Ruled: Transocean cannot recover the attorneys’ fees, costs, and expenses incurred to establish its right to indemnification from BP.



The background image shows several yellow oil pumpjacks in an industrial setting at dusk. The sky is a mix of blue and orange. Overlaid on the image are several semi-transparent geometric shapes in shades of teal, green, and light purple. The text 'INTER-PARTY INDEMNITY' is centered in white, uppercase letters.

INTER-PARTY INDEMNITY

BRACEWELL

INTER-PARTY INDEMNITY

MEG HOLDINGS, LLC V. SAPPHIRE POWER FIN. LLC (NY 2014)

- Sapphire purchased 7 power plants for about \$255M, with \$25.5M escrowed at Closing to support any “indemnification” claims by Sapphire
- MEG representations included:

Section 4.7 ***Litigation.*** Except as set forth on Schedule 4.7, there is no Claim pending or, to Seller’s Knowledge, threatened in writing against any MEG Company that (a) materially affects any MEG Company or the Purchased Assets, or (b) seeks a writ, judgment, order or decree restraining, enjoining or otherwise prohibiting or making illegal any of the transactions contemplated by this Agreement. There are no judgments, rulings or orders

Section 4.25 ***Operation of Projects.*** Except as set forth on Schedule 4.25, the equipment, machinery, interconnections, systems, Property and Intellectual Property included in each Project have been operated and maintained in accordance with Prudent Industry Practices since the Acquisition Date of the respective Project Company.

INTER-PARTY INDEMNITY

MEG HOLDINGS, LLC V. SAPPHIRE POWER FIN. LLC (NY 2014)

- After Closing, Sapphire made claims for “indemnification”:
 - \$6,000 for third-party employment discrimination claim
 - \$18M for repairs/replacements due to MEG’s alleged failure to maintain the plants in accordance with prudent industry practice (i.e., a direct (or “inter-party”) claim between buyer and seller)
- Under Escrow Agreement, Buyer can withhold escrowed amount “if Buyer makes a claim for indemnification under Section 10.1(a) of the Purchase Agreement.”

INTER-PARTY INDEMNITY

MEG HOLDINGS, LLC V. SAPPHIRE POWER FIN. LLC (NY 2014)

Indemnity in Purchase Agreement:

Section 10.1, Indemnification, states the following, in pertinent part:

“(a) Subject to Section 10.2, from and after Closing, Seller shall indemnify, defend and hold Buyer, its affiliates and each of their respective officers, directors, stockholders, members, managers, employees, successors and assigns . . . harmless from and against all Losses incurred or suffered by Buyer Indemnitee resulting from:

- (i) any breach of any representation or warranty of Seller contained in this Agreement; and
- (ii) any breach of any covenant or agreement of Seller contained in this Agreement.

In the PSA, “Loss” is defined as follows:

“any and all judgments, losses, liabilities, amounts paid in settlement, damages, fines, penalties, deficiencies, losses and expenses (including interest, court costs, reasonable fees of attorneys, accountants and other experts or other reasonable expenses of litigation or other proceedings or of any claim, default or assessment). For all purposes in this Agreement the term ‘Losses’ does not include any Non-reimbursable damages.”

INTER-PARTY INDEMNITY

MEG HOLDINGS, LLC V. SAPPHIRE POWER FIN. LLC (NY 2014)

- Waiver of Other Representations
 - MEG makes no representation or warranty to Sapphire other than as set forth in the PSA
- “As Is, Where Is”
 - Except as otherwise expressly provided in the PSA, MEG’s interests in the MEG Companies are being transferred through the sale of the equity interests “as is, where is, with all faults” and MEG disclaims any representations or warranties as to the value or quality of the MEG Companies or their assets

INTER-PARTY INDEMNITY

MEG HOLDINGS, LLC V. SAPPHIRE POWER FIN. LLC (NY 2014)

Back to the Indemnity:

Section 10.1, Indemnification, states the following, in pertinent part:

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- (i) any breach of any representation or warranty of Seller contained in this Agreement; and
- (ii) any breach of any covenant or agreement of Seller contained in this Agreement.

What the Court Said:

Had the sophisticated drafters of the PSA and the Escrow Agreement wanted the indemnification provision 10.1(a), clearly labeled “Indemnification,” to include claims between the parties rather than only third-party claims, they would have stated such.

INTER-PARTY INDEMNITY

MEG HOLDINGS, LLC V. SAPPHIRE POWER FIN. LLC (NY 2014)

- Purchase Agreement included a third-party claim mechanism, but not a direct claim mechanism, which the court viewed as “strengthen[ing] the point that the indemnification provisions...cover only third-party claims”
- MEG was a NY court applying NY law; other courts applying other law sometimes disagree
 - In *Zalkind v. Ceradyne, Inc.* (CA 2011), a CA appellate court affirmed that “indemnification” may cover direct claims and noted several CA decisions with the same holding

INTER-PARTY INDEMNITY

MEG HOLDINGS, LLC V. SAPPHIRE POWER FIN. LLC (NY 2014)

- The MEG court cited two cases involving claims for attorneys' fees under indemnification provisions:
 - *Hooper Assoc. v. AGS Computers* (NY 1989) (“[w]hen a party is under no legal duty to indemnify, a contract assuming that obligation must be strictly construed to avoid reading into it a duty which the parties did not bargain for”)
 - *Gotham Partners L.P. v. High Riv. Ltd Partnership* (NY 2010) (“for an indemnification clause to cover ‘claims between contracting parties rather than third-party claims, its language must unequivocally reflect that intent’”)

INTER-PARTY INDEMNITY

MEG HOLDINGS, LLC V. SAPPHIRE POWER FIN. LLC (NY 2014)

How about a claim for breach of contract?

Section 10.5 is the Waiver of Remedies provision. Section 10.5(a) states:

“Buyer and Seller acknowledge and agree that the foregoing indemnification provisions in this Article X shall be the exclusive remedy of Buyer and Seller with respect to the matters set forth in Article X, except for fraud or intentional misrepresentation; *provided however*, that the foregoing shall not limit or restrict the availability of specific performance or other injunctive or equitable relief to the extent that specific performance or such other relief would otherwise be available to the Parties hereunder.”

What the Court Said:

In other words, section 10.5 limits Sapphire’s remedies to indemnification claims and claims for fraud or intentional misrepresentation. The court has concluded that the only indemnification claims covered are ones for third-party claims. The indemnity claims made by Sapphire are not third-party claims, nor are they ones for fraud or misrepresentation. As such, even if Sapphire could maintain that MEG breached an express warranty by not operating the equipment in a certain way, the Sapphire waived its rights to assert claims on that basis.⁶

INTER-PARTY INDEMNITY DRAFTING SOLUTIONS

- Indemnity Section: Provision creating the “indemnification” obligation should (1) use more than just the term “indemnify” and (2) specify that the obligation covers all claims:
 - “Seller shall indemnify, defend and hold harmless the Purchaser Covered Parties from and against, and shall compensate and reimburse the Purchaser Covered Parties for, all Losses incurred or suffered by any Purchaser Covered Party (whether or not such Losses relate to a direct claim or third party claim) arising out of, relating to or resulting from (A) any representation or warranty of Seller not being true and correct...”

INTER-PARTY INDEMNITY *DRAFTING SOLUTIONS*

- Other Provisions:
 - “Principles of Interpretation” section should include an acknowledgment that the term “indemnification” covers both third party and interparty liability
 - Definition of “Losses” should include a reference to “*decline in value*”
- Ancillary Documents (Escrow Agreement, Guarantee, L/C): Should track the language in the “indemnity” section
 - “If Buyer makes a claim for indemnification, *compensation or reimbursement* under the Purchase Agreement (*whether or not relating to a direct claim or third party claim*)...”

INDEMNITIES GENERALLY RELATED TOPICS

- Statute of Limitations
 - Effective Modification Of Statutory or Common Law Limitations
- Anti-Sandbagging Clause
 - What Did Buyer Know?

STATUTE OF LIMITATIONS: “SURVIVAL”

- Sellers expect that Buyers will only be able to bring claims for breaches of representations during the “survival” periods set forth in the Purchase Agreement
 - E.g., “Seller’s representations and warranties shall survive the Closing until the third anniversary of the Closing”
- Courts may find that this language alone is insufficient to shorten the statute of limitations for breach of contract claims
 - Many jurisdictions require that contractual provisions modifying a statute of limitations must use language that “clearly and unequivocally evidences an intent to do so” in order to be enforceable
- Result: Parties may have liability to one another for a much longer time than anyone expected

STATUTE OF LIMITATIONS: “SURVIVAL”

ESCUE V. SEQUENT, INC. (SIXTH CIRCUIT 2014)

- Sequent, Inc. acquired Better Business Solutions of Alabama, Inc. in a stock-for-stock merger on January 1, 2007
 - Merger Agreement provided that certain representations and warranties would “survive the Closing until...the second anniversary date of the Closing”
- In September 2007, a former stockholder of the acquired company filed claims for breach of Sequent’s representations
- Sixth Circuit:
 - Under Ohio law, agreement to modify the statute of limitations “must be made manifest in clear, unequivocal language”
 - Because the survival clause did not contain an “express reference to ‘actions,’ ‘demands’ or even to breach of the contract” and “the parties’ intent is not manifestly clear from either the contractual language or extrinsic evidence,” the survival clause did not modify the 12-year statute of limitations for breach of contract

DRAFTING SOLUTION – “SURVIVAL”

- State law varies on this issue
- For improved clarity:
 - Ensure that survival provision explicitly references a limitation on “actions, demands and claims”
 - Include acknowledgement that survival period applies notwithstanding any applicable statute of limitations
 - E.g., “Notwithstanding anything to the contrary in this Agreement or any applicable statute of limitations, in no event shall any Party bring any action, demand or claim relating to the inaccuracy or breach of any representation or warranty following the termination of the applicable survival period in this Section....”

INDEMNITIES GENERALLY RELATED TOPICS

- Statute of Limitations
 - Effective Modification Of Statutory or Common Law Limitations
- Anti-Sandbagging
 - What Did Buyer Know?

ANTI-SANDBAGGING

“Pro-Sandbagging” or “Knowledge Savings” Clause

- The representations, warranties and covenants of the Indemnifying Party, and the Indemnified Party's right to indemnification with respect thereto, shall not be affected or deemed waived by reason of any investigation made by or on behalf of the Indemnified Party (including by any of its Representatives) or by reason of the fact that the Indemnified Party or any of its Representatives knew or should have known that any such representation or warranty is, was or might be inaccurate.”

“Anti-Sandbagging” Clause

- *“Seller shall not be liable under this Article IX for any Losses based upon or arising out of any inaccuracy in or breach of any of the representations or warranties of Seller contained in this Agreement if Buyer had knowledge of such inaccuracy or breach, or of the facts underlying such inaccuracy or breach, prior to the Closing.”*

ANTI-SANDBAGGING

- Buyer's Position
 - Inclusion of anti-sandbagging language disincentivizes proper diligence
 - Burden should be on Seller to disclose matters in schedules
 - If there is a post-closing issue, then before the parties can meaningfully discuss the claim, the issue of Buyer's knowledge will have to be resolved
- Seller's Position
 - Inclusion of anti-sandbagging concept leads to more collaborative disclosures
 - It is simply unfair to “lie behind the log”

ANTI-SANDBAGGING

- If Buyer is aware of a specific issue pre-signing, consider seeking a special indemnity
- If Buyer agrees to an anti-sandbagging provision, attempt to limit to:
 - Actual knowledge
 - As of signing
 - Small, fixed group of individuals
- Governing law matters

CONTACT US



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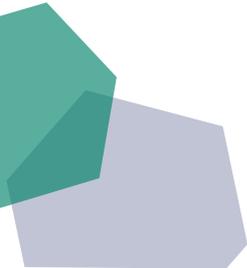
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Trial

Stephen Crain is the firm-wide Head of Litigation and serves on the firm's Management Committee. He focuses predominantly on matters arising in the energy industry and on disputes involving alleged violations of securities laws. He is listed in Chambers USA, Litigation: General Commercial; Legal 500, Energy: Litigation and Commercial Litigation; and in Euromoney: Benchmark Litigation.



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