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Mergers & Acquisitions Law Alert

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Sixth Circuit case specifies additional language required in indemnification survival clauses in M&A agreements

A recent Sixth Circuit case, interpreting Ohio law, found that a merger agreement stating that the representations and warranties "shall survive...the Closing until... the second anniversary date of the Closing...," without more, was not sufficient to modify the statute of limitations for breach of contract claims related to the merger agreement. Fortunately, this issue can be remedied in merger agreements with the addition of a provision expressly limiting when "actions," "demands" or "claims" may be brought.

The following alert describes the Sixth Circuit case in greater detail and provides a sample contract provision that M&A parties can add to their M&A agreements to ensure that courts will respect the parties' intent to modify the statute of limitations in the survival clause of the agreement.

Background of the Sixth Circuit case

Escue v. Sequent, Inc., 2014 FED App. 0412N (6th Cir. 2014), involved the acquisition of Better Business Solutions of Alabama, Inc. ("Better Business") by Sequent, Inc. pursuant to a stock for stock merger that closed on January 1, 2007. On December 18, 2008, the plaintiff, the sole shareholder of Better Business, sent a letter to the defendant corporation stating that he intended to sue the defendant corporation for breaching its representations and warranties. However, the lawsuit was not filed until September 2009.

The defendant corporation argued that the plaintiff's claims were time barred by the survival clause in the merger agreement, which provided, in pertinent part, that certain representations and warranties:

> ...shall survive the execution and delivery of this Agreement and the Closing until the earlier of an initial public offering of [the defendant corporation]'s Common Stock or the second anniversary date of the Closing.

The defendant corporation argued that the survival clause had modified Ohio's 12 year breach of contract statute of limitations to require *filing* of any claims within two years following closing of the merger. Plaintiff, meanwhile, argued that the survival clause had modified the statute of limitations to require only *notice* of any claims within two years following closing of the merger.

Discussion of Sixth Circuit decision

Without deciding whether the survival clause required filing of a claim or only notice of a claim within the two year survival period, the court held that the merger

agreement did not modify Ohio's 12 year statute of limitations because neither the survival clause nor the extrinsic evidence clearly manifested the parties' intent to modify the statute of limitations.

Under Ohio law, an agreement purporting to modify the statute of limitations must be made manifest in clear, unequivocal language.[1] Ohio cases have held that M&A parties must do more than simply state that the representations and warranties survive the closing for a certain period of time for courts to find that the parties intended to modify the statute of limitations.[2] The court in *Escue* concluded that the survival clause in a merger agreement must contain an express reference to limiting "actions," "demands" or "breach of the contract" to clearly manifest an intent to establish a modification to the statute of limitations.[3]

Because the survival clause in the merger agreement did not contain express references to limiting "actions," demands" or "breach of the contract," and the extrinsic evidence did not clearly show the parties' intent, the court held that the merger agreement did not modify the statute of limitations, and that the plaintiff's claim was not time barred.

Drafting strategies for effective survival clauses

To ensure that an M&A agreement clearly manifests an intent to modify the statute of limitations, we recommend that parties add to the survival clause of the M&A agreement a sentence that no actions, demands, or claims may be made after the survival period. Below is an example of such language to add to the survival clause:

> No action, demand or claim for indemnification may be asserted against either party for breach of any representation, warranty, covenant or agreement contained herein, unless written notice of such action, demand or claim is received by such party describing in reasonable detail the facts and circumstances with respect to the subject matter of such claim on or prior to the date on which the representation, warranty, covenant or agreement on which such action, demand or claim is based ceases to survive as set forth in this Section [__].

This type of provision should be uncontroversial among the parties, because it is consistent with the common understanding among buyers and sellers of the operative effect of survival clauses.

Some M&A practitioners believe that a well written "sole remedy" or "exclusive remedy" clause — which provides that the parties' sole and exclusive remedy for any claims or causes of action under the M&A agreement is pursuant to the indemnification section — would express a manifest intent to modify the statute of limitations consistent with the *Escue* decision. However, because the merger agreement in *Escue* did not contain a "sole remedy" or "exclusive remedy" clause, it is not clear whether courts would find this sufficient.

It should be noted, however, that in concluding that a survival provision similar to the one at issue in *Escue* did effectively modify the statute of limitations, the Delaware Court of Chancery cited the presence of a "sole and exclusive remedy" clause as one of the factors supporting its conclusion.[4]

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[1] *Escue* at 8, citing *Arcade Co. Ltd. v. Arcade, LLC*, 105 F. App'x 808, 811 (6th Cir. 2004).

[2] *Escue* at 9, citing *Arcade Co. Ltd.* at 810.

[3] *Escue* at 9.

[4] *GRT, Inc. v. Marathon GTF Tech., Ltd.*, 2011 Del. Ch. LEXIS 99 at p. 36.

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