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NEGÓCIOS EMPRESARIAIS

ANALYSIS OF AN "ESCROW AGREEMENT" IN AN M&A TRANSACTION

ANÁLISE DE UM CONTRATO DE CONTA VINCULADA NO ÂMBITO DE UMA OPERAÇÃO DE FUSÃO/AQUISIÇÃO.

Cristina Celeste Marzo

Abstract: According to an escrow contractual arrangement in an merger and acquisition (M&A) deal, a portion of the purchase price (the "escrow amount") has to be allocated in a separate banking account (the "escrow account"), in order to satisfy buyer's indemnification claims against seller during the post-closing period, by virtue of any breach of seller's representations and warranties provided in the stock purchase agreement ("SPA"). In this regard, the execution of an escrow agreement is of greatest importance to mitigate buyer's risks during the post-closing period of an M&A transaction.

It should be observed that the terms and conditions of an escrow contract will depend on the circumstances of each M&A, and, hence, there is no "one size-fits-all formulae".

The major issues regarding the negotiation and drafting of an escrow agreement will be duly analysed hereto with a view to provide valuable guidelines, considering the lack of literature on the subject.

Keywords: M&A, stock purchase agreement, escrow agreement, risk mitigation.

Resumo: De acordo com o contrato de conta-vinculada ("escrow agreement"), no âmbito de uma operação de "merger and acquisition" (M&A), uma parcela do preço de aquisição ("escrow amount") deve ser depositada em uma conta bancária vinculada ("escrow account"). O valor depositado na escrow account deve ser utilizado para fins de pagamento de eventuais indenizações do comprador contra o vendedor no período posterior a conclusão de venda da companhia ("post-closing"), em virtude do descumprimento pelo vendedor de suas representações e garantias previstas no contrato de compra de ações ("SPA"). Nesse sentido, a celebração de um contrato de conta-vinculada é extremamente importante para mitigar os riscos do comprador no período post-closing de uma operação de M&A.

Cabe observar que os termos e condições de um contrato de conta-vinculada serão negociados de acordo com as circumstâncias de cada operação de M&A. Ou seja, não há uma fórmula padrão ("one size-fits-all formulae").

As principais questões referentes a negociação e elaboração de um contrato de conta-vinculada serão devidamente analisadas aqui com o objetivo de fornecer importantes diretrizes, tendo em vista a lacuna de artigos sobre o assunto.

Palavras-Chave: M&A, contrato de compra de ações, contrato de conta-vinculada, mitigação de riscos.

1. Introduction

This paper aims at providing an analysis of the main provisions of an escrow agreement in a private merger and acquisition

("M&A") transaction. The study hereto will be conducted taking into consideration a private share purchase deal. The rationale for this assumption relies on the fact that in a share purchase the buyer is exposed to a considerable amount of risk in comparison with an asset purchase[1].

The use of an escrow consideration as a contingent mechanism allows buyer to mitigate risks in the post-closing period by means of depositing a portion of the purchase price in a separate banking account, so that the escrow funds can be utilized for payment of potential liabilities of the target company[2].

Despite the fact that each M&A transaction has specific and unique circumstances, one can observe that there are some similar provisions in escrow agreements used by buyers for protecting themselves against risks in the post-closing period.

2. Purpose of an Escrow Agreement: a buyer's risk mitigation tool

An escrow agreement can be defined as the contractual arrangement established by the parties (buyer and seller) in a M&A transaction for allocating a portion of the purchase price in a separate banking account (the "escrow account") to be managed by an independent third party (the "escrow agent"), which is usually a financial

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1 See Patrick A. Gaughan in *Mergers, acquisitions, and corporate restructurings*. John Wiley & Sons, Inc. Fourth Edition. 2007. pp. 23-25. See also Bismark, Nilufer Von (Slaugther & May), *Corporate Acquisitions and Mergers*, Chapter on the UK, in Begg, Peter F.C., *Corporate Acquisitions*, Vol. 3, Kluwer Law Intenational, 2004, pp. 2-4.

2 Please note that the escrow agreements related to earn-out provisions in M&A transaction will not be analysed hereto. For a deep analysis on earn-out provisions, see *American Bar Association Annual Meeting 2004 Earnouts in Business Acquisitions: a practical solution or a trap for the unwary?* — Available at http://apps.americanbar.org/buslaw/newsletter/0029/ materials/pub/10.pdf

institution[3]. Typically, under an escrow contractual arrangement, the buyer is the holder of the escrow account and the seller is the beneficiary party[4]. Consequently, one can conclude that the escrow amount has the nature of a trust and cannot be secured by any creditor.[5]

Indeed, it should be highlighted that an escrow account shall be used as a first means of satisfaction of buyer's indemnification claims against seller for any breach or inaccuracy of its representations and warranties of the stock purchase agreement ("SPA")[6]. As a risk mitigation instrument[7], the escrow agreement aims at securing the buyer with the necessary funds for holding it harmless from any claims, liabilities, and damages in the post-closing period[8]. Thus, the escrow arrangement is an important risk management tool for the buyer, "*alleviating concerns about the seller's ongoing solvency and potential problems in locating the seller's assets for executing judgments*"[9].

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3 See Lou R. Kling & Eileen T. Nugent. *Negotiated Acquisitions of Companies, Subsidiaries and Divisions*. Law Journal Press. 2003, at § 15.06[3][d].

4 See Heminway, Joan MacLeod and McLemore, Timothy M. *Acquisition Escrows in Tennessee: An Annotated Model Tenessee Acquisition Escrow Agreement*. The Tennessee Journal of Business Law. 2006. Available at http://ssrn.com/abstract=1130472 (Accessed on April 3, 2011)

5 See Malak, Paul J. *Escrow Agreements in Business Acquisitions (with Model Agreement)*. The Practical Lawyer. American Law Institute-American Bar Association Committee on Continuing Professional Education. 2000. p. 2.

6 See DePamphilis, Donald M. *Mergers, acquisitions, and other restructuring activities*. Academic Press. 4th Edition. London. 2008. p. 206.

7 It is interesting to note that a M&A insurance policy is also available for the parties to mitigate the risks associated with potential litigation claims and contingencies during the post-closing period. See Warwaruk, Marshall. *Escrow Provisions in M&A Transactions*, Part 2. 2005, available at http://www.corumgroup.com/Escrow-Provisions-in-MA-Transactions-Part-2.aspx (Accessed on April 3, 2011). See also Abbe Dienstag, Howard Spilko and Stephanie Dinkes, *Escrow and Insurance Protections in Public Deals*, in *Mergers & Acquisitions*. New York Law Journal. 2004. NY.

8 See Brown, Robert L., JD. *The Concise Guide to Mergers, Acquisitions and Divestitures: business, legal, finance, accounting, tax, and process aspects*. Palgrave Macmillan. 1st Edition. NY. p. 33.

9 See Walton, Leigh and Kreb, Kevin D. *Purchase Price Adjustments, Earnouts and other Purchase Price Provisions*. 2005. p.7.

However, from a seller's perspective, there is some reluctance to have part of the purchase price deposited in an escrow account, considering that the "retention fund" implies fewer funds to be received by seller at the closing date[10]. For example, there is considerable evidence that private equity sellers tend to avoid the inclusion of an escrow provision in SPAs or they attempt to reduce the escrow period[11].

In addition, it should be clarified that the term of an escrow agreement corresponds to the "statute of limitations" included in the SPA, which provides the period in which the representations and warranties of seller shall remain in force[12]. It is a common practice that this term is fixed by the parties ranging from one to three years, as of the closing date. However, this will depend on each M&A transaction and normally this is a major issue to be negotiated between the parties, since buyer will attempt to increase the indemnification period, as opposite to seller[13]. From a buyer's perspective, it would be convenient to set up the escrow term as the equivalent period set forth in the target company's jurisdiction for filing administrative and judicial

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Available at http://apps.americanbar.org/buslaw/newsletter/0029/materials/pub/10.pdf (Accessed on April 9, 2011).

10 See Scott, Slorach, J. *Corporate Finance, Mergers and Acquisitions (Legal Practice Course Guides)*. Oxford University Press. 2004. p. 114.

11 See Chalmers, Bruce and Criscuolo, Paul. *Buyers in M&A must take into account indemnification issues when dealing with private equity*. 2008. http://www.icis.com/Articles/2007/10/22/9071351/buyers-in-m.html (Accessed on April 3, 2011).

12 See F. Egan, Byron, Vella, Patricia O. and West, Glenn D. *Contractual Limitations on Seller Liability in M&A Transactions*, in American Bar Association Section of Business Law. Spring Meeting Program: Creating Contractual Limitations on Seller Liability that Work Post-Closing: Avoiding Serious Pitfalls in Domestic and International Deals. 2010. pp. 20-23. Available at http://images.jw.com/com/publications/1362.pdf (Accessed on April 10, 2011).

13 See Duran, Stanley J. *Top Ten Indemnification Concerns in M&A transactions*. Association of Corporate Counsel. 2009. pp. 1-2. Available at http://www.acc.com/legalresources/publications/topten/top-ten-indemnification-concerns.cfm?makepdf=1 (Accessed on April 4, 2011).

claims by the competent authorities and third parties (the "prescriptive period")[14].

Furthermore, in public companies M&A deals one can argue that it is not likely that seller will agree to extend the validity of the representations and warranties clause for the post-closing period. The basic concept intrinsic to this is the fact that the majority shareholders of public companies usually do not want to be solely exposed to any risk of indemnification obligations after closing. Accordingly, it is not feasible to request public shareholders to abide an indemnification provision in the post-closing period. Consequently, the use of an escrow consideration is more common in private M&As[15].

In addition, the parties in an M&A deal should also foresee the existence of an escrow arrangement in the SPA, and as a result, sign an escrow agreement to regulate the terms and conditions applicable to administration and disposition of this contingent consideration. Therefore, the terms of an escrow agreement should be compatible with the provisions of the SPA, in order to avoid any conflict of interpretation[16]. For instance, it is certainly advisable that the governing law and dispute resolution mechanism in an escrow agreement should be carefully chosen by the parties according to the terms of the SPA. As a practical matter, there is a tendency for escrow agents to persuade the parties to choose the law of its state to govern poten-

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14 See Ketchum, Harold. A, Geould, Walter B., Kirkpatrick, Neil, Persbacker, Victor L. and Rodgers, Charles H., *Mergers and Acquisitions: planning and action.* Financial Executives Research Foundation. 4th Edition. NY. p. 112.

15 See BenDaniel, David J., Rosenbloom, Arthur H. and Hanks Jr., James J. *International M&A, Joint Ventures & Beyond. Doing the Deal.* John Wiley & Sons, Inc. Second Edition. New York. pp. 52-53. See also Abbe Dienstag, Howard Spilko and Stephanie Dinkes, *Escrow and Insurance Protections in Public Deals*, in *Mergers & Acquisitions.* New York Law Journal. November 8th, 2004. NY.

16 See Heminway, Joan MacLeod and McLemore, Timothy M. *Acquisition Escrows in Tennessee: An Annotated Model Tenessee Acquisition Escrow Agreement.* The Tennessee Journal of Business Law. 2006. Available at http://ssrn.com/abstract=1130472 (Accessed on April 3, 2011).

tial disputes involving the escrow agent.[17] In the following section, the main provisions of an escrow agreement will be discussed.

3. Main Provisions of an Escrow Agreement

3.1 Payment of Indemnity Claims and Release of Escrow Funds

It is of greatest importance to regulate under the escrow agreement the trigger events for payment of indemnity claims with the escrowed funds, as per the terms of the indemnification clause of the SPA[18]. The escrowed funds shall be released by the escrow agent for payment of indemnification claims brought by buyer or third parties under the terms of the escrow contract. For example, the parties can negotiate that the escrowed funds shall be disbursed only for payment of environmental or tax claims[19].

Please note that the materiality of the target company's contingencies typically varies according to its size (e.g small, medium or large company) and corporate activity. It is crucial for buyer to conduct a deep due diligence in order to evaluate the financial, accounting, commercial and legal situation of the target, so that buyer can have a true and clear picture of the target's current and potential liabilities. This process is very time consuming but it is a *sine qua non* condition for buyer to negotiate the representation and warranties and indemnification clauses of the SPA, and, therefore, to establish

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17 See Fox, Charles M. *Working with Contracts: What Law School Doesn't Teach You*. Practising Law Institute. Second Edition. 2002. p. 80.

18 See Howard L. Shecter, *Selected Risk Issues in Merger and Acquisition Transactions*, Miami Law Review. Vol. 51. 1996-1997. pp. 757-758.

19 See Duran, Stanley J. *Top Ten Indemnification Concerns in M&A transactions*. Association of Corporate Counsel. 2009. pp. 3. Available at http://www.acc.com/legalresources/publications/topten/top-ten-indemnification-concerns.cfm?makepdf=1 (Accessed on April 4, 2011).

the purchase price and the amount to be deposited in the escrow account[20]. There is considerable evidence that in a great number of M&A transactions, the escrow amount corresponds to approximately 10% of the purchase price[21]. Moreover, it is customary to find "baskets and deductibles" provisions in the indemnification provision of the SPA as a form of limitation of the buyer's indemnification rights. As per the basket clause, the parties can agree that claims in the post-closing period should reach a determined threshold so that buyer can be indemnified. For instance, the claims and loses should be greater than US$ 100,000 (one hundred thousand dollars) in order that buyer can file a claim notice requesting the escrow account funds. The deductible provision allows the buyer only to recover the excess amount over the basket. The main aim of this provision is to avoid disputes over insignificant amounts[22].

Additionally, it is fundamental to regulate in the escrow agreement the applicable procedure for dealing with payment of claims. It should be clear in the escrow document when the escrow agent has to release the funds[23]. Thus, the escrow agreement should provide

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20 See Healy, David W. *M&A Deals: Key Issues, Tips and Tactics*. 2005. Fenwick and West LLP. pp. 4-5. Available at http://macabacus.com/docs/fenwick_deals.pdf (accessed on April 11, 2011).

21 See American Bar Association Committee on Negotiated Acquisitions, Model Stock Purchase Agreement with Commentary. 1995. p. 206.

22 See F. Egan, Byron, Vella, Patricia O. and West, Glenn D. *Contractual Limitations on Seller Liability in M&A Transactions, in American Bar Association Section of Business Law. Spring Meeting Program: Creating Contractual Limitations on Seller Liability that Work Post-Closing: Avoiding Serious Pitfalls in Domestic and International Deals*. April 22, 2010. p. 46. Available at http://images.jw.com/com/publications/1362.pdf (accessed on April 10, 2011). See also Warwaruk, Marshall. *Escrow Provisions in M&A Transactions, Part 1*. 2005. Available at http://www.corumgroup.com/Escrow-Provisions-in-MA-Transactions-Part-1.aspx (accessed on April 6, 2011).

23 See Malak, Paul J. *Escrow Agreements in Business Acquisitions (with Model Agreement)*. The Practical Lawyer. American Law Institute-American Bar Association Committee on Continuing Professional Education. June, 2000. p. 2.

"comprehensive mechanics and guidelines for all possible situations which could arise during the life of the agreement"[24].

Please note that during the term of the escrow agreement, whenever buyer has a claim against seller for any breach of the representations and warranties, buyer has to send a notice to both seller and escrow agent. Seller can file an objection to buyer's claim within a certain period, as of the receipt of buyer's notice. In case seller disputes buyer's claim, the escrowed funds cannot be released by escrow agent until the resolution of the dispute. If seller does not object the claim, the escrow agent shall withdraw the necessary amount from the escrow funds for payment of buyer's claim[25].

With respect to third party claims against the target, it is worth mentioning that buyer can defend such a claim and be reimbursed from all the legal costs in connection thereto or the parties can agree that seller should conduct the defence. This provision should be duly reflected in the escrow agreement[26].

At the expiration of the escrow agreement, the escrow agent shall release to seller any remaining escrow amount, except for escrowed funds that might be object of a claim pending a court decision or an arbitral award[27].

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24 See Muchnyk, Illya. *Escrow Arrangements and Settlements in Cross-Border M&A Transactions Involving Ukraine*. DLA Piper. June 2010. p. 2. Available at http://executiveview.com/knowledge_centre.php?id=11831 (accessed on April 3, 2011).

25 See Malak, Paul J. *Escrow Agreements in Business Acquisitions (with Model Agreement)*. The Practical Lawyer. American Law Institute-American Bar Association Committee on Continuing Professional Education. June, 2000. pp. 2-3.

26 See Malak, Paul J. *Escrow Agreements in Business Acquisitions (with Model Agreement)*. The Practical Lawyer. American Law Institute-American Bar Association Committee on Continuing Professional Education. June, 2000. p. 2.

27 See Scott, Slorach, J. *Corporate Finance, Mergers and Acquisitions* (Legal Practice Course Guides). Oxford University Press. 2004. p. 114.

3.2 Investment and Taxation of Escrow Funds

It is worth mentioning that the funds deposited in an escrow account shall be invested by the escrow agent according to joint written instructions of buyer and seller. It should be emphasized that the parties have discretion to establish the term and nature of any permitted investment to be made with the escrow funds[28].

The escrow agreement should regulate the types of permitted investment, being a common practice that the escrowed funds be invested in liquid and safety instruments[29]. The parties can also mutually agree to authorize the escrow agent to effect further investments in addition to the permitted investments described in the escrow contract. This is a customary market practice that allows the parties to have flexibility for investing the escrow amount[30].

Furthermore, any interest or other income received on the investment and reinvestment of the escrow funds shall be credited to the escrow account and any losses incurred on such investment and reinvestment shall be debited against the escrow account, respectively. Additionally, the mechanics and procedures for distribution of ay income earned by the escrowed funds must be duly regulated in the escrow agreement. Considering that seller is typically the beneficiary of the escrow account, any interest or income might be disbursed to him. However, usually the income is retained in the escrow account for satisfying the payment of potential claims[31]. In this sense, in case

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28 See American Bar Association Committee on Negotiated Acquisitions, Model Stock Purchase Agreement with Commentary. 1995. pp. 303-304.

29 See American Bar Association Committee on Negotiated Acquisitions, Model Stock Purchase Agreement with Commentary.1995. p. 53.

30 See JP Morgan. Treasury Services. Escrow Services: Frequently Asked Questions. p. 1. Available at http://www.jpmorgan.com/.../BlobServer?...Escrow%20FAQ (accessed on April 3, 2011).

31 See Malak, Paul J. *Escrow Agreements in Business Acquisitions (with Model Agreement).* The Practical Lawyer. American Law Institute-American Bar Association Committee on Continuing Professional Education. June, 2000. p. 2.

there is a need to liquidate the permitted investments to obtain the necessary resources to make claim payments under the terms of the escrow agreement, the parties shall inform the escrow agent (by means of a written notice) which permitted investments shall be liquidated[32].

Moreover, the existence of an escrow amount will normally raise some tax issues, mainly for seller, considering that any capital gain should be taxed. However, the tax implications will depend on the governing law of the escrow agreement, as each jurisdiction has a different tax law[33]. For instance, there are a considerable number of precedents of the US Tax Court stating that the escrow funds do not represent an "immediate income recognition" for seller, and, as a consequence, seller is not obliged to pay any taxes on capital gain during the escrow period. It is relevant to note that this understanding is based on the fact that under an escrow contractual arrangement seller is not entitled to receive the principal of the funds which are allocated for any potential contingency during the escrow period. However, any escrow interest and income should by duly reported to the tax authorities by seller or buyer depending on the terms of the escrow agreement. An efficient alternative to deal with this issue and avoid a potential conflict between the parties regarding which one should bear the tax burden is to allocate the escrow income in tax-free investments[34].

3.3 The role and obligations of the Escrow Agent

The escrow agent should be a third independent party nomi-

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32 See American Bar Association Committee on Negotiated Acquisitions, Model Stock Purchase Agreement with Commentary. 1995. pp. 303-304.

33 See Yahya, Renad Haj and Trinh Chubbock, *Oil and Gas Mergers and Acquisitions: contingent consideration and bridging the value gap*, International Energy Law Review. 2011. p. 4.

34 See Koenig, James C. and Boise, Craig M. *Contingent Consideration: The Taxation of Earnouts and Escrows*, in Mergers and Acquisitions. The Monthly Tax Journal. Vol. 2. Number 3. July, 2001. pp. 12-16.

nated by the parties to hold and dispose of the escrowed funds until the termination of the escrow agreement. Accordingly, the escrow agent should remit to the parties statements on the escrow funds under a regular basis with a view to comply with its monitoring and reporting functions regarding the administration of the escrow account[35].

In this light, the escrow agent shall act with due diligence and care, strictly pursuant to the terms established in the escrow contract. In fact, the escrow agent cannot be held responsible for any type of financial, tax or business consulting, considering that it has a mere custodian function[36]. It follows that the escrow agent will not agree to be exposed to any risks related to the management of the escrow account. Based on this fact, it is customary that the escrow agent will require the parties to include a clear and detailed indemnity clause in the escrow agreement, by means of which it can be held harmless and indemnified from and against any loss, liability, damage or expense by virtue of the performance of the escrow contract. The only exception in which the escrow agent should be held liable is whenever it acts with gross negligence or wilful misconduct[37].

Typically, the parties share the payment of the escrow agent's fees, but this decision will be object to negotiation[38]. A study conducted by J.P. Morgan indicates that in the vast majority of M&A deals escrow agent's fees have been shared between sellers and buyers[39].

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35 See Mahaffy, A. Paul, "Deal killers and deal savers: Escrow agents, M&A insurance and other ways to help close problem asset and share purchases" 2000. p. 5. http://www.bbburn.com/pmart9.htm (Accessed on April 3, 2011).

36 See "Citigroup Agency and Trust — Escrow Agent Services" pp. 4-6. http://www.citigroup.com/transactionservices/home/securities_svcs/agency/mas.jsp (accessed on April 19, 2011).

37 See Lou R. Kling & Eileen T. Nugent. "Negotiated Acquisitions of Companies, Subsidiaries and Divisions". Law Journal Press. 2003, at § 15.06[3][d].

38 See American Bar Association Committee on Negotiated Agreements, Model Asset Purchase Agreement with Commentary: Exhibits, Ancillary Documents and Appendices 51. 2001. p. 56.

39 See "J.P. Morgan Issues 2010 M&A Holdback Escrow Report". http://www.jpmor-

The parties should include a clear provision in the escrow agreement regulating the payment of the agent's fees.

Moreover, the resignation and substitution rules of the escrow agent need to be regulated in the escrow contract. Usually, a written and prior resignation notice should be remitted by the escrow agent to the parties. In the event they cannot appoint a substitute escrow agent, the resigning escrow agent is entitled to deposit the escrowed funds into a competent court[40].

Finally, it is essential that the parties cooperate with the escrow agent and provide it with all the necessary information and documents in order that it can fulfil its duties and responsibilities.

4. Execution of ancillary documents

It seems beyond doubt that the most important document of an M&A transaction is the SPA, considering that it provides all terms and conditions of the deal, including the execution of the escrow agreement[41]. In fact, the execution of an escrow agreement normally constitutes a condition precedent for closing[42]. As it has already been discussed hereto, the terms of the escrow agreement should be compatible with the SPA. Indeed, the escrow agreement can be deemed as an instrumental document to the SPA and, thus, it should be drafted taking into account the SPA provisions. For instance, the payment

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gan.com/tss/General/J_P_Morgan_Issues_2010_M_and_A_Holdback_Escrow_/1284071199297 (accessed on April 1st, 2011).

40 See American Bar Association Committee on Negotiated Acquisitions, Model Stock Purchase Agreement with Commentary.1995. p. 56.

41 See Scott, Slorach, J. *Corporate Finance, Mergers and Acquisitions* (Legal Practice Course Guides). Oxford University Press. 2004. pp. 111-114.

42 See Heminway, Joan MacLeod and McLemore, Timothy M. *Acquisition Escrows in Tennessee: An Annotated Model Tenessee Acquisition Escrow Agreement.* Available at http://ssrn.com/abstract=1130472 (accessed on April 3, 2011).

of claims clause of the escrow agreement shall be constructed according to the terms of the indemnification and representations and warranties clauses of the SPA. Please refer to item 3.1.

Furthermore, the execution of the following ancillary documents is relevant with respect to an escrow agreement: (i) disclosure letter; (ii) certificate attesting the validity and accuracy of representations and warranties; and (iii) legal opinions[43].

The disclosure letter is a document provided by seller outlining the disclosed contingencies and liabilities during the due diligence of the target. This is a crucial instrument, considering that any undisclosed liability shall be indemnified by seller during the post-closing period with the use of the escrowed funds[44]. In this context, it is likely that seller will try not being responsible for disclosed contingencies or will attempt to limit its liability[45].

Taking into account that the validity and accuracy of the representations and warranties is a condition precedent for closing, both buyer and seller shall provide at the closing date certificates attesting that these statements are still true ("bring-down certificates"). In case there is any change to the representations and warranties, the parties' officers have to deliver updated certificates attesting the current status of the statements. Bear in mind that such documents are extremely important in order to avoid any conflict between the parties that might arise from false representations and warranties, and, therefore,

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43 See BenDaniel, David J., Rosebloom, Arthur H. and Hanks Jr., James J. *International M&A, Joint Ventures & Beyond — Doing the Deal*. John Wily & Sons, Inc. Second Edition. New York. pp. 66-67.

44 See Howson, Peter. *Due Diligence — The Critical Stage in Mergers and Acquisitions*. Gower. 2003. pp. 71-74.

45 See Picot, Gerhard. *The Implementation of Mergers and Acquisitions under Business Law Aspects: the Formation of the Transaction Agreement*, in Handbook of International Mergers and Acquisitions: preparation, implementation and integration. Palgrave Macmillan. 2002. NY. p. 65.

jeopardise the deal[46]. It is relevant to emphasise that the escrow funds shall be used to pay indemnity claims, by virtue of a breach in seller's representations and warranties. However, as already discussed hereto, the escrow amount usually corresponds to only 10% of the purchase price[47]. Thus, it is essential that buyer be provided with true, valid and accurate statements of seller.

Finally, the execution of legal opinions by parties' solicitors is of greatest importance in the closing. These opinions provide both parties with assurance that the SPA and ancillary documents, such as the escrow agreement, are valid, binding and enforceable according to a specific jurisdiction. For example, if the target is a foreign company, it is crucial that buyer confirms with a local solicitor that the terms of the escrow agreement are enforceable in the target's jurisdiction and remedies are available in case of breach[48].

5. Conclusion

It can be concluded that the execution of an escrow agreement is of greatest relevance in an M&A deal to reduce buyer's risks associated with a breach of seller's representations and warranties in the post-closing term.

Indeed, the allocation of part of the purchase price in the escrow account provides buyer with considerable comfort in case seller

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46 See Brown, Robert L., JD. *The Concise Guide to Mergers, Acquisitions and Divestitures: business, legal, finance, accounting, tax, and process aspects*. Palgrave Macmillan. 1st Edition. NY. p. 199.

47 See American Bar Association Committee on Negotiated Acquisitions, Model Stock Purchase Agreement with Commentary. 1995. p. 206.

48 See American Bar Association, Business Law Section, Committee on Legal Opinions, *Third Party Legal Opinion Report including the Legal Opinion Accord*, 47 Bus. Law No. 1. 1991. See also Fuld, James J. *Foreign Legal Opinions in American Business Transactions*. International Business Lawyer 1975. Vol. 3.

does not have enough funds to pay indemnification claims in the post-closing phase. From a buyer's perspective, it is advisable to negotiate a long escrow term, which should be equivalent to the prescriptive period set forth in the target's jurisdiction for filling of actions by competent authorities and third parties.

Finally, there is no one size-fits-all formulae to reach a decision on the exact terms of the escrow contract and, therefore, the circumstances of each transaction will lead to the negotiation of the escrow provisions. Hence, it can be held that clauses regarding escrow amount, permitted investments, payment of claims and release of funds vary according to each M&A deal.