

11. Indemnification; Remedies

COMMENT

Article 11 of the Model Agreement provides for indemnification and other remedies. Generally, the buyer of a privately held company seeks to impose, not only on the seller but also on its shareholders, financial responsibility for breaches of representations and covenants in the acquisition agreement and for other specified matters that may not be the subject of representations. The conflict between the buyer's desire for that protection and the shareholders' desire not to have continuing responsibility for a business that they no longer own often results in intense negotiations. Thus, there is no such thing as a set of "standard" indemnification provisions. There is, however, a standard set of issues to be dealt with in the indemnification provisions of an acquisition agreement. Article 11 of the Model Agreement addresses these issues in a way that favors Buyer. The Comments identify areas in which the seller may propose a different resolution.

The organization of Article 11 of the Model Agreement is as follows. [Section 11.1](#) provides that the parties' representations survive the [Closing](#) and are thus available as the basis for post-Closing monetary remedies. It also attempts to negate defenses based upon [Knowledge](#) and implied waiver. [Section 11.2](#) defines the matters for which Seller and Shareholders will have post-Closing monetary liability. It is not limited to matters arising from inaccuracies in Seller's representations. [Section 11.3](#) provides a specific monetary remedy for environmental matters. It is included as an example of a provision that deals specifically with contingencies that may not be adequately covered by the more general indemnification provisions. The types of contingencies that may be covered in this manner vary from transaction to transaction. [Section 11.4](#) defines the matters for which Buyer will have post-Closing monetary liability. In a cash acquisition, the scope of this provision is very limited; indeed, it is often omitted entirely. [Sections 11.5](#) and [11.6](#) set forth levels of damage for which post-Closing monetary remedies are unavailable. [Section 11.7](#) specifies the time periods during which post-Closing monetary remedies may be sought. [Section 11.8](#) provides setoff rights against the [Promissory Note](#) delivered as part of the [Purchase Price](#) as an alternative to claims under the escrow. [Section 11.9](#) provides procedures to be followed for, and in the defense of, [Third-Party Claims](#). [Section 11.10](#) provides the procedure for matters not involving Third-Party Claims. [Section 11.11](#) provides that the indemnification provided for in Article 11 is applicable notwithstanding the negligence of, or strict liability imposed upon, the indemnitee.

11.1 SURVIVAL

All representations, warranties, covenants and obligations in this Agreement, the [Disclosure Letter](#), the supplements to the Disclosure Letter, the certificates delivered pursuant to [Section 2.7](#) and any other certificate or document delivered pursuant to this Agreement shall survive the Closing and the consummation of the [Contemplated Transactions](#), subject to [Section 11.7](#). The right to indemnification, reimbursement or other remedy based upon such representations, warranties, covenants and obligations shall not be affected by any investigation (including any environmental investigation or assessment) conducted with respect to, or any [Knowledge](#) acquired (or capable of being acquired) at any time, whether before or after the execution and delivery of this Agreement or the [Closing Date](#), with respect to the accuracy or inaccuracy of or compliance with any such representation, warranty, covenant or obligation. The waiver of any condition based upon the accuracy of any representation or warranty, or on the performance of or compliance with any covenant or obligation, will not affect the right to indemnification, reimbursement or other remedy based upon such representations, warranties, covenants and obligations.

COMMENT

The representations and warranties made by the seller and its shareholders in acquisitions of assets of private companies are typically, although not universally, intended to provide a basis for post-closing liability if they prove to be inaccurate. In acquisitions of assets of public companies without controlling shareholders, the seller's representations typically terminate at the closing and, thus, serve principally as information-gathering mechanisms, closing conditions and a basis for liability if the closing does not occur (see the introductory Comment to Article 3 under the caption "[Purposes of the Seller's Representations](#)"). If the shareholders of a private company selling its assets are numerous and include investors who have not actively participated in the business (such as venture capital investors in a development stage company), they may analogize their situation to that of the shareholders of a public company and argue that their representations should not survive the closing. It would be unusual, however, for the shareholders' representations to terminate at the closing in a private sale. If the shareholders are numerous, they can sign a joinder agreement, which avoids having each of them sign the acquisition agreement.

If the seller's representations are intended to provide a basis for post-closing liability, it is common for the acquisition agreement to include an express survival clause (as set forth above) to avoid the possibility that a court might import the real property law principle that obligations merge in the delivery of a deed and hold that the representations merge with the sale of the assets and, thus, cannot form the basis of a remedy after the closing. *Cf.* BUSINESS ACQUISITIONS ch. 31, at 1279–80 (Herz & Baller eds., 2d ed. 1981). Although no such case is known, the custom of explicitly providing for survival of representations in business acquisitions is sufficiently well established that it is unlikely to be abandoned.

Even in the relatively rare cases in which the shareholders of a private company selling its assets are able to negotiate the absence of contractual post-closing remedies based upon their representations, they may still be subject to post-closing liability based upon those representations under principles of common law fraud.

Section 11.1 provides that [Knowledge](#) of an inaccuracy by the indemnified party is not a defense to the claim for indemnity, which permits Buyer to assert an indemnification claim not only for inaccuracies first discovered after the [Closing](#) but also for inaccuracies disclosed or discovered before the Closing. This approach is often the

subject of considerable debate. A seller may argue that the buyer should be required to disclose a known breach of the seller's representations before the closing and waive it, renegotiate the purchase price or refuse to close. The buyer may respond that (a) it is entitled to rely upon the representations made when the acquisition agreement was signed, which, presumably, entered into the buyer's determination of the price that it is willing to pay and (b) that the seller should be unable to limit the buyer's options to waiving the breach or terminating the acquisition. The buyer can argue that it has purchased the representations and the related right to indemnification and is entitled to a purchase-price adjustment for an inaccuracy in those representations, regardless of the buyer's knowledge. In addition, the buyer can argue that any recognition of a defense based upon the buyer's knowledge could convert each claim for indemnification into an extensive discovery inquiry into the state of the buyer's knowledge. See generally Committee on Negotiated Acquisitions, *Purchasing the Stock of a Privately Held Company: The Legal Effect of an Acquisition Review*, 51 BUS. LAW. 479 (1996).

If the buyer is willing to accept some limitation on its entitlement to indemnification based upon its knowledge, it should carefully define the circumstances in which knowledge is to have this effect. For example, the acquisition agreement could distinguish among knowledge that the buyer had before signing the acquisition agreement, knowledge acquired through the buyer's pre-closing investigation and knowledge resulting from the seller's pre-closing disclosures and could limit the class of persons within the buyer's organization whose knowledge is relevant (for example, the actual personal knowledge of named officers). An aggressive seller may request a contractual provision requiring that the buyer disclose its discovery of an inaccuracy immediately and elect at that time to waive the inaccuracy or terminate the acquisition agreement or an "antisanbagging" provision precluding an indemnity claim for breaches known to the buyer before closing. An example of such a provision follows:

[Except as set forth in a Certificate to be delivered by Buyer at the Closing,] to the Knowledge of Buyer, Buyer is not aware of any facts or circumstances that would serve as the basis for a claim by Buyer against Seller or any Shareholder based upon a breach of any of the representations and warranties of Seller and Shareholders contained in this Agreement [or breach of any of Seller's or any Shareholders' covenants or agreements to be performed by any of them at or prior to Closing]. Buyer shall be deemed to have waived in full any breach of any of Seller's and Shareholders' representations and warranties [and any such covenants and agreements] of which Buyer has such awareness [to its Knowledge] at the Closing.

A buyer should be wary of such a provision, which may prevent it from making its decision on the basis of the cumulative effect of all inaccuracies discovered before the closing. The buyer should also recognize the problems an antisandbagging provision presents with respect to the definition of "Knowledge." See the [Comment to that definition in Section 1.1](#).

The buyer's ability to assert a fraud claim after the closing may be adversely affected if the buyer discovers an inaccuracy before the closing but fails to disclose the inaccuracy to the seller until after the closing. In such a case, the seller may assert that the buyer did not rely on the representation or that its claim is barred by waiver or estoppel.

The doctrine of substituted performance can come into play when both parties recognize before the closing that the seller and the shareholders cannot fully perform their obligations. If the seller and the shareholders offer to perform, albeit imperfectly, can the buyer accept without waiving its right to sue on the breach? The common law has long been that, if a breaching party expressly conditions its substitute performance

on such a waiver, the nonbreaching party may not accept the substitute performance, even with an express reservation of rights, and also retain its right to sue under the original contract. See *United States v. Lamont*, 155 U.S. 303, 309–10 (1894); RESTATEMENT (SECOND) OF CONTRACTS §278, cmt. a. Thus, if the seller offers to close on the condition that the buyer waive its right to sue on the breach, under the common law, the buyer must choose whether to close or to sue but cannot close and sue. Although the acquisition agreement may contain an express reservation of the buyer's right to close and sue, it is unclear whether courts will respect such a provision and allow the buyer to close and sue for indemnification.

The survival of an indemnification claim after the buyer's discovery during pre-closing investigations of a possible inaccuracy in the seller's representations was the issue in *CBS, Inc. v. Ziff-Davis Publishing Co.*, 553 N.E.2d 997 (N.Y. 1990). The buyer of a business advised the seller before the closing of facts that had come to the buyer's attention and, in the buyer's judgment, constituted a breach of a warranty. The seller denied the existence of a breach and insisted on closing. The buyer asserted that closing on its part with this knowledge would not constitute a waiver of its rights. After the closing, the buyer sued the seller on the alleged breach of warranty. The New York Court of Appeals held that, in contrast to a tort action based upon fraud or misrepresentation, which requires the plaintiff's belief in the truth of the information warranted, the critical question in a contractual claim based upon an express warranty is "whether [the buyer] believed [it] was purchasing the [seller's] promise as to its truth." The Court stated:

The express warranty is as much a part of the contract as any other term. Once the express warranty is shown to have been relied on as part of the contract, the right to be indemnified in damages for its breach does not depend on proof that the buyer thereafter believed that the assurances of fact made in the warranty would be fulfilled. The right to indemnification depends only on establishing that the warranty was breached.

Id. at 1001 (citations omitted).

Although the *Ziff-Davis* opinion was unequivocal, the unusual facts of this case (a pre-closing assertion of a breach of warranty by the buyer and the seller's threat to litigate if the buyer refused to close), the contrary views of the lower courts and a vigorous dissent in the Court of Appeals all suggest that the issue should not be regarded as completely settled. A decision of the U.S. Court of Appeals for the Second Circuit (applying New York law) has increased the uncertainty by construing *Ziff-Davis* as limited to cases in which the seller does not acknowledge any breach at the closing and, thus, as inapplicable to situations in which the sellers disclose an inaccuracy in a representation before the closing. See *Galli v. Metz*, 973 F.2d 145, 150–51 (2d Cir. 1992). The *Galli* court explained:

In *Ziff-Davis*, there was a dispute at the time of closing as to the accuracy of particular warranties. *Ziff-Davis* has far less force where the parties agree at closing that certain warranties are not accurate. Where a buyer closes on a contract in the full knowledge and acceptance of facts disclosed by the seller which would constitute a breach of warranty under the terms of the contract, the buyer should be foreclosed from later asserting the breach. In that situation, unless the buyer expressly preserves his rights (as CBS did in *Ziff-Davis*), we think the buyer has waived the breach.

Id.

It is not apparent from the *Galli* opinion whether the agreement in question contained a provision similar to Section 11.1 purporting to avoid such a waiver; under an

agreement containing such a provision, the buyer could attempt to distinguish *Galli* on that basis. It is also unclear whether *Galli* would apply to a situation in which the disclosed inaccuracy was not (or was not agreed to be) sufficiently material to excuse the buyer from completing the acquisition (see [Section 7.1](#) and the related Comment).

The Eighth Circuit seems to agree with the dissent in *Ziff-Davis* and holds, in essence, that, if the buyer acquires knowledge of a breach from any source (not just the seller's acknowledgment of the breach) before the closing, the buyer waives its right to sue. See *Hendricks v. Callahan*, 972 F.2d 190, 195–96 (8th Cir. 1992) (applying Minnesota law and holding that a buyer's personal knowledge of an outstanding lien defeats a claim under either a property title warranty or a financial statement warranty even though the lien was not specifically disclosed or otherwise exempted).

The conflict between the *Ziff-Davis* approach and the *Hendricks* approach has been resolved under Connecticut and Pennsylvania law in favor of the concept that an express warranty in an acquisition agreement is now grounded in contract rather than in tort and that the parties should be entitled to the benefit of their bargain expressed in the purchase agreement. In *Pegasus Management Co., Inc. v. Lyssa, Inc.*, 995 F. Supp. 43 (D. Mass. 1998), the court followed *Ziff-Davis* and held that Connecticut law does not require a claimant to demonstrate reliance on express warranties in a purchase agreement in order to recover on its warranty indemnity claims, commenting that, under Connecticut law, indemnity clauses are given their plain meaning, even if the meaning is very broad. The court further held that the claimant did not waive its rights to the benefits of the express warranties where the purchase agreement provided that “[e]very . . . warranty . . . set forth in this Agreement and . . . the rights and remedies . . . for any one or more breaches of this Agreement by the Sellers shall . . . not be deemed waived by the Closing and shall be effective regardless of . . . any prior knowledge by or on the part of the Purchaser.” Similarly, in *American Family Brands, Inc. v. Giuffrida Enterprises, Inc.*, No. 96-7062, 1998 WL 196402 (E.D. Pa. Apr. 23, 1998), the court, following Pennsylvania law and asset purchase agreement sections providing that “all of the representations . . . shall survive the execution and delivery of this Agreement and the consummation of the transactions contemplated hereunder” and “no waiver of the provisions hereof shall be effective unless in writing and signed by the party to be charged with such waiver,” sustained a claim for breach of a seller's representation that there had been no material adverse change in seller's earnings, etc. even though the seller had delivered to the buyer interim financial statements showing a significant drop in earnings. *Id.* at *6.

Given the holdings of *Galli* and *Hendricks*, the effect of the survival and nonwaiver language in Section 11.1 is uncertain. Section 11.1 protects Buyer if, in the face of a known dispute, Seller and Shareholders close believing or asserting that they are offering full performance under the acquisition agreement when, as adjudged later, they have not. Reliance on Section 11.1, however, may be risky in cases in which there is no dispute over the inaccuracy of a representation. A buyer that proceeds with the closing and later sues for indemnification can expect to be met with a defense based upon waiver and nonreliance with an uncertain outcome.

There does not appear to be any legitimate policy served by refusing to give effect to an acquisition agreement provision entitling a buyer to rely upon its right to indemnification and reimbursement based upon the seller's representations even if the buyer learns that they are inaccurate before the closing. Representations are often viewed by the parties as a risk-allocation and price-adjustment mechanism, not necessarily as assurances regarding the accuracy of the facts that they state, and should be given effect as such. *Galli* should be limited to situations in which the agreement is ambiguous with respect to the effect of the buyer's knowledge.

11.2 INDEMNIFICATION AND REIMBURSEMENT BY SELLER AND SHAREHOLDERS

Seller and each Shareholder, jointly and severally, will indemnify and hold harmless Buyer, and its Representatives, shareholders, subsidiaries and **Related Persons** (collectively, the **“Buyer Indemnified Persons”**), and will reimburse the Buyer Indemnified Persons for any loss, liability, claim, damage, expense (including costs of investigation and defense and reasonable attorneys’ fees and expenses) or diminution of value, whether or not involving a **Third-Party Claim** (collectively, **“Damages”**), arising from or in connection with:

- (a) any **Breach** of any representation or warranty made by Seller or either Shareholder in (i) this Agreement (without giving effect to any supplement to the **Disclosure Letter**), (ii) the Disclosure Letter, (iii) the supplements to the Disclosure Letter, (iv) the certificates delivered pursuant to **Section 2.7** (for this purpose, each such certificate will be deemed to have stated that Seller’s and Shareholders’ representations and warranties in this Agreement fulfill the requirements of **Section 7.1** as of the **Closing Date** as if made on the Closing Date without giving effect to any supplement to the Disclosure Letter, unless the certificate expressly states that the matters disclosed in a supplement have caused a condition specified in Section 7.1 not to be satisfied), (v) any transfer instrument or (vi) any other certificate, document, writing or instrument delivered by Seller or either Shareholder pursuant to this Agreement;
- (b) any Breach of any covenant or obligation of Seller or either Shareholder in this Agreement or in any other certificate, document, writing or instrument delivered by Seller or either Shareholder pursuant to this Agreement;
- (c) any **Liability** arising out of the ownership or operation of the Assets prior to the **Effective Time** other than the **Assumed Liabilities**;
- (d) any brokerage or finder’s fees or commissions or similar payments based upon any agreement or understanding made, or alleged to have been made, by any **Person** with Seller or either Shareholder (or any Person acting on their behalf) in connection with any of the **Contemplated Transactions**;
- (e) any product or component thereof manufactured by or shipped, or any services provided by, Seller, in whole or in part, prior to the Closing Date;
- (f) any matter disclosed in Parts _____ of the Disclosure Letter;
- (g) any noncompliance with any **Bulk Sales Laws** or fraudulent transfer law in respect of the Contemplated Transactions;
- (h) any liability under the **WARN Act** or any similar state or local **Legal Requirement** that may result from an **“Employment Loss”**, as defined by 29 U.S.C. § 2101(a)(6), caused by any action of Seller prior to the Closing or by Buyer’s decision not to hire previous employees of Seller;
- (i) any **Employee Plan** established or maintained by Seller; or
- (j) any **Retained Liabilities**.

COMMENT

Although the inaccuracy of a representation that survives the closing may give rise to a claim for damages for breach of the acquisition agreement without any express indemnification provision, it is customary in the acquisition of assets of a privately

held company for the buyer to be given a clearly specified right of indemnification for breaches of representations, warranties, covenants and obligations and for certain other liabilities. Although customary in concept, the scope and details of the indemnification provisions are often the subject of intense negotiation.

Indemnification provisions should be carefully tailored to the type and structure of the acquisition, the identity of the parties and the specific business risks associated with the seller. The Model Agreement indemnification provisions may require significant adjustment before application to a merger or stock purchase because the transfer of liabilities by operation of law in each case is different. Other adjustments may be required for a purchase from a consolidated group of companies, a foreign corporation or a joint venture because there may be different risks and difficulties in obtaining indemnification in each case. Still other adjustments will be required to address risks associated with the nature of the seller's business and its past manner of operation.

Certain business risks and liabilities are not covered by traditional representations and may be covered by specific indemnification provisions (see, for example, subsections (c) through (i)). Similar provision may also be made for liability resulting from a pending and disclosed lawsuit against the seller that is not an assumed liability. See also the discussion concerning WARN Act liabilities in the [Comment to Section 10.1](#).

In the absence of explicit provision to the contrary, the buyer's remedies for inaccuracies in the seller's and the shareholders' representations may not be limited to those provided by the indemnification provisions. The buyer may also have causes of action based upon breach of contract, fraud and misrepresentation and other federal and state statutory claims until the expiration of the applicable statute of limitations. The seller, therefore, may want to add a clause providing that the indemnification provisions are the sole remedy for any claims relating to the sale of the assets. This clause could also limit the parties' rights to monetary damages only, at least after the closing. (See [Section 13.5](#) with respect to equitable remedies for enforcement of the Model Agreement and the first sentence of [Section 13.6](#) relating to cumulative remedies.) In some cases, the seller may prefer not to raise the issue and instead to rely on the limitations on when claims may be asserted ([Section 11.7](#)) and the deductible or "basket" provisions ([Sections 11.5](#) and [11.6](#)) as evidence of an intention to make the indemnification provisions the parties' exclusive remedy. The Model Agreement does not state that indemnification is the exclusive remedy, and these limitations expressly apply to liability "for indemnification or otherwise," indicating a contrary intention of the parties.

The scope of the indemnification provisions is important. A buyer generally will want the indemnification provisions to cover breaches of representations in the disclosure letter, any supplements to the disclosure letter and any other certificates delivered pursuant to the acquisition agreement, but may not want the indemnification provisions to cover breaches of noncompetition agreements, ancillary service agreements and similar agreements related to the acquisition, for which there would normally be separate breach of contract remedies, separate limitations (if any) regarding timing and amounts of any claims for damages and, perhaps, equitable remedies.

Section 11.2(a)(i) provides for indemnification for any breach of Seller's and Shareholders' representations in the acquisition agreement and the [Disclosure Letter](#) as of the date of signing. A seller may seek to exclude from the indemnity a breach of the representations in the original acquisition agreement if the breach is disclosed by amendments to the disclosure letter before the closing. This provides an incentive for the seller to update the disclosure letter carefully, although it also limits the buyer's remedy to refusing to complete the acquisition if a material breach of the original representations is discovered and disclosed by the seller. For a discussion of related issues, see the [Comment to Section 11.1](#).

Section 11.2(a)(iv) also provides for indemnification for an undisclosed breach of

Seller's representations as of the [Closing Date](#) through the reference in subsection (a) to the [Closing](#) certificate required by [Section 2.7](#). This represents customary practice. The Model Agreement departs from customary practice, however, by providing that, if a certificate delivered at Closing by Seller or Shareholders discloses inaccuracies in Seller's representations as of the Closing Date, this disclosure will be disregarded for purposes of an indemnification claim (that is, Seller and Shareholders will still be subject to indemnification liability for such inaccuracies) unless Seller states in the certificates delivered pursuant to [Section 2.7](#) that these inaccuracies resulted in failure of the condition set forth in [Section 7.1](#), thus permitting Buyer to elect not to close. Although unusual, this structure is designed to protect Buyer from changes that occur after the execution of the acquisition agreement and before the Closing that are disclosed before the Closing. The provision places an additional burden upon Seller to expressly state in writing that, due to inaccuracies in its representations and warranties as of the Closing Date, Buyer has no obligation to close the transaction. Only if Buyer elects to close after such statement is made in the certificate will Buyer lose its right to indemnification for damages resulting from such inaccuracies. Such disclosure, however, would not affect Buyer's indemnification rights to the extent that the representations and warranties were also breached as of the signing date.

The Model Agreement provides for indemnification for any inaccuracy in the documents delivered pursuant to the acquisition agreement. Broadly interpreted, this could apply to any documents reviewed by the buyer during its due diligence investigation. The buyer may believe that it is entitled to this degree of protection, but the seller can argue that (a) if the buyer wants to be assured of a given fact, that fact should be included in the representations in the acquisition agreement, and (b) to demand that all documents provided by the seller be factually accurate, or to require the seller to correct inaccuracies in them, places unrealistic demands on the seller and would needlessly hamper the due diligence process. As an alternative, the seller and its shareholders may represent that they are not aware of any material inaccuracies or omissions in certain specified documents reviewed by the buyer during the due diligence process.

[Section 11.2](#) provides for joint and several liability, which the buyer will typically request and the seller, seeking to limit the exposure of its shareholders to several liability (usually in proportion to each shareholder's percentage ownership), may oppose. Occasionally, different liability will be imposed on different shareholders, depending upon the representations at issue, and the seller itself will almost always be jointly and severally liable to the buyer without any such limitation. The shareholders may separately agree to allocate responsibility among themselves in a manner different from that provided in the acquisition agreement (for example, a shareholder who has been active in the business may be willing to accept a greater share of the liability than one who has not). See the Contribution Agreement attached as [Ancillary Document 5](#).

Factors of creditworthiness may influence the buyer in selecting the persons from whom to seek indemnity. Given the instant [Fact Pattern](#), Seller will not be creditworthy after the [Closing](#) because it will likely distribute its net assets to its shareholders as soon as practicable. If the seller is part of a consolidated group of companies, it may request that the indemnity be limited to, and the buyer may be satisfied with an indemnity from, a single member of the seller's consolidated group (often the ultimate parent), so long as the buyer is reasonably comfortable with the credit of the indemnitor. In other circumstances, the buyer may seek an indemnity (or guaranty of an indemnity) from an affiliate (for example, an individual who is the sole shareholder of a thinly capitalized holding company). For other ways of dealing with an indemnitor whose credit is questionable, see the [Comment to Section 11.8](#).

The persons indemnified may include virtually everyone on the buyer's side of the acquisition, including directors, officers and shareholders, who may become defen-

dants in litigation involving the acquired business or the assets or who may suffer a loss resulting from their association with problems at the acquired business. It may be appropriate to include fiduciaries of the buyer's employee benefit plans if such plans have played a role in the acquisition, such as when an employee stock ownership plan participates in a leveraged buyout. These persons are not, however, expressly made third-party beneficiaries of the indemnification provisions, which may, therefore, be read as giving the buyer a contractual right to cause the seller to indemnify such persons, and [Section 13.9](#) provides that no [Third-Party](#) rights are created by the acquisition agreement. Creation of third-party beneficiary status may prevent the buyer from amending the indemnification provisions or compromising claims for indemnification without obtaining the consent of the third-party beneficiaries.

The scope of damage awards is a matter of state law. The definition of "[Damages](#)" in the Model Agreement is very broad and includes, among other things, "diminution of value" and other losses unrelated to third-party claims. Moreover, the definition of "[Damages](#)" does not exclude incidental, consequential or punitive damages, thereby reserving to the buyer a claim for these damages in an indemnification dispute. A seller may seek to narrow the definition.

The common law definition of the term "indemnification" describes a restitutionary cause of action in which a plaintiff sues a defendant for reimbursement of payments made by the plaintiff to a third party. A court may hold, therefore, that a drafter's unadorned use of the term "indemnification" (usually coupled with "and hold harmless") refers only to compensation for losses due to third-party claims. See *Pacific Gas & Electric Co. v. G. W. Thomas Drayage & Rigging Co.*, 442 P.2d 641, 646 n.9 (Cal. 1968) (indemnity clause in a contract ambiguous on the issue; failure to admit extrinsic evidence on the point was error); see also *Mesa Sand & Gravel Co. v. Landfill, Inc.*, 759 P.2d 757, 760 (Colo. Ct. App. 1988), *rev'd in part on other grounds*, 776 P.2d 362 (Colo. 1989) (indemnification clause covers only payments made to third parties). *But see Atari Corp. v. Ernst & Whinney*, 981 F.2d 1025, 1031–32 (9th Cir. 1992) (limiting *Pacific Gas & Electric* and relying on Black's Law Dictionary; the term "indemnification" is not limited to repayment of amounts expended on third-party claims); *Edward E. Gillen Co. v. United States*, 825 F.2d 1155, 1157 (7th Cir. 1987) (same). Modern usage and practice have redefined the term "indemnification" in the acquisition context to refer to compensation for all losses and expenses, from any source, caused by a breach of the acquisition agreement (or other specified events). The courts, presumably, will respect express contract language that incorporates the broader meaning. In [Section 11.2](#) of the Model Agreement, the express language that a [Third-Party Claim](#) is not required makes the parties' intent unequivocally clear that compensable damages may exist absent a [Third-Party Claim](#) and if no payment has been made by Buyer to any [Person](#).

The amount to be indemnified is generally the dollar value of the out-of-pocket payment or loss. That amount may not fully compensate the buyer, however, if the loss relates to an item that was the basis of a pricing multiple. For example, if the buyer agreed to pay \$10,000,000, which represented five times earnings, but it was discovered after the closing that annual earnings were overstated by \$200,000 because inventories were overstated by that amount, indemnification of \$200,000 for the inventory shortage would not reimburse the buyer fully for its \$1,000,000 overpayment. The acquisition agreement could specify the basis for the calculation of the purchase price (which may be hotly contested by the seller) and provide specifically for indemnification for overpayments based upon that pricing methodology. The buyer should proceed cautiously in this area because the corollary to the argument that it is entitled to indemnification based upon a multiple of earnings is that any matter that affects the balance sheet but not the earnings statement (for example, fixed asset valuation) should

not be indemnified at all. Furthermore, raising the subject in negotiations may lead to an express provision excluding the possibility of determining damages on this basis. The inclusion of diminution of value as an element of damages gives the buyer flexibility to seek recovery on this basis without an express statement of its pricing methodology.

The seller often argues that the appropriate measure of damages is the amount of the buyer's out-of-pocket payment, less any tax benefit that the buyer receives as a result of the loss, liability or expense. If this approach is accepted, the logical extension is to include in the measure of damages the tax cost to the buyer of receiving the indemnification payment (including tax costs resulting from a reduction in basis, and the resulting reduction in depreciation and amortization or increase in gain recognized on a sale, if the indemnification payment is treated as an adjustment of purchase price). The resulting provisions, and the impact on the buyer's administration of its tax affairs, are highly complex, and the entire issue of adjustment for tax benefits and costs is often omitted to avoid this complexity. The seller may also insist that the acquisition agreement explicitly state that damages will be net of any insurance proceeds or payments from any other responsible parties. If the buyer is willing to accept such a limitation, it should be careful to ensure that it is compensated for any cost it incurs due to insurance or other third-party recoveries, including those that may result from retrospective premium adjustments, experience-based premium adjustments and indemnification obligations.

An aggressive seller may also seek to reduce the damages to which the buyer is entitled by any so-called found assets (assets of the seller not reflected on its financial statements). The problems inherent in valuing such assets and in determining whether they add to the value to the seller in a way not already taken into account in the purchase price lead most buyers to reject any such proposal.

Occasionally, a buyer insists that damages include interest from the date the buyer first is required to pay any expense through the date the indemnification payment is received. Such a provision may be appropriate if the buyer expects to incur substantial expenses before the buyer's right to indemnification has been established and also lessens the seller's incentive to dispute the claim for purposes of delay.

If the acquisition agreement contains post-closing adjustment mechanisms, the seller should ensure that the indemnification provisions do not require the seller and the shareholders to compensate the buyer for matters already rectified in the post-closing adjustment process. This can be done by providing that the damages subject to indemnification shall be reduced by the amount of any corresponding post-closing purchase-price reduction.

Indemnification generally is not available for claims made that later prove to be groundless. Thus, the buyer could incur substantial expenses in investigating and litigating a claim without being able to obtain indemnification. In this respect, the indemnification provisions of the Model Agreement, and most acquisition agreements, provide less protection than indemnities given in other situations such as securities underwriting agreements.

One method of providing additional, if desired, protection for the buyer would be to insert "defend," immediately before "indemnify" in the first line of Section 11.2. Some attorneys would also include any allegation, for example, of a breach of a representation as a basis for invoking the seller's indemnification obligations. Note the use of "alleged" in Section 11.2(d). "Defend," has not been included in the first line of Section 11.2 for several reasons: (a) Sections 11.2, 11.3 and 11.4 address the monetary allocation of risk; (b) Section 11.9 deals specifically with the procedures for handling the defense of [Third-Party Claims](#); and (c) perhaps most importantly, the buyer does not always want the seller to be responsible for the actual defense of a third-party

claim, as distinguished from the issue of who bears the cost of defense. Note that [Section 11.10](#) provides that a claim for indemnification not involving a [Third-Party Claim](#) must be paid promptly by the party from whom indemnification is sought.

11.3 INDEMNIFICATION AND REIMBURSEMENT BY SELLER— ENVIRONMENTAL MATTERS

In addition to the other indemnification provisions in this Article 11, Seller and each Shareholder, jointly and severally, will indemnify and hold harmless Buyer and the other [Buyer Indemnified Persons](#), and will reimburse Buyer and the other Buyer Indemnified Persons, for any [Damages](#) (including costs of cleanup, containment or other remediation) arising from or in connection with:

- (a) any [Environmental, Health and Safety Liabilities](#) arising out of or relating to:
 - (i) the ownership or operation by any [Person](#) at any time on or prior to the [Closing Date](#) of any of the [Facilities](#), [Assets](#) or the business of Seller, or
 - (ii) any [Hazardous Materials](#) or other contaminants that were present on the [Facilities](#) or [Assets](#) at any time on or prior to the [Closing Date](#); or
- (b) any bodily injury (including illness, disability and death, regardless of when any such bodily injury occurred, was incurred or manifested itself), personal injury, property damage (including trespass, nuisance, wrongful eviction and deprivation of the use of real property) or other damage of or to any [Person](#) or any [Assets](#) in any way arising from or allegedly arising from any [Hazardous Activity](#) conducted by any [Person](#) with respect to the business of Seller or the [Assets](#) prior to the [Closing Date](#) or from any [Hazardous Material](#) that was (i) present or suspected to be present on or before the [Closing Date](#) on or at the [Facilities](#) (or present or suspected to be present on any other property, if such [Hazardous Material](#) emanated or allegedly emanated from any [Facility](#) and was present or suspected to be present on any [Facility](#), on or prior to the [Closing Date](#)) or (ii) [Released](#) or allegedly Released by any [Person](#) on or at any [Facilities](#) or [Assets](#) at any time on or prior to the [Closing Date](#).

Buyer will be entitled to control any [Remedial Action](#), any [Proceeding](#) relating to an [Environmental Claim](#) and, except as provided in the following sentence, any other [Proceeding](#) with respect to which indemnity may be sought under this Section 11.3. The procedure described in [Section 11.9](#) will apply to any claim solely for monetary damages relating to a matter covered by this Section 11.3.

COMMENT

It is not unusual for an asset purchase agreement to contain indemnities for specific matters that are disclosed by the seller and, therefore, would not be covered by an indemnification limited to breaches of representations (such as a disclosed pending litigation) or that represent an allocation of risks for matters not known to either party. The Section 11.3 provision for indemnification for environmental matters is an example of this type of indemnity and supplements and overlaps the indemnification provided in [Section 11.2\(a\)](#), which addresses inaccuracies in or inconsistencies with Seller's representations (including those pertaining to the environment in [Section 3.22](#)).

There are several reasons why a buyer may seek to include separate indemnification for environmental matters instead of relying on the general indemnification based upon

the seller's representations. Environmental matters are often the subject of a risk allocation agreement with respect to unknown and unknowable liabilities, and sellers who are willing to assume those risks may nevertheless be reluctant to make representations concerning factual matters of which they can not possibly have knowledge. An indemnification obligation that goes beyond the scope of the representation implements such an agreement. In addition, the nature of, and the potential for disruption arising from, environmental cleanup activities often leads the buyer to seek different procedures for handling claims with respect to environmental matters. A buyer will often feel a greater need to control the cleanup and related proceedings than it will to control other types of litigation. Finally, whereas indemnification with respect to representations regarding compliance with laws typically relates to laws in effect as of the closing, environmental indemnification provisions such as that in Section 11.3 impose an indemnification obligation with respect to [Environmental, Health and Safety Liabilities](#), the definition of which in Section 1.1 is broad enough to cover liabilities under not only existing but also future environmental laws.

The seller may object to indemnification obligations regarding future environmental laws and concomitant liabilities arising from common law decisions interpreting such laws. From the buyer's perspective, however, such indemnification is needed to account for strict liability statutes, such as [CERCLA](#), that impose liability retroactively. The seller may insist that the indemnification clearly be limited to existing or prior laws.

The effectiveness of contractual provisions such as indemnification in protecting the buyer against environmental liabilities is difficult to evaluate. Such liabilities may be discovered at any time in the future and are not cut off by any statute of limitations that refers to the date of release of hazardous materials. In contrast, a contractual provision may have an express temporal limitation and, in any event, should be expected to decrease in usefulness over time as parties go out of existence or become difficult to locate (especially when the shareholders are individuals). The buyer may be reluctant to assume that the shareholders will be available and have adequate resources to meet an obligation that matures several years after the acquisition. In addition, environmental liabilities may be asserted by governmental agencies and third parties, which are not bound by the acquisition agreement and are not bound to pursue only the indemnitor.

It is often difficult to assess the economic adequacy of an environmental indemnity. Even with an environmental audit, estimates of the cost of remediation or compliance may prove to be considerably understated years later when the process is completed and the shareholders' financial ability to meet that obligation at that time cannot be assured. These limitations on the usefulness of indemnification provisions may lead, as a practical matter, to the negotiation of a price reduction, environmental insurance or an increased escrow of funds or letter of credit to meet indemnification obligations in conjunction with some limitation on the breadth of the provisions themselves. The amount of monies saved by the buyer at the time of the closing often will be far more certain than the amount it may receive years later under an indemnification provision.

Despite some authority to the effect that indemnity agreements between potentially responsible parties under [CERCLA](#) are unenforceable (see *CPC Int'l, Inc. v. Aerojet-General Corp.*, 759 F. Supp. 1269 (W.D. Mich. 1991); *AM Int'l Inc. v. International Forging Equip.*, 743 F. Supp. 525 (N.D. Ohio 1990)), it seems settled that Section 107(e)(1) of CERCLA (42 U.S.C. § 9607(e)(1)) expressly allows the contractual allocation of environmental liabilities between potentially responsible parties, and such an indemnification provision would, thus, be enforceable between the buyer and the seller. See, e.g., *Smith Land & Improvement Corp. v. Celotex Corp.*, 851 F.2d 86 (3rd Cir.1988), *cert. denied*, 488 U.S. 1029 (1989); *Mardan Corp. v. CGC Music, Ltd.*,

804 F.2d 1454 (9th Cir. 1986). Section 107(e)(1) of CERCLA, however, bars such a contractual allocation between parties from limiting the rights of the government or any third parties to seek redress from either of the contracting parties.

One consequence of treating an unknown risk through an indemnity instead of a representation is that the buyer may be required to proceed with the acquisition even if a basis for the liability in question is discovered prior to the closing because the existence of a liability subject to indemnification will not, by itself, cause a failure of the condition specified in Section 7.1. The representations in Section 3.22 substantially overlap this indemnity in order to avoid that consequence.

The issue of control of cleanup and other environmental matters is often controversial. The buyer may argue for control based upon the unusually great potential that these matters have for interference with business operations. The seller may argue for control based upon its financial responsibility under the indemnification provision.

If the seller and the shareholders are unwilling to commit to such broad indemnification provisions, or if the buyer is not satisfied with such provisions because of specific environmental risks that are disclosed or become known through the due diligence process or are to be anticipated from the nature of the seller's business, several alternatives exist for resolving the risk allocation problems that may arise. For example, the seller may ultimately agree to a reduction in the purchase price in return for deletion or limitation of its indemnification obligations.

The seller and the shareholders are likely to have several concerns with the indemnification provisions in Section 11.3. Many of these concerns are discussed in the Comment to Section 3.22, such as the indemnification for third-party actions and with respect to substances that may be considered hazardous in the future or with respect to future environmental laws. The seller and the shareholders may also be interested in having the buyer indemnify them for liabilities arising from the operation of the seller's business after the closing, although they may find it difficult to articulate the basis upon which they may have liability for these matters.

Although representations and indemnification provisions address many environmental issues, it is typical for the buyer to undertake an environmental due diligence process prior to acquiring any interest from the seller. See the Comment to Section 7.10.

11.4 INDEMNIFICATION AND REIMBURSEMENT BY BUYER

Buyer will indemnify and hold harmless Seller, and will reimburse Seller, for any Damages arising from or in connection with:

- (a) any Breach of any representation or warranty made by Buyer in this Agreement or in any certificate, document, writing or instrument delivered by Buyer pursuant to this Agreement;
- (b) any Breach of any covenant or obligation of Buyer in this Agreement or in any other certificate, document, writing or instrument delivered by Buyer pursuant to this Agreement;
- (c) any claim by any Person for brokerage or finder's fees or commissions or similar payments based upon any agreement or understanding alleged to have been made by such Person with Buyer (or any Person acting on Buyer's behalf) in connection with any of the Contemplated Transactions;
- (d) any obligations of Buyer with respect to bargaining with the collective bargaining representatives of Active Hired Employees subsequent to the Closing; or
- (e) any Assumed Liabilities.

COMMENT

In general, the indemnification by the buyer is similar to that by the seller. The significance of the buyer's indemnity will depend to a large extent upon the type of consideration to be paid and, as a result, on the breadth of the buyer's representations. If the consideration paid to a seller is equity securities of the buyer, the seller may seek broad representations and indemnification comparable to that given by the seller, including indemnification that covers specific known problems. In all cash transactions, however, the buyer's representations are usually minimal, and the buyer generally runs little risk of liability for post-closing indemnification. It is not unusual for the buyer's first draft to omit this provision entirely.

A seller might request that the acquisition agreement contain an analogue to [Section 11.2\(c\)](#) to allocate the risk of post-closing operations more clearly to the buyer. Such a provision could read as follows:

- (c) **any Liability arising out of the ownership or operation of the Assets after the Effective Time other than the Retained Liabilities;**

11.5 LIMITATIONS ON AMOUNT—SELLER AND SHAREHOLDERS

Seller and Shareholders shall have no liability (for indemnification or otherwise) with respect to claims under [Section 11.2\(a\)](#) until the total of all [Damages](#) with respect to such matters exceeds _____ dollars (\$_____) and then only for the amount by which such [Damages](#) exceed _____ dollars (\$_____). However, this [Section 11.5](#) will not apply to claims under [Section 11.2\(b\)](#) through (j) or to matters arising in respect of [Sections 3.9, 3.11, 3.14, 3.22, 3.29, 3.30, 3.31](#) or [3.32](#) or to any [Breach](#) of any of Seller's and Shareholders' representations and warranties of which the Seller had [Knowledge](#) at any time prior to the date on which such representation and warranty is made or any intentional [Breach](#) by Seller or either Shareholder of any covenant or obligation, and Seller and the Shareholders will be jointly and severally liable for all [Damages](#) with respect to such [Breaches](#).

COMMENT

[Section 11.5](#) provides the Seller and the Shareholders with a safety net, or "basket," with respect to specified categories of indemnification but does not establish a ceiling, or "cap." The basket is a minimum amount that must be exceeded before any indemnification is owed—in effect, it is a deductible. A more aggressive buyer may wish to provide for a "threshold" deductible that, once crossed, entitles the indemnified party to recover all damages rather than merely the excess over the basket. The purpose of the basket or deductible is (a) to recognize that representations concerning an ongoing business are unlikely to be perfectly accurate and (b) to avoid disputes over insignificant amounts. In addition, the buyer can point to the basket as a reason why specific representations do not need materiality qualifications.

In the Model Agreement, Seller's and Shareholders' representations are generally not subject to materiality qualifications, and the full dollar amount of damages caused by a breach must be indemnified, subject to the effect of the basket established by this section. This framework avoids "double dipping," that is, the situation in which a seller contends that the breach exists only to the extent that it is material, and then the material breach is subjected to the deduction of the basket. If the acquisition agreement contains materiality qualifications to the seller's representations, the buyer should con-

sider a provision to the effect that such a materiality qualification will not be taken into account in determining the magnitude of the damages occasioned by the breach for purposes of calculating whether they are applied to the basket; otherwise, the immaterial items may be material in the aggregate but not applied to the basket. Another approach would involve the use of a provision such as the following:

If Buyer would have a claim for indemnification under Sections 11.2(a) [and others] if the representation and warranty [and others] to which the claim relates did not include a materiality qualification and the aggregate amount of all such claims exceeds _____ dollars (\$_____), then the Buyer shall be entitled to indemnification for the amount of such claims in excess of _____ dollars (\$_____) in the aggregate (subject to the limitations on amount in Section 11.5) notwithstanding the inclusion of a materiality qualification in the relevant provisions of this Agreement.

A buyer will usually want the seller's and the shareholders' indemnity obligation for certain matters, such as the retained liabilities, to be absolute or "first dollar" and not subject to the basket. For example, the buyer may insist that the seller pay all tax liabilities from a pre-closing period or the damages resulting from a disclosed lawsuit without regard to the basket. Section 11.5 lists a number of sections to which the basket would not apply, including title, labor and environmental matters. The parties also may negotiate different baskets for different types of liabilities; the buyer should consider the aggregate effect of those baskets.

The shareholders may also seek to provide for a maximum indemnifiable amount. The shareholders' argument for such a provision is that they had limited liability as shareholders and should be in no worse position with the seller having sold the assets than before the seller sold the assets; this argument may not be persuasive to a buyer that views the assets as a component of its overall business strategy or intends to invest additional capital. If a maximum amount is established, it usually does not apply to liabilities for taxes, environmental matters or ERISA matters—for which the buyer may have liability under applicable law—or defects in the ownership of the Assets. The parties may also negotiate separate limits for different kinds of liabilities.

Baskets and thresholds often do not apply to breaches of representations of which the seller had knowledge or a willful failure by the seller to comply with a covenant or obligation. The rationale is that the seller should not be allowed to reduce the purchase price or the amount of the basket or threshold by behavior that is less than forthright. Similarly, the buyer will argue that any limitation as to the maximum amount should not apply to a seller that engages in intentional wrongdoing.

The basket in Section 11.5 only applies to claims under Section 11.2(a), which provides for indemnification for breaches of representations and warranties. The basket does not apply to any other indemnification provided in Section 11.2 (e.g., breaches of obligations to deliver all of the Assets as promised or from Seller's failure to satisfy retained liabilities) or 11.3 (environmental matters). This distinction is necessary to protect the buyer from net asset shortfalls that would otherwise preclude the buyer from receiving the net assets for which it bargained.

11.6 LIMITATIONS ON AMOUNT—BUYER

Buyer will have no liability (for indemnification or otherwise) with respect to claims under Section 11.4(a) until the total of all Damages with respect to such matters

exceeds _____ dollars (\$_____) and then only for the amount by which such Damages exceed _____ dollars (\$_____). However, this Section 11.6 will not apply to claims under Section 11.4(b) through (e) or matters arising in respect of Section 4.4 or to any Breach of any of Buyer's representations and warranties of which Buyer had Knowledge at any time prior to the date on which such representation and warranty is made or any intentional Breach by Buyer of any covenant or obligation, and Buyer will be liable for all Damages with respect to such Breaches.

COMMENT

In its first draft, the buyer will usually suggest a basket below which it is not required to respond in damages for breaches of its representations, typically the same dollar amount as that used for the seller's basket.

11.7 TIME LIMITATIONS

- (a) If the Closing occurs, Seller and Shareholders will have liability (for indemnification or otherwise) with respect to any Breach of (i) a covenant or obligation to be performed or complied with prior to the Closing Date (other than those in Sections 2.1 and 2.4(b) and Articles 10 and 12, as to which a claim may be made at any time) or (ii) a representation or warranty (other than those in Sections 3.9, 3.14, 3.16, 3.22, 3.29, 3.30, 3.31 and 3.32, as to which a claim may be made at any time), only if on or before _____, 20____, Buyer notifies Seller or Shareholders of a claim specifying the factual basis of the claim in reasonable detail to the extent then known by Buyer.
- (b) If the Closing occurs, Buyer will have liability (for indemnification or otherwise) with respect to any Breach of (i) a covenant or obligation to be performed or complied with prior to the Closing Date (other than those in Article 12, as to which a claim may be made at any time) or (ii) a representation or warranty (other than that set forth in Section 4.4, as to which a claim may be made at any time), only if on or before _____, 20____, Seller or Shareholders notify Buyer of a claim specifying the factual basis of the claim in reasonable detail to the extent then known by Seller or Shareholders.

COMMENT

It is common for an acquisition agreement to specify the time period within which a claim for indemnification must be made. The seller and its shareholders want to have uncertainty eliminated after a period of time, and the buyer wants to have a reasonable opportunity to discover any basis for indemnification. The time period will vary depending upon factors such as the type of business, the adequacy of financial statements, the buyer's plans for retaining existing management, the buyer's ability to perform a thorough investigation prior to the acquisition, the method of determination of the purchase price and the relative bargaining strength of the parties. A two-year period may be sufficient for most liabilities because it will permit at least one post-closing annual audit and because, as a practical matter, many hidden liabilities will be uncovered within two years. An extended or unlimited time period for title to assets,

products liability, taxes, employment issues and environmental issues, however, is not unusual.

Section 11.7 provides that claims generally with respect to representations or covenants must be asserted by the buyer within a specified time period known as a “survival” period, except with respect to identified representations or covenants as to which a claim may be made at any time. It is also possible to provide that a different (than the general) survival period will apply to other identified representations or covenants. Some attorneys request that representations that are fraudulently made survive indefinitely. It is also important to differentiate between covenants to be performed or complied with before and after closing.

The appropriate standard for some types of liabilities may be the period of time during which a private or governmental plaintiff could bring a claim for actions taken or circumstances existing prior to the closing. For example, indemnification for tax liabilities often extends for as long as the relevant statute of limitations for collection of the tax. If this approach is taken, the limitation should be drafted to include extensions of the statute of limitations (which are frequently granted in tax audits), situations in which there is no statute of limitations (such as those referred to in Section 6501(c) of the Code) and a brief period after expiration of the statute of limitations to permit a claim for indemnification to be made if the tax authorities act on the last possible day.

The seller’s obligations with respect to retained liabilities should not be affected by any limitations on the time or amount of general indemnification payments.

The buyer should consider the relationship between the time periods within which a claim for indemnification may be made and the time periods for other post-closing transactions. For example, if there is an escrow, the buyer will want to have the escrow last until any significant claims for indemnification have been paid or finally adjudicated. Similarly, if part of the purchase price is to be paid by promissory note, or if there is to be an “earn-out” pursuant to which part of the consideration for the assets is based upon future performance, the buyer will want to be able to offset claims for indemnification against any payments that it owes on the promissory note or earn-out (see [Section 11.8](#)).

In drafting time limitations, the buyer’s counsel should consider whether they should apply only to claims for indemnification (see the [Comment to Section 11.2](#)).

11.8 RIGHT OF SETOFF; ESCROW

Upon notice to Seller specifying in reasonable detail the basis therefor, Buyer may set off any amount to which it may be entitled under this Article 11 against amounts otherwise payable under the [Promissory Note](#) or may give notice of a claim in such amount under the [Escrow Agreement](#). The exercise of such right of setoff by Buyer in good faith, whether or not ultimately determined to be justified, will not constitute an event of default under the [Promissory Note](#) or any instrument securing the [Promissory Note](#). Neither the exercise of nor the failure to exercise such right of setoff or to give a notice of a claim under the [Escrow Agreement](#) will constitute an election of remedies or limit Buyer in any manner in the enforcement of any other remedies that may be available to it.

COMMENT

Regardless of the clarity of the acquisition agreement on the allocation of risk and the buyer’s right of indemnification, the buyer may have difficulty enforcing the indem-

nity—especially against shareholders who are individuals—unless it places a portion of the purchase price in escrow, holds back a portion of the purchase price (often in the form of a promissory note, an earn-out or payments under consulting or noncompetition agreements) with a right of setoff or obtains other security (such as a letter of credit) to secure performance of the seller's and the shareholders' indemnification obligations. These techniques shift bargaining power in post-closing disputes from the seller and the shareholders to the buyer and usually will be resisted by the seller.

An escrow provision may give the buyer the desired security, especially when there are several shareholders and the buyer will have difficulty in obtaining jurisdiction over the shareholders or in collecting on the indemnity without an escrow. Shareholders who are jointly and severally liable may also favor an escrow in order to ensure that other shareholders share in any indemnity payment. The amount and duration of the escrow will be determined by negotiation, based upon the parties' analyses of the magnitude and probability of potential claims and the period of time during which they may be brought. The shareholders may insist that the size of the required escrow diminish in stages over time. The buyer should be careful that there is no implication that the escrow is the exclusive remedy for breaches and nonperformance, although a request for an escrow is often met with a suggestion by the shareholders that claims against the escrow be the buyer's exclusive remedy.

The buyer may also seek an express right of setoff against sums otherwise payable to the seller or the shareholders. The buyer obtains more protection from an express right of setoff against deferred purchase-price payments due under a promissory note than from a deposit of the same amounts in an escrow because the former leaves the buyer in control of the funds, thus giving the buyer more leverage in resolving disputes with the seller. The buyer may also want to apply the setoff against payments under employment, consulting or noncompetition agreements (although state law may prohibit setoffs against payments due under employment agreements). The comfort received by the buyer from an express right of setoff depends upon the schedule of the payments against which it can withhold. Even if the seller agrees to express setoff rights, the seller may attempt to prohibit setoffs prior to definitive resolution of a dispute and to preserve customary provisions that call for acceleration of any payments due by the buyer if the buyer wrongfully attempts setoff. Also, the seller may seek to require that the buyer exercise its setoff rights on a pro rata basis in proportion to the amounts due to each shareholder. If the promissory note is to be pledged to a bank, the bank, as pledgee, will likely resist setoff rights (especially because the inclusion of express setoff rights will make the promissory note nonnegotiable). As in the case of an escrow, the suggestion of an express right of setoff often leads to discussions of exclusive remedies.

The buyer may wish to expressly provide that the setoff applies to the amounts (principal and interest) first coming due under the promissory note. This is obviously more advantageous to the buyer from a cash flow standpoint. The seller will prefer that the setoff apply to the principal of the promissory note in the inverse order of maturity. This also raises the question of whether the seller is entitled to interest on the amount set off or, in the case of an escrow, the disputed amount. The buyer's position will be that this constitutes a reduction in the purchase price, and, therefore, the seller should not be entitled to interest on the amount of the reduction. The seller may argue that it should be entitled to interest, at least up to the time the buyer is required to make payment to a third party of the amount claimed. It may be difficult, however, for the seller to justify receiving interest when the setoff relates to a diminution in value of the assets acquired.

Rather than inviting counterproposals from the seller by including an express right of setoff in the acquisition agreement, the buyer's counsel may decide to omit such a provision and rely on the buyer's common law right of counter-claim and setoff instead.

Even without an express right of setoff in the acquisition agreement or related documents such as a promissory note or an employment, consulting or noncompetition agreement, the buyer can, as a practical matter, withhold amounts from payments due to the seller and the shareholders under the acquisition agreement or the related documents on the ground that the buyer is entitled to indemnification for these amounts under the acquisition agreement. The question, then, is whether, if the seller and the shareholders sue the buyer for its failure to make full payment, the buyer will be able to counterclaim that it is entitled to set off the amounts for which it believes it is entitled to indemnification.

The common law of counterclaim and setoff varies from state to state, and when deciding whether to include or forego an express right of setoff in the acquisition agreement, the buyer's counsel should examine the law governing the acquisition agreement. The buyer's counsel should determine whether the applicable law contains requirements such as a common transaction, mutuality of parties and a liquidated amount and, if so, whether those requirements would be met in the context of a dispute under the acquisition agreement and related documents. Counterclaim generally is mandatory when both the payment due to the plaintiff and the amount set off by the defendant relate to the same transaction (see *United States v. Southern California Edison Co.*, 229 F. Supp. 268, 270 (S.D. Cal. 1964)); when different transactions are involved, the court may, in its discretion, permit a counterclaim (see *Rochester-Genesee Reg'l Transp. Dist., Inc. v. Trans World Airlines, Inc.*, 383 N.Y.S.2d 856, 857 (1976)) but is not obligated to do so (see *Columbia Gas Transmission Corp. v. Larry H. Wright, Inc.*, 443 F. Supp. 14 (S.D. Ohio 1977); *Townsend v. Bentley*, 292 S.E.2d 19 (N.C. Ct. App. 1982)). Although a promissory note representing deferred purchase-price payments would almost certainly be considered part of the same transaction as the acquisition, it is less certain that the execution of an employment, consulting or noncompetition agreement, even if a condition to the closing of the acquisition, and its subsequent performance would be deemed part of the same transaction as the acquisition. In addition, a counterclaim might not be possible if the parties obligated to make and entitled to receive the various payments are different (that is, if there is not "mutuality of parties").

Under the *D'Oench, Duhme* doctrine, which arose from a 1942 Supreme Court decision and has since been expanded by various statutes and judicial decisions, defenses such as setoff rights under an acquisition agreement generally are not effective against the Federal Deposit Insurance Corporation (FDIC), the Resolution Trust Corporation (RTC) and subsequent assignees or holders in due course of a note that once was in the possession of the FDIC or the RTC. See *D'Oench, Duhme & Co. v. FDIC*, 315 U.S. 447 (1942); see also 12 U.S.C. § 1823(e); *Porras v. Petroplex Sav. Ass'n*, 903 F.2d 379 (5th. Cir. 1990); *Bell & Murphy & Assoc., Inc. v. InterFirst Bank Gateway, N.A.*, 894 F.2d 750 (5th. Cir. 1990), *cert. denied*, 498 U.S. 895 (1990); *FSLIC v. Murray*, 853 F.2d 1251 (5th. Cir. 1988). An exception to the *D'Oench, Duhme* doctrine exists when the asserted defense arises from an agreement reflected in the failed bank's records. See *FDIC v. Plato*, 981 F.2d 852 (5th. Cir. 1993); *Resolution Trust Corp. v. Oaks Apartments Joint Venture*, 966 F.2d 995 (5th. Cir. 1992). Therefore, if a buyer gives a seller a negotiable promissory note and that note ever comes into the possession of a bank that later fails, the buyer could lose its setoff rights under the acquisition agreement unless the failed bank had reflected in its records the acquisition agreement and the buyer's setoff rights. As an alternative to nonnegotiable notes, a buyer could issue notes that can be transferred only to persons who agree in writing to recognize in their official records both the acquisition and the buyer's setoff rights.

Section 11.8 addresses the possible consequences of an unjustified setoff. It allows Buyer to set off amounts for which Buyer in good faith believes that it is entitled to

indemnification from Seller and Shareholders against payments due to them under the [Promissory Note](#) without bearing the risk that, if Seller and Shareholders ultimately prevail on the indemnification claim, they will be able to accelerate the Promissory Note or obtain damages or injunctive relief. Such a provision gives Buyer considerable leverage and will be resisted by Seller. In order to lessen the leverage that the buyer has from simply withholding payment, the seller might require that an amount equal to the setoff be paid by the buyer into an escrow with payment of fees and costs going to the prevailing party.

11.9 THIRD-PARTY CLAIMS

- (a) Promptly after receipt by a [Person](#) entitled to indemnity under [Section 11.2](#), [11.3](#) (to the extent provided in the last sentence of [Section 11.3](#)) or [11.4](#) (an “[Indemnified Person](#)”) of notice of the assertion of a [Third-Party Claim](#) against it, such Indemnified Person shall give notice to the Person obligated to indemnify under such [Section](#) (an “[Indemnifying Person](#)”) of the assertion of such [Third-Party Claim](#), provided that the failure to notify the Indemnifying Person will not relieve the Indemnifying Person of any liability that it may have to any Indemnified Person, except to the extent that the Indemnifying Person demonstrates that the defense of such [Third-Party Claim](#) is prejudiced by the Indemnified Person’s failure to give such notice.
- (b) If an Indemnified Person gives notice to the Indemnifying Person pursuant to [Section 11.9\(a\)](#) of the assertion of a [Third-Party Claim](#), the Indemnifying Person shall be entitled to participate in the defense of such [Third-Party Claim](#) and, to the extent that it wishes (unless (i) the Indemnifying Person is also a Person against whom the [Third-Party Claim](#) is made and the Indemnified Person determines in good faith that joint representation would be inappropriate or (ii) the Indemnifying Person fails to provide reasonable assurance to the Indemnified Person of its financial capacity to defend such [Third-Party Claim](#) and provide indemnification with respect to such [Third-Party Claim](#)), to assume the defense of such [Third-Party Claim](#) with counsel satisfactory to the Indemnified Person. After notice from the Indemnifying Person to the Indemnified Person of its election to assume the defense of such [Third-Party Claim](#), the Indemnifying Person shall not, so long as it diligently conducts such defense, be liable to the Indemnified Person under this [Article 11](#) for any fees of other counsel or any other expenses with respect to the defense of such [Third-Party Claim](#), in each case subsequently incurred by the Indemnified Person in connection with the defense of such [Third-Party Claim](#), other than reasonable costs of investigation. If the Indemnifying Person assumes the defense of a [Third-Party Claim](#), (i) such assumption will conclusively establish for purposes of this [Agreement](#) that the claims made in that [Third-Party Claim](#) are within the scope of and subject to indemnification, and (ii) no compromise or settlement of such [Third-Party Claims](#) may be effected by the Indemnifying Person without the Indemnified Person’s [Consent](#) unless (A) there is no finding or admission of any violation of [Legal Requirement](#) or any violation of the rights of any Person; (B) the sole relief provided is monetary damages that are paid in full by the Indemnifying Person; and (C) the Indemnified Person shall have no liability with respect to any compromise or settlement of such [Third-Party Claims](#) effected without its [Consent](#).

If notice is given to an Indemnifying Person of the assertion of any Third-Party Claim and the Indemnifying Person does not, within ten (10) days after the Indemnified Person's notice is given, give notice to the Indemnified Person of its election to assume the defense of such Third-Party Claim, the Indemnifying Person will be bound by any determination made in such Third-Party Claim or any compromise or settlement effected by the Indemnified Person.

- (c) Notwithstanding the foregoing, if an Indemnified Person determines in good faith that there is a reasonable probability that a Third-Party Claim may adversely affect it or its **Related Persons** other than as a result of monetary damages for which it would be entitled to indemnification under this Agreement, the Indemnified Person may, by notice to the Indemnifying Person, assume the exclusive right to defend, compromise or settle such Third-Party Claim, but the Indemnifying Person will not be bound by any determination of any Third-Party Claim so defended for the purposes of this Agreement or any compromise or settlement effected without its Consent (which may not be unreasonably withheld).
- (d) Notwithstanding the provisions of **Section 13.4**, Seller and each Shareholder hereby consent to the nonexclusive jurisdiction of any court in which a **Proceeding** in respect of a Third-Party Claim is brought against any Buyer Indemnified Person for purposes of any claim that a Buyer Indemnified Person may have under this Agreement with respect to such Proceeding or the matters alleged therein and agree that process may be served on Seller and Shareholders with respect to such a claim anywhere in the world.
- (e) With respect to any Third-Party Claim subject to indemnification under this Article 11: (i) both the Indemnified Person and the Indemnifying Person, as the case may be, shall keep the other Person fully informed of the status of such Third-Party Claim and any related Proceedings at all stages thereof where such Person is not represented by its own counsel, and (ii) the parties agree (each at its own expense) to render to each other such assistance as they may reasonably require of each other and to cooperate in good faith with each other in order to ensure the proper and adequate defense of any Third-Party Claim.
- (f) With respect to any Third-Party Claim subject to indemnification under this Article 11, the parties agree to cooperate in such a manner as to preserve in full (to the extent possible) the confidentiality of all Confidential Information and the attorney-client and work-product privileges. In connection therewith, each party agrees that: (i) it will use its **Best Efforts**, in respect of any Third-Party Claim in which it has assumed or participated in the defense, to avoid production of **Confidential Information** (consistent with applicable law and rules of procedure), and (ii) all communications between any party hereto and counsel responsible for or participating in the defense of any Third-Party Claim shall, to the extent possible, be made so as to preserve any applicable attorney-client or work-product privilege.

COMMENT

It is common to permit an indemnifying party to have some role in the defense of the claim. There is considerable room for negotiation of the manner in which that role is implemented. Because the buyer is more likely to be an indemnified party than an indemnifying party, the Model Agreement provides procedures that are favorable to the indemnified party.

The indemnified party normally will be required to give the indemnifying party notice of third-party claims for which indemnity is sought. The Model Agreement requires such notice only after a proceeding is commenced and provides that the indemnified party's failure to give notice does not affect the indemnifying party's obligations unless the failure to give notice results in prejudice to the defense of the proceeding. A seller may want to require notice of threatened proceedings and of claims that do not yet involve proceedings and to provide that prompt notice is a condition to indemnification; the buyer will likely be very reluctant to introduce the risk and uncertainty inherent in a notice requirement based upon any event other than the initiation of formal proceedings.

The Model Agreement permits the indemnifying party to participate in and assume the defense of proceedings for which indemnification is sought but imposes significant limitations on its right to do so. The indemnifying party's right to assume the defense of other proceedings is subject to (a) a conflict-of-interest test if the claim is also made against the indemnifying party, (b) a requirement that the indemnifying party demonstrate its financial capacity to conduct the defense and provide indemnification if it is unsuccessful and (c) a requirement that the defense be conducted with counsel satisfactory to the indemnified party. The seller will often resist the financial capacity requirement and seek either to modify the requirement that counsel be satisfactory with a reasonableness qualification or to identify satisfactory counsel in the acquisition agreement (the seller's counsel should carefully consider in whose interest they are acting if they specify themselves). The seller may also seek to require that, in cases in which it does not assume the defense, all indemnified parties be represented by the same counsel (subject to conflict of interest concerns).

The seller may seek to modify the provision that the indemnifying party is bound by the indemnified party's defense or settlement of a proceeding if the indemnifying party does not assume the defense of that proceeding within ten days after notice of the proceeding. The seller may request a right to assume the defense of the proceeding at a later date and a requirement for advance notice of a proposed settlement.

An indemnified party usually will be reluctant to permit an indemnifying party to assume the defense of a proceeding while reserving the right to argue that the claims made in that proceeding are not subject to indemnification. Accordingly, the Model Agreement excludes that possibility. The seller may object, however, that the nature of the claims could be unclear at the start of a proceeding and may seek the right to reserve its rights in a manner similar to that often permitted to liability insurers.

An indemnifying party that has assumed the defense of a proceeding will seek the broadest possible right to settle the matter. The Model Agreement imposes strict limits on that right; the conditions relating to the effect on other claims and the admission of violations of legal requirements are often the subject of negotiation.

Section 11.9(c) permits the indemnified party to retain control of a proceeding that presents a significant risk of injury beyond monetary damages that would be borne by the indemnifying party, but the price of that retained control is that the indemnifying party will not be bound by determinations made in that proceeding. The buyer may want to maintain control of a proceeding seeking equitable relief that could have an impact on its business that would be difficult to measure as a monetary loss or of a proceeding involving product liability claims that extend beyond the seller's businesses (a tobacco company that acquires another tobacco company, for example, is unlikely to be willing to surrender control of any of its products liability cases).

Section 11.9(d) permits Buyer to minimize the risk of inconsistent determinations by asserting its claim for indemnification in the same proceeding as the claims against Buyer.

Environmental indemnification often presents special procedural issues because of the wide range of remediation techniques that may be available and the potential for

disruption of the seller's businesses. These matters are often dealt with in separate provisions (see [Section 11.3](#)).

11.10 OTHER CLAIMS

A claim for indemnification for any matter not involving a [Third-Party Claim](#) may be asserted by notice to the party from whom indemnification is sought and shall be paid promptly after such notice.

COMMENT

This section emphasizes the parties' intention that indemnification remedies provided in the acquisition agreement are not limited to [Third-Party Claims](#). Some courts have implied such a limitation in the absence of clear contractual language to the contrary. See the [Comment to Section 11.2](#).

11.11 INDEMNIFICATION IN CASE OF STRICT LIABILITY OR INDEMNITEE NEGLIGENCE

THE INDEMNIFICATION PROVISIONS IN THIS ARTICLE 11 SHALL BE ENFORCEABLE REGARDLESS OF WHETHER THE LIABILITY IS BASED UPON PAST, PRESENT OR FUTURE ACTS, CLAIMS OR [LEGAL REQUIREMENTS](#) (INCLUDING ANY PAST, PRESENT OR FUTURE [BULK SALES LAW](#), [ENVIRONMENTAL LAW](#), [FRAUDULENT TRANSFER ACT](#), [OCCUPATIONAL SAFETY AND HEALTH LAW](#) OR PRODUCTS LIABILITY, SECURITIES OR OTHER LEGAL REQUIREMENT) AND REGARDLESS OF WHETHER ANY [PERSON](#) (INCLUDING THE PERSON FROM WHOM INDEMNIFICATION IS SOUGHT) ALLEGES OR PROVES THE SOLE, CONCURRENT, CONTRIBUTORY OR COMPARATIVE NEGLIGENCE OF THE PERSON SEEKING INDEMNIFICATION OR THE SOLE OR CONCURRENT STRICT LIABILITY IMPOSED UPON THE PERSON SEEKING INDEMNIFICATION.

COMMENT

Purpose of Section. The need for this section is illustrated by *Fina, Inc. v. ARCO*, 200 F.3rd 266 (5th Cir. 2000), in which the U.S. Court of Appeals for the Fifth Circuit invalidated an asset purchase agreement indemnification provision in the context of environmental liabilities. In the *Fina* case, the liabilities arose from actions of three different owners over a thirty-year period during which both seller and buyer owned and operated the business and contributed to the environmental condition. The asset purchase agreement indemnification provision provided that the indemnitor "shall indemnify, defend and hold harmless [the indemnitee] . . . against all claims, actions, demands, losses or liabilities arising from the use or operation of the Assets . . . and accruing from and after closing." The Fifth Circuit, applying Delaware law pursuant to the agreement's choice of law provision, held that the indemnification provision did not satisfy the Delaware requirement that indemnification provisions that require payment for liabilities imposed upon the indemnitee for the indemnitee's own negligence or pursuant to strict liability statutes such as [CERCLA](#) must be clear and unequivocal. The court explained that the risk shifting in such a situation is so extraordinary that, to be enforceable, the provision must state with specificity the types of risks that the agreement is transferring to the indemnitor.

There are other situations where the acquisition agreement may allocate the liability to the seller whereas the buyer's action or failure to act (perhaps negligently) may contribute to the loss. For example, a defective product may be shipped prior to closing, but the buyer may fail to effect a timely recall, which could have prevented the liability, or an account receivable may prove uncollectible because of the buyer's failure to diligently pursue its collection or otherwise satisfy the customer's requirements.

This section is intended to prevent the allocation of risks elsewhere in Article 11 from frustration by court holdings, such as the *Fina* case, that indemnification provisions are ambiguous and unenforceable because they do not contain specific words that certain kinds of risks are intended to be shifted by the Agreement. As discussed below, the majority rule appears to be that agreements that have the effect of shifting liability for a person's own negligence, or for strict liability imposed upon the person, must, at a minimum, be clear and unequivocal and, in some jurisdictions, must be expressly stated. The section is in all capital letters because a minority of jurisdictions require that the risk shifting provision be conspicuously presented.

Indemnification for Indemnitee's Own Negligence. Indemnities, releases and other exculpatory provisions are generally enforceable as between the parties absent statutory exceptions for certain kinds of liabilities (e.g., Section 14 of the Securities Act and Section 29 of the Exchange Act) and judicially created exceptions (e.g. some courts as a matter of public policy will not allow a party to shift responsibility for its own gross negligence or intentional misconduct). See RESTATEMENT (SECOND) OF CONTRACTS § 195 cmt. b (1981) ("Language inserted by a party in an agreement for the purpose of exempting [it] from liability for negligent conduct is scrutinized with particular care and a court may require specific and conspicuous reference to negligence Furthermore, a party's attempt to exempt [itself] from liability for negligent conduct may fail as unconscionable.") As a result of these public policy concerns or seller's negotiations, some counsel add an exception for liabilities arising from an indemnitee's gross negligence or willful misconduct.

Assuming none of these exceptions is applicable, the judicial focus turns to whether the words of the contract are sufficient to shift responsibility for the particular liability. A minority of courts have adopted the "literal enforcement approach" under which a broadly worded indemnity for any and all claims is held to encompass claims from unforeseen events including the indemnitee's own negligence. The majority of courts closely scrutinize, and are reluctant to enforce, indemnification or other exculpatory arrangements that shift liability away from the culpable party and require that provisions having such an effect be "clear and unequivocal" in stating the risks that are being transferred to the indemnitor. See Conwell, *Recent Decisions: The Maryland Court of Appeals*, 57 MD. L. REV. 706 (1998). If an indemnity provision is not sufficiently specific, a court may refuse to enforce the purported imposition on the indemnitor of liability for the indemnitee's own negligence or strict liability. *Fina, Inc. v. ARCO*, 200 F.3d 266 (5th Cir. 2000).

The actual application of the "clear and unequivocal" standard varies from state to state and from situation to situation. Jurisdictions such as Florida, New Hampshire, Wyoming and Illinois do not mandate that any specific wording or magic language be used in order for an indemnity to be enforceable to transfer responsibility for the indemnitee's negligence. See *Hardage Enterprises v. Fidesys Corp.*, 570 So.2d 436, 437 (Fla. App. 1990); *Audley v. Melton*, 640 A. 2d 777 (N.H. 1994); *Boehm v. Cody Country Chamber of Commerce*, 748 P.2d 704 (Wyo.1987); *Neumann v. Gloria Marshall Figure Salon*, 500 N.E. 2d 1011, 1014 (Ill. 1986). Jurisdictions such as New York, Minnesota, Missouri, Maine, North Dakota and Delaware require also that reference to the negligence or fault of the indemnitee be set forth within the contract. See *Gross*

v. Sweet, 458 N.Y.S.2d 162 (1983) (holding that the language of the indemnity must plainly and precisely indicate that the limitation of liability extends to negligence or fault of the indemnitee); Schlobohn v. Spa Petite, Inc., 326 N.W.2d 920, 923 (Minn. 1982) (holding that indemnity is enforceable where “negligence” is expressly stated); Alack v. Vic Tanny Intern, 923 S.W.2d 330 (Mo. 1996) (holding that a bright-line test is established requiring that the words “negligence” or “fault” be used conspicuously); Doyle v. Bowdoin College, 403 A.2d 1206, 1208 (Me. 1979) (holding that there must be an express reference to liability for negligence); Blum v. Kauffman, 297 A.2d 48, 49 (Del. 1972) (holding that a release did not “clearly and unequivocally” express the intent of the parties without the word “negligence”); Fina v. Arco, 200 F.3d 266, 270 (5th Cir. 2000) (applying Delaware law and explaining that no Delaware case has allowed indemnification of a party for its own negligence without making specific reference to the negligence of the indemnified party and requiring, at a minimum, that indemnity provisions demonstrate that “the subject of negligence of the indemnitee was expressly considered by the parties drafting the agreement”). Under the “express negligence” doctrine followed by Texas courts, an indemnification agreement is not enforceable to indemnify a party from the consequences of its own negligence unless such intent is specifically stated within the four corners of the agreement. See Ethyl Corp. v. Daniel Constr. Co., 725 S.W.2d 705, 708 (Tex. 1987); Atlantic Richfield Co. v. Petroleum Personnel, Inc., 768 S.W.2d 724 (Tex. 1989).

Indemnification for Strict Liability. Concluding that the transfer of a liability based upon strict liability involves an extraordinary shifting of risk analogous to the shifting of responsibility for an indemnitee’s own negligence, some courts have held that the clear and unequivocal rule is equally applicable to indemnification for strict liability claims. See, e.g., Fina, Inc. v. ARCO, 200 F.2d 300 (5th Cir. 2000); Purolator Prod. v. Allied Signal, Inc., 772 F. Supp. 124, 131 n.3 (W.D.N.Y. 1991); Houston Lighting & Power Co. v. Atchison, Topeka & Santa Fe Ry., 890 S.W.2d 455, 458 (Tex. 1994); see also Parker and Savich, *Contractual Efforts to Allocate the Risk of Environmental Liability: Is There a Way to Make Indemnities Worth More Than the Paper They Are Written On?*, 44 Sw. L.J. 1349 (1991). The court concluded that this broad clause in the Fina asset purchase agreement did not satisfy the clear and unequivocal test in respect of strict liability claims because there was no specific reference to claims based upon strict liability.

In view of the judicial hostility to the contractual shifting of liability for strict liability risks, counsel may wish to include in the asset purchase agreement references to additional kinds of strict liability claims for which indemnification is intended.

Conspicuousness. In addition to requiring that the exculpatory provision be explicit, some courts require that its presentation be conspicuous. See Dresser Indus. v. Page Petroleum, Inc., 853 S.W.2d 505 (Tex. 1993) (“Because indemnification of a party for its own negligence is an extraordinary shifting of risk, this Court has developed fair notice requirements which . . . include the express negligence doctrine and the conspicuousness requirements. The express negligence doctrine states that a party seeking indemnity from the consequences of that party’s own negligence must express that intent in specific terms within the four corners of the contract. The conspicuous requirement mandates that something must appear on the face of the [contract] to attract the attention of a reasonable person when he looks at it.”); Alack v. Vic Tanny Intern. of Missouri, Inc., 923 S.W.2d 330, 337 (Mo. *en banc* 1996). Although most courts appear not to have imposed a comparable “conspicuousness” requirement to date, some lawyers feel it prudent to put their express negligence words in all capital letters, bold face or other conspicuous type.

