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Edition

SMB Law Group

Created by
SMB Law Group

Built for
**Searchers,
Independent
sponsors, and
Holdco buyers.**

What Happens When **Something Goes Wrong** After You Buy

A buyer's guide to indemnification
in small business acquisitions

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How to Use This Guide

The Deal We Will Use Throughout

PART ONE - The Foundation

1. What Indemnification Actually Is
2. Why You Cannot Just Unwind the Deal
3. The Five Questions Every Indemnification Section Answers

PART TWO - The Five Questions

4. Survival: How Long the Promises Last
5. Scope: What the Seller Is Actually on the Hook For
6. Procedures: What You Actually Do When You Have a Claim
7. Limitations: Mini-Baskets, Baskets, and Caps
8. What Counts as a Loss

PART THREE - Where Buyers Actually Get Hurt

9. Fraud: The Exception, and Its Limits
10. What Gets Special Treatment, and Why
11. Asset Deal vs. Stock Deal: Why Structure Changes Your Exposure
12. Sandbagging: What Silence Means When You Knew
13. Known Problems and Line Item Indemnities

PART FOUR - Actually Getting Paid

14. Escrow, Holdbacks, and Set-off
15. If Your Deal Is SBA Financed, Read This Twice
16. Who You Are Actually Suing
17. Reps and Warranty Insurance: When It Changes the Whole Section

PART FIVE - Tools

18. The Negotiation Cheat Sheet
19. Red Flags in a Seller's First Draft
20. Your Post-Closing Runbook
21. Glossary

The Bottom Line

About SMB Law Group

Important Notices

How to Use This Guide

Most legal guides explain concepts. This one is built to be used while you are actually negotiating, so it is organized around what you will be doing.

If you are reading this before you have an LOI

Read Parts 1 and 2. You will finish knowing more about indemnification than most first-time buyers know at closing, and you will negotiate the LOI better for it.

If you have a draft purchase agreement in front of you right now

Go straight to Section 18, the Negotiation Cheat Sheet, and Section 19, Red Flags in a Seller's Draft. Then come back and read the sections behind whichever items you flagged.

If you have already closed

Section 20 is the post-closing runbook. Do it this week. The single most common way a good indemnification claim dies is that nobody calendared the survival date.

One running example

Every concept in this guide is worked through the same deal, a \$3.2 million pest control acquisition in Tampa. The numbers are made up. The structure is not. It is what a normal SBA-financed searcher deal looks like, and running one example the whole way through is the only honest way to show how these provisions interact. They do interact. That is the part nobody explains.

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The Deal We Will Use Throughout

Meet the deal. Everything in this guide gets worked through these numbers.

THE DEAL

Coastal Pest & Termite, LLC • Tampa, Florida • residential and commercial pest control • 14 employees • \$1.1M EBITDA

Buyer is a first-time searcher acquiring through a newly formed Florida LLC. Two individual sellers own the target through a single-member holding entity.

Structure and financing

Indemnification terms as negotiated

Component	Amount	Amount
Purchase price	\$3,200,000	Asset purchase, roughly 2.9x EBITDA
SBA 7(a) loan	\$2,680,000	10-year term
Seller Note A	\$160,000	Full standby for the life of the SBA loan. Counts toward the equity injection.
Seller Note B	\$200,000	5-year amortizing, roughly \$3,800 per month. Does not count toward the equity injection.
Buyer cash	\$160,000	Genuine, non-borrowed equity

Term	Standard reps	Fundamental reps, taxes, environmental
Survival	18 months	Applicable statute of limitations
Cap	\$320,000 (10% of price)	\$3,200,000 (100% of price)
De minimis per claim	\$32,000 (1%), tipping	None. First dollar.
Escrow	\$2,500	None
Set-off	\$200,000 (6.25%), released at 18 months	Same escrow, then direct recourse
Set-off	Against Seller Note B only, with lender consent	Same

Equity injection check: 10% of \$3,200,000 is \$320,000, satisfied with \$160,000 of buyer cash plus a \$160,000 full-standby seller note. A seller note can cover at most half of the required injection, which is why Note A is \$160,000 and not more.

What Indemnification Actually Is

When you buy a business, you get the keys. The seller gets the money. But that trade only works because the seller is also handing you a set of promises about the business: how it is run, what it owns, what it owes. Those promises are called representations and warranties, or reps and warranties.

If those promises turn out to be false, you need a way to do something about it. That is indemnification.

Think of it like a warranty on a car. The warranty tells you what is covered. Indemnification is what happens after: where you take the car, who pays, what the process looks like. The reps and warranties are the promise. Indemnification is the machinery that enforces it.

DEFINITIONS

Reps and warranties. Statements the seller makes about the state of the business, which the buyer relies on in deciding the deal is worth doing.

Indemnification. The contractual obligation to make you whole when one of those statements turns out to be false, plus the rules for how, how much, how long, and out of what money.

Here is the thing to hold onto. Nearly everything a buyer thinks of as “protection” in a purchase agreement lives in two places: the reps, which define what you were promised, and the indemnification section, which defines what that promise is actually worth. A beautiful set of reps with a broken indemnification section is a beautiful set of reps you cannot enforce.



Why You Cannot Just Unwind the Deal

Buyers ask this constantly, usually about four months after closing: can I just give it back? As a practical matter, no. The legal remedy that unwinds a closed deal is called rescission, and it is extraordinary relief that courts grant sparingly, generally in cases of clear fraud. It is not a remedy you plan around.

More to the point, your own purchase agreement almost certainly took it off the table. Nearly every purchase agreement contains an exclusive remedy provision saying that after closing, indemnification is your sole and exclusive remedy for breaches of the agreement, usually with a carve-out for fraud and sometimes for specific performance of covenants.

WHY THIS MATTERS

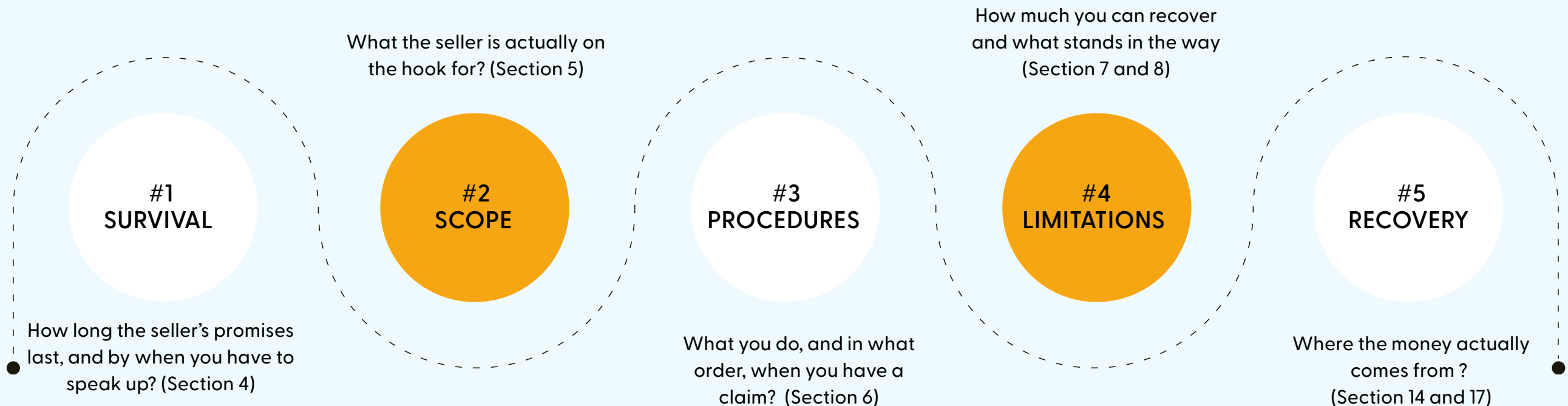
Once you close, the indemnification section is your recovery. There is no second door. Every hour you spend on it before signing is worth ten hours of arguing about it afterward.

This is also why the indemnification section deserves your attention at the same moment you are exhausted and just want to close. The provisions that matter most get negotiated last, at the point of maximum fatigue. That is not an accident.



The Five Questions Every Indemnification Section Answers

Strip away the drafting and every indemnification section is answering five questions. The rest of this guide walks through them in order.



If you can answer all five about your own agreement without opening it, you understand your deal. Most buyers cannot answer three.

Survival: How Long the Promises Last

Reps do not last forever. The survival provision sets the deadline by which you have to bring a claim, and reps fall into three buckets.

Bucket one: standard reps

Things like no pending litigation, employees are properly classified, the equipment works, the financials are accurate. These typically survive 12 to 18 months after closing. The logic is that if something is wrong with a standard rep, running the business for a year will surface it. There is a better way to argue for the number than “longer is better.” Ask for a survival period that runs through at least one complete financial statement audit cycle after closing. That is the moment a buyer is most likely to discover an accounting or tax problem from the pre-closing period, and it is a reason a seller can accept without feeling gouged.

Bucket two: Fundamental reps

A short list of things so basic that the whole deal depended on them being true. Ownership is the classic example: if the seller does not actually own the business, nothing else matters. Typical fundamental reps are due organization and authority, title to the equity or assets, no conflicts, and brokers. These survive far longer, commonly for a set number of years, for the applicable statute of limitations, or for the statute of limitations plus 60 days. Indefinite survival gets asked for and occasionally granted, but it is rare, and in some states it may not be enforceable. More on that next.

The list of reps that get this treatment is worth knowing, because it is where the negotiation happens. Almost always: due organization, due authority, capitalization or ownership of the equity, title to the assets, brokers, and taxes. Often, but you have to ask: no conflicts, employee benefits and ERISA, related party transactions, sufficiency of assets, subsidiaries, environmental, and intellectual property. Every rep you move from the first list to the second is worth real money at month nineteen.

Bucket three: the specials

Taxes and environmental usually get their own treatment, surviving for the statute of limitations applicable to that specific issue. That varies by federal and state law and by tax type, so it is not a single fixed number. Sometimes employee benefits and compliance with law join this bucket.

RED FLAG: A seller draft that puts all reps, fundamental ones included, on a flat 12-month survival. That is not a market term dressed up as one. It is a request that you stop being able to sue over whether they owned the business, one year after you paid for it.

Whether your survival clause does what everyone assumes it does

Here is a wrinkle almost nobody explains, and it cuts in both directions depending on which side you are on.

A survival period is a private agreement about when a claim can be brought, and state law does not always let private parties move that line. Some states treat a long or indefinite survival period as an impermissible contractual extension of the statute of limitations and will not enforce the part that runs past it. That is a buyer problem: the six-year fundamental rep survival you negotiated may be worth three years.

Other states run the opposite way. In California and New York, courts have held that saying reps “survive for 18 months” limits only the window in which a breach can occur, not the window in which a buyer can sue. Without clear language limiting the time to bring a claim, a buyer may have the full contract statute of limitations. That is a seller problem, and it is why well-drafted agreements say expressly that no claim may be brought after the survival date.

Two practical consequences. First, read your survival clause and your governing law clause together, because they are one provision pretending to be two. Second, if you want a genuinely long window, the governing law choice is a lever: New York carries a six-year contract statute of limitations and Illinois carries ten, while Delaware runs three but permits a written contract involving at least \$100,000 to specify its own period, up to twenty years from accrual.

RED FLAG: A governing law clause chosen because somebody had a form, in an agreement whose survival periods depend on it. Venue and governing law usually get decided in the last hour by whoever is less tired. It is one of the few last-hour decisions that changes what your reps are worth.



The mechanical point that costs buyers real money

Survival periods are claim deadlines, not damage deadlines. If you deliver a proper claim notice before the period expires, the claim generally stays alive until it is resolved, even if resolving it takes another two years. Miss the date by a week and a real claim is worth zero.

Check your agreement for the exact language. You want something along the lines of: any claim for which notice is given prior to expiration survives until finally resolved. If it is not there, ask for it. It costs the seller nothing to give and it is the difference between a claim and a memory.

Take the notice requirements seriously as written. Delaware courts have held that where an agreement clearly says the buyer has no right to recover unless it complies with the notice provisions, that compliance is a condition precedent and failing it can forfeit the claim entirely. Not reduce it. Forfeit it. And if your escrow agreement carries its own notice requirements, assume you have to satisfy both documents, because the agreements are read together.

RUN THE NUMBERS

Coastal Pest, closing on March 15. Standard reps survive 18 months, so the deadline is September 15 of the following year. On August 28, six weeks before expiry, the buyer's bookkeeper finds a \$60,000 problem in pre-closing payroll tax filings but the investigation will take months.

Right move. Deliver the claim notice now, describing the issue and a good faith estimate, and let the investigation continue. The claim is preserved.

Wrong move. Wait until you can quantify it precisely. On September 16 the claim is worth nothing, no matter how right you were.



What to ask for

Term	Ask for	You will likely get	Walk-away
Standard reps	24 months, or through one full audit cycle	12 to 18 months	Under 12 months
Fundamental reps	Statute of limitations plus 60 days	A set number of years, or the SOL	Same as standard reps
Which reps are fundamental	The long list, including environmental, benefits, and IP	The short list plus one or two	Ownership and authority only
Taxes	Statute of limitations plus 60 days	Statute of limitations	Under 3 years
Environmental	Statute of limitations	3 to 5 years, or SOL	Same as standard reps
Notice tolls expiry	Express language	Express language	No tolling language at all

These ranges reflect what we see in lower middle market deals. Your leverage, your competition for the deal, and how badly the seller wants out will move them.

Scope: What the Seller Is Actually on the Hook For

Survival tells you how long. Scope tells you for what. It is the shortest section in most agreements and the easiest to skim past, which is why things go missing from it.

At a minimum, the seller should be indemnifying you for:

- Breaches of the representations and warranties.
- Breaches of the covenants, which are the promises about what each side does before and after closing. Non-competes live here. So does the obligation to cooperate on the transition.
- All taxes attributable to pre-closing periods, including the pre-closing portion of any period that straddles the closing date.
- In an asset deal, any liability you did not expressly agree to assume, called the excluded liabilities or retained liabilities.
- Unpaid transaction expenses and any company indebtedness that was not paid at closing or accounted for in the purchase price.
- Fraud, intentional misrepresentation, and willful misconduct, listed as their own indemnified matters rather than left to the carve-outs elsewhere.
- If you are buying equity from more than one owner, any inaccuracy in the schedule allocating the purchase price among them, and any claim by one of them about what they were owed. You do not want to be the venue for a dispute among the sellers.
- Anything on the deal-specific list, meaning the known problems diligence turned up. See Section 13.

RED FLAG: Scope that covers breaches of reps but says nothing about covenants or excluded liabilities. Now the non-compete has no teeth and the liability the seller expressly kept is your problem to litigate about.

The other half of scope: who gets to claim

Scope is usually read as a question about what is covered. It is equally a question about who is covered, and buyers lose here quietly.

Under ordinary contract law only the parties to an agreement can enforce it. So the definition of Indemnified Parties needs to be wide enough to cover everyone who might actually need to bring a claim: you, your affiliates, the acquired company itself after closing, and the directors, officers, employees, and representatives of each. If your acquisition entity is not the same entity that signed the purchase agreement, check that too.

Then check the boilerplate against it. Nearly every purchase agreement contains a no third party beneficiary clause saying non-parties cannot enforce the agreement. If your indemnified parties include people who did not sign, the third party beneficiary section needs an express exception for them. Two provisions, ninety pages apart, that have to agree with each other.

RED FLAG: A broad Indemnified Parties definition sitting in an agreement whose third party beneficiary clause has no carve-out for it. This is a drafting mismatch, not a negotiating position, and it usually gets fixed on request.

One drafting note worth understanding. Scope in most agreements is written as a list, and lists are exhaustive. If it is not on the list, it is not indemnified. That cuts both ways and it is why the deal-specific items matter so much: a general rep about “compliance with law” is a much weaker instrument than a named indemnity for the specific compliance problem you already found.

Procedures: What You Actually Do When You Have a Claim

This is the part of the indemnification section that almost no buyer reads closely until the day they need it, which is exactly the wrong day to read it for the first time.

THE CLAIM RUNBOOK
1. Confirm the survival period has not expired. Do this first, always, before anything else.
2. Identify the specific rep, covenant, or indemnity the facts breach. "The seller was dishonest" is not a claim. "Section 3.14(b) said all employees were properly classified" is.
3. Deliver written notice in the exact manner the notice provision requires. Certified mail, email to a named person, copy to their counsel: do it the way the agreement says, not the convenient way.
4. Include what the agreement requires the notice to include. Usually a description of the claim, the provision breached, and a good faith estimate of losses. A deficient notice is a live way to lose a real claim.
5. Preserve the evidence. Documents, communications, the diligence file, the disclosure schedules as delivered.
6. Watch the response window. The seller usually gets a set number of days to accept, dispute, or stay silent, and silence sometimes counts as acceptance.
7. If a third party is suing you, follow the third party claim procedure precisely. This is where control of the defense gets decided.



Third party claims: who runs the defense

When the claim comes from outside, a customer, a regulator, a former employee, the agreement usually lets the seller take over the defense at their expense, because they are the one paying. That is reasonable in principle and dangerous in practice, because the seller no longer owns the business and does not care about your customer relationships or your reputation in a small market.

Negotiate for the right to keep or take back control when the claim seeks injunctive or equitable relief, involves criminal allegations, comes from a customer or supplier you need, would produce losses above the cap so the seller is spending your money rather than theirs, or where the seller simply is not defending diligently. If you have leverage, add one more: the seller has to acknowledge in writing that the claim is indemnifiable before it gets to take over the defense. Otherwise the seller runs your lawsuit for a year and then argues it never owed you anything.

On settlement, the standard formulation is that the seller cannot settle without your written consent unless the settlement is money only, creates no ongoing obligation or restriction on you, and unconditionally releases you from the whole claim. All three conditions, not one of them. And if you are the one controlling the defense, expect a mirror provision requiring the seller's consent, not to be unreasonably withheld.

Conditions you have to satisfy first: Some agreements require you to pursue insurance before going after the seller, and most require you to mitigate. Both are reasonable in principle. Watch the mitigation duty in one specific scenario: if you had to pay a third party and the seller later argues you failed to mitigate, you can end up recovering less than you actually paid out. Push for the mitigation standard to be commercially reasonable efforts and for it not to require you to spend your own money or start litigation.

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A PRACTICAL NOTE: Following the procedure does not guarantee a payout. Before you bring a claim, weigh recovery against the cost of fighting for it, and against the relationship. If the seller is carrying a note, still consulting, or still known to your customers, a \$30,000 claim can cost more than \$30,000 in ways that never show up on an invoice.

Limitations: Mini-Baskets, Baskets, and Caps

Even when a seller clearly breached a rep, your recovery is not unlimited. Three mechanisms narrow it, and they stack. Buyers usually know about two of them.

Mechanism	What it does	Where buyers get hurt
Mini-basket, or de minimis	A per-claim minimum. A loss below it does not count at all, and does not even count toward the basket.	Set high, it silently deletes the majority of real-world claims.
Basket	An aggregate floor. Until your qualifying losses add up past it, you recover nothing.	Whether it is a deductible or a tipping basket changes recovery by the full amount of the threshold.
Cap	A ceiling on total recovery.	The cap is not the same thing as the money available to pay it, and is often set equal to the escrow.

The mini-basket: the one nobody negotiates : A per-claim minimum goes by two names. Your agreement may call it a de minimis threshold or a mini-basket, and they mean the same thing: below that number, the loss is simply ignored. It is usually one clause, often a single number, and it is the least negotiated term in the entire section.

The seller’s stated reason for wanting one is fair enough. Without it, a buyer can go hunting for every trivial breach and stack them up to reach the basket. The question is never whether to have one. It is what the number is.

It should not be. A de minimis works like a filter placed in front of the basket, and small claims are how most breaches actually show up. Set the number wrong and you can have a year of legitimate problems and recover nothing.



Run the numbers

The death by a thousand cuts problem. In the first year after closing, Coastal Pest hits nine separate small breaches: a mislabeled chemical inventory, two unrecorded customer credits, a missing equipment title, and so on. They average \$2,100 each, \$18,900 in total.

With the \$2,500 de minimis in our deal: none of the nine claims qualifies. None of them counts toward the \$32,000 basket either. Total recovery: \$0.

With no de minimis: all \$18,900 counts toward the basket. Still under \$32,000, so still no recovery, but the buyer is now \$18,900 into the basket. One more \$15,000 problem tips it and the buyer recovers \$33,900 from dollar one.

THE LESSON: De minimis and basket are one system, not two clauses. Negotiate them together or you will win one and lose the other.

Baskets: deductible or tipping

A basket sets an aggregate floor. Below it, small losses are on you. Think of it like an insurance deductible: minor issues are not worth the machinery of a formal claim, and the seller should not be answering for every rounding error in a business you now run.

Baskets come in three forms, and the difference is worth real money.

- **True deductible**, sometimes called an excess liability basket. You absorb losses up to the threshold. Above it, you are reimbursed only for the amount over the threshold.
- **Tipping basket**, sometimes called a threshold or dollar-one basket. Once you hit the number, the seller owes you back to dollar one, not just the amount above it.
- **The hybrid**. Once you clear the threshold, you recover back to some number below the threshold but above zero. It splits the difference and it is a useful place to land when the seller will not give you a true tipping basket.

Be honest with yourself about the starting point. Deductibles are the more common structure and the one a seller's draft will show up with. A tipping basket is something you ask for and trade for, not something you are entitled to. If you cannot get it, the hybrid is the trade worth proposing.

One more scoping point. Baskets and mini-baskets normally apply only to breaches of reps and warranties. Covenants, fraud, and the specifically negotiated indemnities should be recoverable from the first dollar, and fundamental reps are usually carved out too. If the basket in your draft applies to everything, that is not a number problem, it is a scope problem, and it is a cleaner fight to win.



Run the numbers

Month four. A Department of Labor audit finds six technicians were misclassified as independent contractors before closing. Back wages, overtime, employer payroll taxes and penalties come to \$47,000.

Walk it through the stack, in order:

- Survival: month four of an 18-month period. Alive.
- De minimis: one claim of \$47,000, well over \$2,500. It qualifies.
- Basket: \$47,000 clears the \$32,000 threshold. Because it is a tipping basket, recovery goes back to dollar one.
- Cap: \$47,000 is far under the \$320,000 standard rep cap. No haircut.
- Source: the escrow holds \$200,000. Paid from escrow.

RECOVERY: \$47,000. Change one term and it changes: with a true deductible instead of a tipping basket, recovery is \$15,000. With a \$50,000 de minimis, recovery is \$0. Same facts, same breach, same seller. Three different outcomes, all decided months earlier by clauses nobody argued about.

Caps: the ceiling

Caps work the other direction. They set a ceiling on total recovery, even if your claims add up to more.

Why would a buyer agree to a limit at all? Two reasons, and neither of them is that caps are fair. Sellers want certainty about their maximum exposure after closing, and they usually have enough leverage to get it. Market practice has settled around caps, so the live negotiation is over the number, not whether there is one.

Caps are not one size fits all within a single deal. Standard reps carry a lower cap, commonly 10% to 20% of the purchase price in deals this size. Fundamental reps, taxes, environmental, and fraud are commonly carved out of the cap entirely or given a much higher one, often the full purchase price. If a specific category worries you after diligence, ask for it to be excluded from the cap or given its own higher number rather than accepting the general cap and hoping.

Know which one you have : A cap tells you the ceiling. It does not tell you where the money comes from, and the two are frequently the same number without anyone saying so.

When a deal has an indemnification escrow, the cap is often set equal to the escrow amount. That is a normal structure, not an aggressive one. What matters is the next question: is the escrow your sole source of recovery for those claims, or is it just the first place you look before you can go after the sellers directly? Sellers ask for the first. Buyers should give it only for standard reps, if at all, and never for taxes, fundamental reps, or fraud.

In our deal the standard rep cap is \$320,000 and the escrow is \$200,000. If the agreement makes escrow the exclusive remedy for standard reps, the \$320,000 was never real. Read the cap and the recovery provisions together, every time. If they disagree, the recovery provision wins.



What to ask for

Term	Ask for	You will likely get	Walk-away
Mini-basket	None, or under 0.05% of price	0.05% to 0.1% of price	Over 0.25% of price
Basket type	Tipping	Deductible, or a hybrid if you push	Deductible with a large threshold
Basket size	0.5% of price	0.5% to 1% of price	Over 1.5% of price
Basket and mini-basket scope	Reps only	Reps only	Applies to covenants and negotiated indemnities
Standard rep cap	20% of price	10% to 15% of price, often equal to escrow	Under 10%
Fundamental, tax, fraud cap	Carved out, or 100% of price	100% of price	Anything under 100%
Escrow as sole recourse	No	Standard reps only, if at all	Sole recourse for everything

What Counts as a Loss

Caps and baskets get all the attention. The definition of “Losses” quietly does just as much work, and it sits forty pages away in the definitions section where nobody reads it.

Most agreements start from actual out-of-pocket damages plus attorneys’ fees, and then fight over the rest: incidental damages, consequential and indirect damages including lost profits, diminution in value, damages based on a multiple, and punitive damages. Punitive damages, where recoverable at all, are usually limited to amounts actually awarded against you in a third party claim, which is sensible.

The one to watch is any exclusion of damages calculated as a multiple of earnings or as diminution in value. That single exclusion can matter more than the cap.

RUN THE NUMBERS

The multiple problem. The seller repped that the top ten customer contracts were assignable. The largest commercial account, an apartment management company worth \$95,000 a year in EBITDA, turns out to have an anti-assignment clause. The customer uses it to leave three months after closing.

The buyer paid roughly 2.9x EBITDA. What is that breach worth?

Direct damages only: roughly \$95,000, one year of lost earnings, and the seller will argue for less.

Multiple-based measure: roughly \$275,000, because the buyer paid 2.9x for earnings that were never there.

The difference is \$180,000 on a single breach, decided entirely by whether the definition of Losses excludes multiple-of-earnings damages. The standard rep cap in this deal is \$320,000. The definition of Losses just moved more money than the cap did.



Do not settle for silence on the multiple

Buyers often treat a Losses definition that says nothing about multiples as a win, on the theory that silence leaves the argument open. It does leave it open, and that is the problem. Delaware courts have worked through exactly this fight, and what silence buys you is an expensive dispute with an uncertain outcome at the worst possible moment.

The better ask is express language: losses may be calculated using a multiple, and here is the multiple, stated as the one implied by the purchase price. A seller who will not give you that will often give you something narrower, such as a multiple available only for breaches of specified reps, or only where the breach causes a recurring reduction in earnings. Any of those beats silence, because all of them beat litigating about it later.

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The materiality scrape

Many reps are qualified by materiality: “there are no material undisclosed liabilities,” “the company is in compliance in all material respects.” A materiality scrape reads those qualifiers out of the reps when you are calculating losses, and sometimes when you are deciding whether a breach occurred at all.

Without a scrape, a seller can argue that a \$40,000 problem is not material, so there was no breach, so there is nothing to indemnify, and you never even reach the basket. That is the double materiality problem, and it is the argument to make at the table: the basket already is a materiality test, expressed in dollars and agreed by both sides. Applying materiality qualifiers on top of it makes you clear the same hurdle twice.

Scrapes come in two sizes and the vocabulary matters when you are negotiating. A double materiality scrape reads the qualifiers out both for deciding whether a breach happened and for calculating losses. A single scrape reads them out only for calculating losses, which leaves the seller free to argue there was never a breach at all. Ask for the double. If you get the single, understand what you gave up.

Expect the seller to carve specific reps out of the scrape, and expect some of it to be reasonable. A no material adverse effect rep and a full disclosure rep lose their meaning entirely if you delete the word material, so those carve-outs are usually fine. A carve-out for the material contracts rep is a real concession. And reps already carved out of the basket do not need the scrape, because they were never subject to double materiality in the first place.

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Fraud: The Exception, and Its Limits

Every rule about caps has an exception. If a seller commits fraud, meaning they knew a representation was false and told you anyway, the cap typically does not apply and there is no dollar ceiling on what you can recover.

That is different from an honest mistake. If a seller genuinely believed a rep was accurate and it turns out to be wrong, that is an ordinary breach, subject to every limitation in Section 7. But if a seller knowingly misrepresented something to get the deal done, that is fraud, and it opens the door to full recovery.

This distinction is also why sellers and their counsel take disclosure seriously. The protection of a cap disappears the moment fraud is in play, and a seller who is well advised would much rather disclose a problem and negotiate over it than hide it and lose every limitation in the agreement.

Two cautions before you treat this as a safety net

The carve-out is only as good as its definition. Many agreements define “Fraud” narrowly: knowing misstatements of the express representations in the agreement, and nothing else. Pair that with a non-reliance provision, which says you did not rely on anything outside the four corners of the document, and every claim built on what the seller told you in a meeting is gone. Read the definition before you rely on it.

Fraud means proving the seller knew. That is a high bar, a different case from a breach claim, and an expensive fight. You are proving a state of mind, usually from documents you do not have. Treat the fraud exception as a backstop, not a plan.



Why sellers care about the definition too

It is worth knowing why the other side fights over this, because it explains what you can trade. A fraud carve-out with no definition is dangerous to a seller in a way that has nothing to do with lying. Some states recognize reckless fraud, meaning a rep made without knowing whether it was true. Under a broad, undefined carve-out, a claim that everyone assumed was an ordinary capped breach can be recast as a tort claim outside every limitation in the agreement.

So the seller wants a definition and you want a broad carve-out, and the trade is usually a defined term that covers knowing misstatements of the express reps plus intentional misrepresentation and willful misconduct. Check that your exclusive remedy provision carves out all three, not just the word fraud, and that it also preserves equitable relief so you can actually enforce the non-compete.

The practical takeaway is not that the fraud carve-out is worthless. It is that a buyer who is relying on it has already lost the more important negotiation. Get the caps, the survival, and the escrow right, and treat fraud as the thing that saves you in the rare case where everything else failed.



What Gets Special Treatment, and Why

Some categories get carved out of the normal de minimis, basket, and cap structure entirely: taxes, environmental liability, and the fundamental reps like ownership.

Why? Because a breach in these areas usually means somebody did something wrong, not that ordinary business risk played out. If a seller did not pay their sales tax, that is not an accident the way a compressor failing is an accident. The same logic applies to environmental violations and to whether the seller owned what they sold you.

So these categories are treated as more serious. They typically get first-dollar recovery with no basket, a cap at 100% of the purchase price, and survival tied to the applicable statute of limitations rather than a negotiated 18 months.

RUN THE NUMBERS

Nine months after closing, the Florida Department of Revenue assesses \$85,000 in unpaid sales tax, interest, and penalties for pre-closing periods.

This was an asset purchase and the buyer never agreed to assume the liability. It does not matter. Under Florida law, a buyer of more than half a business is jointly and severally liable with the seller for the seller's unpaid Florida taxes, unless the buyer obtained a certificate of compliance from the Department of Revenue before closing. Many states have a version of this rule. Coastal Pest's buyer did not get the certificate.

The good news is that taxes are carved out. No de minimis, no basket, cap of \$3,200,000, survival tied to the statute of limitations. The buyer has a clean right to the full \$85,000.

The bad news is where the money is. The escrow has \$153,000 left after the earlier misclassification claim. That covers it. If the assessment had been \$400,000, the carve-out would have given the buyer a perfect right to collect from a selling entity that had already distributed the proceeds and dissolved.



Asset Deal vs. Stock Deal: Why Structure Changes Your Exposure

The general rule in an asset deal is that liabilities you did not agree to assume stay with the selling entity. You bought the assets, not the company, and the old entity keeps its own history. But “general rule” is doing real work in that sentence, and a buyer who treats it as a guarantee is going to be unpleasantly surprised.

Successor liability: the doctrines

Courts pull liabilities across to an asset buyer under several common law theories:

- **De facto merger.** The transaction looks like a merger in substance even though it was papered as an asset sale.
- **Mere continuation.** Same business, same management, same customers, same location, new name on the door.
- **Fraudulent transfer.** The sale was structured to put assets beyond the reach of the seller’s creditors.
- **Product line successor liability.** In some states, a buyer who continues manufacturing a product line inherits liability for units the seller made.



Successor liability: the statutes

The statutory exposure is broader and, for a small business buyer, more likely to actually bite:

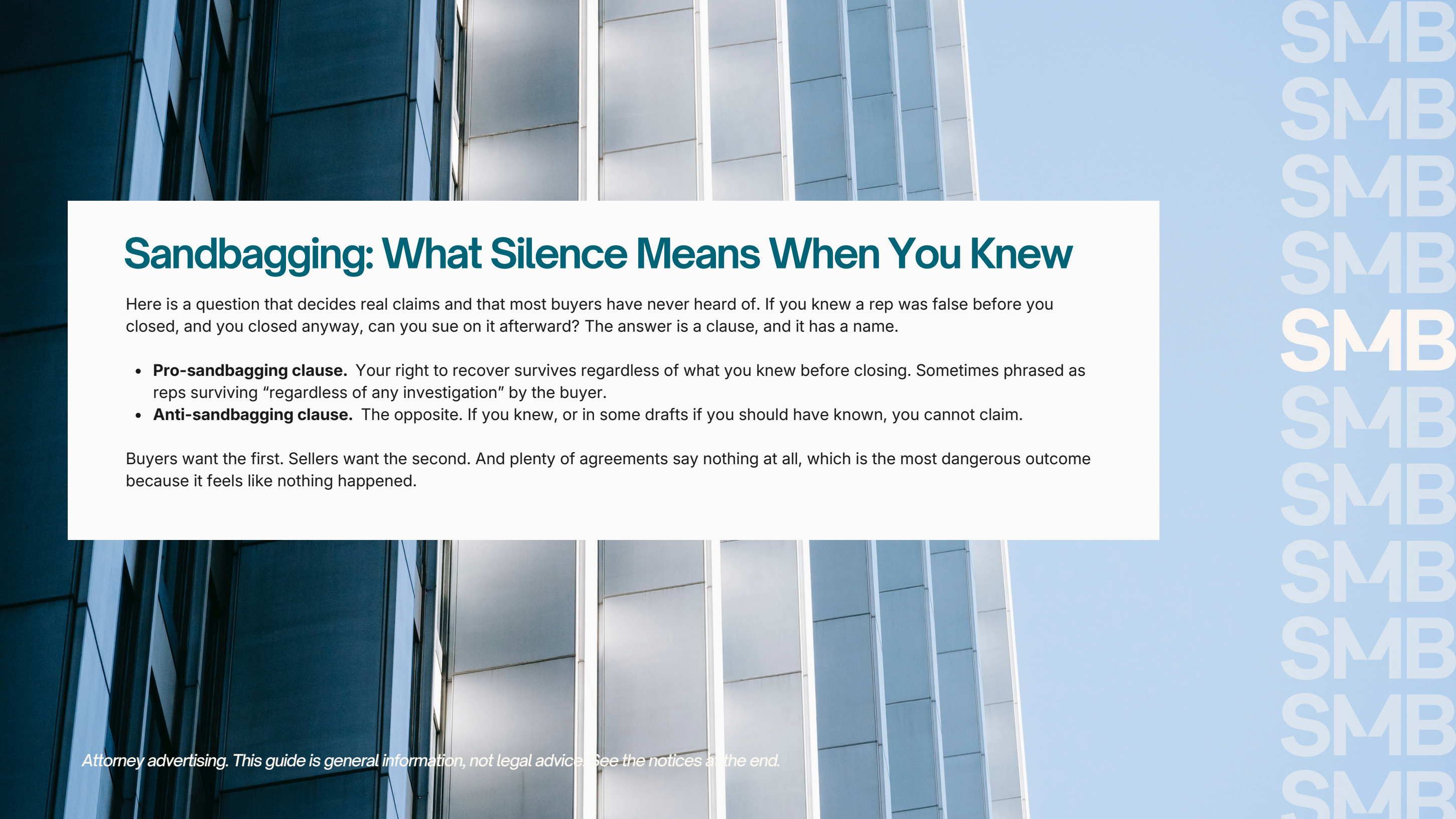
- State successor liability for unpaid sales and use taxes, which is what caught Coastal Pest's buyer in Section 10.
- Unemployment insurance experience rating, which can carry the seller's bad claims history and rate into your business.
- Environmental liability under CERCLA and state analogs, which attaches to ownership and operation rather than to contract.
- Multiemployer pension withdrawal liability, if the target has union employees under a multiemployer plan.
- Successor obligations under labor and employment law, including the National Labor Relations Act and, in some circuits, employment discrimination claims.
- Bulk sales requirements, which still exist in a handful of states.

An asset deal narrows your exposure. It does not eliminate it, and your indemnification section should address pre-closing liabilities directly rather than assuming structure took care of it.

You are buying the company itself, including everything it is carrying, known and unknown. There is no structural protection to fall back on. Your indemnification section needs an express indemnity for all pre-closing liabilities and all pre-closing taxes, including the pre-closing portion of any straddle period, with the allocation method spelled out.

RED FLAG: A stock deal where the indemnity covers breaches of reps but has no standalone pre-closing liabilities indemnity. Every liability that does not happen to breach a rep is now yours, and the universe of liabilities that do not breach a rep is larger than you think.





Sandbagging: What Silence Means When You Knew

Here is a question that decides real claims and that most buyers have never heard of. If you knew a rep was false before you closed, and you closed anyway, can you sue on it afterward? The answer is a clause, and it has a name.

- **Pro-sandbagging clause.** Your right to recover survives regardless of what you knew before closing. Sometimes phrased as reps surviving “regardless of any investigation” by the buyer.
- **Anti-sandbagging clause.** The opposite. If you knew, or in some drafts if you should have known, you cannot claim.

Buyers want the first. Sellers want the second. And plenty of agreements say nothing at all, which is the most dangerous outcome because it feels like nothing happened.

When the agreement is silent

Silence sends the question to your governing law clause, and the states do not agree. Three worth knowing, because they cover most of where these deals land:

- **Delaware.** Sandbagging is generally permitted unless the agreement says otherwise. The reasoning is that a breach of contract claim has no reliance element, so a buyer is entitled to enforce the representations it paid for. Silence favors the buyer.
- **Texas.** The opposite default. Texas generally requires an express pro-sandbagging provision before a buyer can bring a claim on a breach it knew about. Silence favors the seller. Worth knowing, because a great many of these deals are Texas deals.
- **New York.** It turns on where you learned it. If the parties understood the rep was false before closing and you closed without reserving your rights, you are generally treated as having waived it. If you learned the truth from a third party rather than from the seller, or it was common knowledge, your claim is materially stronger.

That last distinction is a useful habit regardless of governing law: when diligence turns up a problem, note how you learned it. It is a free record that occasionally turns out to be worth a lot. Do not leave this to the default rule of whatever state ended up in your governing law clause, which was probably negotiated by someone who was thinking about venue rather than about this.

Run the numbers

Diligence turns up that two service trucks are titled to one of the sellers personally, not to the LLC. That contradicts the assets rep. The buyer knows about it eight days before closing, everyone is tired, and the seller says they will “take care of it.”

Three possible worlds after closing, if the trucks never get transferred:

- Pro-sandbagging clause: the buyer has a claim. The rep was false, the buyer’s knowledge is irrelevant.
- Anti-sandbagging clause: the buyer has nothing. They knew.
- Silent agreement, Florida governing law: an expensive argument with an uncertain answer, over two trucks.

WHAT SHOULD HAVE HAPPENED: Fix it at closing, or hold back the value of the trucks, or write a two-sentence line item indemnity. Eight days was plenty of time. The clause fight only exists because nobody spent twenty minutes.

If you have to accept an anti-sandbagging clause

Sometimes you will not win this one. If you have to take it, narrow it in three places. Define knowledge as the actual knowledge of a short list of named individuals on your team, not constructive knowledge and not what you should have known after reasonable inquiry. Carve out anything the seller disclosed so late that you could not realistically act on it. And carve out information whose significance was not apparent until after closing, which happens more often than it sounds.

Understand what an anti-sandbagging clause does procedurally, too. It hands the seller an affirmative defense and it means that to collect you now have to prove two things instead of one: that the rep was breached, and that you did not know.

Disclosure schedules: Most of what the seller discloses lives in the disclosure schedules attached to the purchase agreement. They are not boilerplate. Every item on them is a carve-out from a representation you are otherwise relying on, and they are the only place in the deal where the seller gets to shrink the promises you are buying.

Then negotiate the update right, which is a separate provision and an underrated one. If the seller can amend its schedules up to closing, a new disclosure on the last day leaves you choosing between closing without any indemnity for it and walking away from a deal you have spent six months and real money on. That is not a choice. Ask that post-signing updates require your consent, or that any update does not cure a breach and does not limit your indemnity, which is the standard buyer position and the one worth holding.



RED FLAG: A schedule that discloses an item “for informational purposes only” or that purports to qualify “all representations” rather than the specific rep it sits under. A general cross-qualifier can quietly convert one disclosure into a defense against every rep in the agreement.

Known Problems and Line Item Indemnities

Sometimes a seller discloses a problem before closing instead of hiding it. That is the system working. It also puts you in a specific spot: because they told you, it is not a hidden misrepresentation you can later claim they lied about. If you close without addressing it separately, you have effectively priced it in. The fix is a line item indemnity: a standalone provision saying the seller will indemnify you for that particular disclosed issue, on its own terms, separate from how the general reps are treated.

What a line item indemnity should say (subject to negotiation)

- Identify the issue specifically. Name the lawsuit, the assessment, the customer, the permit.
- No basket and no de minimis. First dollar.
- Its own cap, the general cap or none at all.
- Survival until the issue is finally resolved, not 18 months.
- A dedicated source of recovery: additional escrow, a specific holdback, or an express set-off right against a seller note.
- Who controls the defense, if it is a live dispute.

RUN THE NUMBERS
During diligence the seller discloses that a former customer is suing over property damage from a termite treatment, seeking \$120,000. It goes on Schedule 3.11 as an exception to the litigation rep.
If the buyer closes with nothing more: the litigation rep is not breached, because the suit was disclosed. The general indemnity does not reach it. The buyer owns a \$120,000 lawsuit.
With a line item indemnity: the sellers indemnify for that specific matter, uncapped, no basket, surviving until the case is finally resolved, backed by an additional \$120,000 added to escrow and released only on final resolution. Cost to negotiate: one paragraph and one number.



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PART FOUR

Actually Getting Paid

A right to recover and an ability to collect are two different things. This part is about the second one, including the SBA constraint that catches most searchers.

14. Escrow, Holdbacks, and Set-off
15. If Your Deal Is SBA Financed, Read This Twice
16. Who You Are Actually Suing
17. Reps and Warranty Insurance: When It Changes the Whole Section

Attorney advertising. This guide is general information, not legal advice. See the notices at the end.

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Escrow, Holdbacks, and Set-off

Here is the part buyers care about most in practice. If you win a claim, how do you actually collect? There are three mechanisms and they are not equally good.

Escrow: A portion of the purchase price sits with a neutral third party after closing. If you have a valid claim, you are paid out of that account instead of chasing the seller. It is the most familiar mechanism and the easiest to get, because sellers understand it and lenders like it.

What to negotiate: the amount, the release date, whether there is a partial release at an interim date, what happens to disputed amounts at the release date, and who pays the escrow agent. Push for disputed amounts to be held past the release date until resolved, which is standard and occasionally missing.

Two things to expect rather than fight. The escrow duration will usually mirror the general survival period, so 12 to 18 months, and phased releases are a normal ask if you want more than that on the back end. And the seller will almost always require that indemnity payments come out of escrow first before anyone pays you directly. That is fine. What is not fine is escrow first turning into escrow only. Those are different provisions and they are one word apart.

One drafting point that causes real problems: the escrow agreement is a separate document, and courts will read it together with the purchase agreement as a single scheme. If both documents contain notice requirements for indemnification claims, assume you have to comply with both. Ask your counsel to reconcile the two before signing, because nobody reconciles them at month sixteen when a claim is live.



Escrow, Holdbacks, and Set-off

Holdbacks: Same idea without the third party. Instead of sending the full purchase price at closing, you hold back a portion yourself. Harder to negotiate, because sellers understandably do not love the buyer sitting on their money with no neutral in the middle. Better for you if you can get it, because the cash is already in your hands.

Set-off:If there is seller financing or an earnout, a set-off right lets you reduce what you owe the seller by the amount of a valid claim. In the small business deals we close, this is the most common recovery mechanism, because most of these deals carry a seller note.

The most contested question is when the right kicks in. As a buyer you want to pause payments the moment you deliver a claim notice, the same way an escrow freezes. Sellers push for amounts they have agreed to or that have been finally adjudicated, which in practice means years. This one is genuinely negotiated deal by deal, and a reasonable landing spot is that disputed amounts get held in escrow rather than paid, so neither side has the money while the fight runs.

Mechanism	Strength	Weakness	Get it when
Escrow	Money is already set aside and neutral	Released on a fixed date, then gone	Always. This is the baseline
Holdback	Cash is in your account	Sellers resist, lenders may object	You have leverage or the seller needs speed
Set-off	Costs the seller nothing to give	Only worth what is still owed, and may be blocked	There is a seller note. See Section 15 first.



If Your Deal Is SBA Financed, Read This Twice

A set-off right is only worth what the seller is still owed, and in an SBA 7(a) deal you are not the one who decides when the seller gets paid. Two separate constraints stack here, and most buyers discover both after signing.

Constraint one: the standby period

Under the SBA's current rules, a seller note that counts toward your equity injection has to sit on full standby for the life of the SBA loan, not the 24 months the market spent years getting used to. Full standby means no principal and no interest to the seller for the entire term.

On a ten-year loan, that is ten years with nothing flowing to the seller. There is nothing to set off against until the SBA loan is paid off or refinanced.

Constraint two: your lender

Even where a payment stream exists, the paper may not let you touch it. Many lenders will not permit set-off against a seller note that counts toward the equity injection at all, on the view that the injection has to be real money at risk rather than something the buyer can claw back. Beyond that, the standby agreement your lender requires, commonly SBA Form 155, and your loan documents will typically restrict the seller's ability to collect and may require lender consent before you exercise any offset against seller debt.

The result is a purchase agreement that grants you a set-off right your loan documents will not let you use. Both documents are signed at the same closing, usually by different lawyers, and nobody reads them against each other.



Run the numbers

Month four. The buyer has a clean \$47,000 misclassification claim.

- Seller Note A, \$160,000, full standby for the life of the SBA loan. No payments are flowing. Nothing to offset. For ten years.
- Seller Note B, \$200,000, amortizing at roughly \$3,800 a month. There is a payment stream here, but it takes more than twelve months of withheld payments to cover \$47,000, and the lender's consent requirement sits on top of it.
- Escrow, \$200,000. Available now, on the agreement's own terms, no lender in the middle.

THIS IS WHY ESCROW IS NOT OPTIONAL IN AN SBA DEAL: The recovery mechanism the market talks about most is the one least likely to work in the structure the market uses most.

- TIMING NOTE:** SBA program rules change on a published schedule and have changed materially in the last two years. Confirm the current standby treatment, equity injection limits, and refinance seasoning with your lender before you rely on any of the above. Nothing in this guide is a substitute for the SOP in effect on your closing date.

Who You Are Actually Suing

Here is what buyers overlook until it is too late. An indemnification right is only as good as your ability to collect on it.

If your only claim is against the selling entity, and that entity dissolves after closing, which is common and often the seller’s tax advisor’s idea, your indemnification right may be worth nothing. There is nobody left to collect from.

RUN THE NUMBERS

Month fourteen. The buyer discovers a \$210,000 environmental problem at the leased facility from pre-closing operations.

Environmental is carved out, so no basket and a 100% cap. The right is perfect.

The escrow holds \$153,000 after the earlier misclassification claim. The selling entity dissolved sixty days after closing and distributed the proceeds to its two members. The purchase agreement names only “Seller” as the indemnifying party.

Recoverable: \$153,000 from escrow. The remaining \$57,000 is a claim against an entity that no longer exists.

What fixes this, in order of value: name the individual members as indemnifying parties; make their liability joint and several; add a covenant that the selling entity will not dissolve or distribute proceeds during the survival period; and size the escrow against your real downside rather than against what looks normal.



The checklist

- Are the individual owners named as indemnifying parties, or only the entity?
- How is their liability structured? There are four options and the differences are large. Joint and several means any one of them is liable for the whole loss, which is what you want. Several but not joint means each is liable only for their pro rata share, so you chase each of them separately for a fraction of your own claim. The middle ground, and the one that actually gets agreed in multi-owner deals, is joint and several for company-level breaches but several only for a breach that a particular owner personally caused. Joint but not several is rare and you can ignore it.
- If a selling owner is itself an entity, is there a parent guaranty or a personal guaranty behind it? Ask for one, and understand that guaranties are not self-executing and can be difficult to enforce. A guaranty is better than nothing and worse than escrow.
- Is there a covenant against dissolution or distribution during the survival period?
- If a seller is a trust or an estate, who is actually on the hook and does the obligation survive the individual?
- Do you have any credit information at all on the individual sellers? You did full diligence on the business and none on the people who owe you money.

This is also the strongest argument for escrow. An escrow account does not dissolve, does not move, and does not have to be sued. Money you already control is worth more than a right to collect from someone who may not be there when you need them.



Reps and Warranty Insurance: When It Changes the Whole Section

Everything up to this point assumes the seller is the one standing behind the representations. There is another model, and it is worth knowing about even if your first deal is too small for it.

Reps and warranty insurance is a policy, almost always bought by the buyer, that covers losses from breaches of the seller's representations. The insurer takes the risk, you pay a premium, and the seller gets to walk away closer to clean.

What it does to the indemnification section:

When there is a policy, the indemnification section usually shrinks. The seller's indemnity may be limited to a small retention, or to fundamental reps and fraud only, or eliminated for general reps entirely. Escrows get smaller or disappear. At the far end of this trend are deals where the reps simply do not survive closing and there is no indemnity for breaching them at all, sometimes called walk-away deals. Your recovery is the policy, and nothing else.

So if you are handed a purchase agreement with a strangely thin indemnification section, the first question is whether a policy is supposed to be sitting underneath it. If the answer is no, you are not looking at a modern structure. You are looking at no protection.



What to check if your deal has a policy

- What the policy excludes. Insurers exclude known issues, and often exclude specific areas after their own diligence. Anything excluded needs to come back to the seller as a line item indemnity, because otherwise it belongs to nobody but you.
- The retention, which is the policy's version of a deductible, and who bears it. It is commonly split with the seller at first and then drops after a period.
- Whether the seller's remaining indemnity is capped at the retention, and what survives above it.
- Whether the policy covers the fundamental reps at a higher limit, and whether it covers pre-closing taxes.
- How the policy interacts with the insurance offset in the definition of Losses, so you are not reducing the seller's obligation by the proceeds of a policy you paid for yourself.

THIS FITS FOR A SEARCHER: For a \$3 million deal like Coastal Pest, this is usually not a live option. Traditional escrow and indemnity is the structure, and the rest of this guide is the playbook.

It becomes a real question as deal size climbs and as you move away from SBA financing toward conventional or sponsor-backed capital. If you are building a holdco and your third acquisition is meaningfully larger than your first, ask about it before you assume it is out of reach. The answer changes with deal size, industry, and the year.

Tools

A cheat sheet for the negotiation, a red flag list for the seller’s first draft, a runbook for the week after closing, and a glossary.

- 18. The Negotiation Cheat Sheet
- 19. Red Flags in a Seller’s First Draft
- 20. Your Post-Closing Runbook
- 21. Glossary



The Negotiation Cheat Sheet

Bring this to the call. Ranges reflect what we see in lower middle market deals and will move with your leverage, your competition for the deal, and how badly the seller wants out.

Term	Ask for	Likely landing zone	Walk-away
Standard rep survival	24 months, or one full audit cycle	12 to 18 months	Under 12 months
Fundamental rep survival	SOL plus 60 days	A set number of years, or the SOL	Same as standard reps
Which reps are fundamental	The long list	The short list plus one or two	Ownership and authority only
Tax survival	SOL plus 60 days	Statute of limitations	Under 3 years
Governing law	Chosen for the survival period	Chosen for venue	Chosen because someone had a form
Claim survives on notice	Express language	Express language	Absent
Mini-basket (de minimis)	None	0.05% to 0.1% of price	Over 0.25% of price
Basket type	Tipping	Deductible, hybrid if you push	Deductible, large threshold
Basket size	0.5% of price	0.5% to 1% of price	Over 1.5% of price
Basket and mini-basket scope	Reps only	Reps only	Covenants and negotiated indemnities too

Term	Ask for	Likely landing zone	Walk-away
Standard rep cap	20% of price	10% to 15%, often equal to escrow	Under 10%
Fundamental, tax, environmental, fraud cap	Carved out, or 100%	100% of price	Under 100%
Materiality scrape	Double: breach and damages	Single: damages only	None
Multiple-of-earnings damages	Expressly permitted, multiple stated	Silent, which invites a fight	Expressly excluded
Fees and costs in Losses	Included	Included	Excluded
Insurance and tax offset	Proceeds received, net of cost, no duty to pursue	Proceeds received, net of cost	Theoretical coverage, duty to pursue
Sandbagging	Express pro-sandbagging	Silent, so check governing law	Anti-sandbagging on constructive knowledge
Schedule updates	Consent required	No cure, no limit on indemnity	Seller may update and cure
Indemnified Parties definition	Buyer, affiliates, the company, their people	Buyer and affiliates	Buyer only
Third party beneficiary carve-out	Express, matching the above	Express	Missing
Control of third party defense	Carve-outs, plus acknowledgment of liability	Carve-outs	Seller controls everything

Term	Ask for	Likely landing zone	Walk-away
Escrow	10% of price, 18 months	5% to 10%, 12 to 18 months	No escrow
Escrow as sole recourse	No	Standard reps only, if at all	Sole recourse for everything
Set-off	On notice of claim	On final determination	No set-off right
Indemnifying parties	Individuals, joint and several	Individuals, joint and several	Entity only
Structure of liability	Joint and several	J&S for company breaches, several for personal	Several only
Known issues	Line item indemnity, first dollar	Line item indemnity	Several only

Red Flags in a Seller's First Draft

Run this list against the draft in front of you. Anything you check is a conversation, not necessarily a fight.

Survival

- All reps, fundamental ones included, on a single short survival period.
- No language preserving a claim once notice is given.
- Survival running from signing rather than from closing.
- A governing law clause nobody chose on purpose, in an agreement whose survival periods depend on it.
- A long or indefinite survival period in a state that may not enforce a contractual extension of the limitations period.

Procedures

- A notice provision written so that failing it forfeits the claim, with no cure period and no materiality qualifier.
- An escrow agreement carrying its own notice requirements that nobody has reconciled with the purchase agreement.
- The seller controlling the defense of any third party claim, with no carve-outs and no requirement that it first acknowledge the claim is indemnifiable.
- A settlement provision letting the seller settle without your consent on anything short of money only, no ongoing obligation, and a full release of you.
- A duty to mitigate with no limit, so the seller can argue you should have spent your own money or sued someone.

Losses

Limitations

- A mini-basket or de minimis threshold you have not done the arithmetic on.
- A true deductible basket where you assumed you had a tipping basket.
- The basket and mini-basket applying to covenants, taxes, fundamental reps, or the line item indemnities.
- A cap equal to the escrow, combined with escrow as sole recourse, which makes the cap decorative.

Red Flags in a Seller's First Draft

Run this list against the draft in front of you. Anything you check is a conversation, not necessarily a fight.

Losses

- "Multiple of earnings" or "diminution in value" excluded by name.
- Silence on whether a multiple may be used, which is not neutral, it is a deferred fight.
- A single materiality scrape where you assumed you had a double, or no scrape at all alongside a basket.
- An insurance offset measured by coverage theoretically available rather than proceeds actually received.
- A tax benefit offset with no matching gross-up for tax you owe on the indemnity payment itself.
- Attorneys' fees and costs of investigation outside the definition.
- Recovery reduced by insurance and tax benefits with no netting for the cost of obtaining them.
- An obligation to sue your own insurer before claiming.

Structure and scope

- A stock deal with no standalone pre-closing liabilities indemnity.
- An asset deal that assumes structure handles successor liability.
- Scope covering reps but not covenants.
- No pre-closing tax indemnity, or no straddle-period allocation method.
- An Indemnified Parties definition narrow enough to exclude your affiliates, the acquired company, or your own officers.
- A no third party beneficiary clause with no express carve-out for the indemnified parties named elsewhere.
- Nothing addressing unpaid transaction expenses or company debt that was not accounted for in the price.
- A thin or absent indemnity with no reps and warranty policy sitting underneath it.

Losses

Fraud and remedies

- A narrow contractual definition of "Fraud" paired with a broad non-reliance provision.
- An exclusive remedy provision with no fraud carve-out at all.
- A fraud carve-out that omits intentional misrepresentation and willful misconduct.
- No carve-out for specific performance of the non-compete and other covenants.

Red Flags in a Seller's First Draft

Run this list against the draft in front of you. Anything you check is a conversation, not necessarily a fight.

Knowledge and disclosure

- An anti-sandbagging clause, especially one reaching what you “should have known.”
- Silence on sandbagging paired with a governing law you did not choose deliberately.
- Schedules that qualify “all representations” rather than the specific rep.
- Schedules delivered fewer than five business days before signing.
- A right for the seller to update its schedules through closing, where the update cures the breach or limits your indemnity.
- An anti-sandbagging clause reaching constructive knowledge, or knowledge of anyone on your side rather than named individuals.

Collection

- Only the entity named as an indemnifying party.
- Several liability rather than joint and several among multiple sellers, with no middle-ground structure proposed.
- An entity seller with no parent guaranty or personal guaranty behind it.

Fraud and remedies

- A narrow contractual definition of “Fraud” paired with a broad non-reliance provision.
- An exclusive remedy provision with no fraud carve-out at all.
- A fraud carve-out that omits intentional misrepresentation and willful misconduct.
- No carve-out for specific performance of the non-compete and other covenants.

If you check more than six of these:

You are not looking at a normal seller draft with a few aggressive terms. You are looking at a coordinated position, and it usually means the seller has counsel who does this and you need counsel who does too. That is not a sales line, it is the pattern.

Your Post-Closing Runbook

The most common way a good claim dies is not that the buyer loses. It is that nobody calendared anything. Do this in the first week.

Week one

- Calendar every survival date: standard reps, fundamental reps, taxes, environmental, and each line item indemnity. Put them in the same calendar you actually look at.
- Calendar the escrow release date, and a reminder 45 days before it.
- Calendar the seller note dates, the standby period, and any earnout measurement dates.
- Save a clean, dated copy of the executed agreement, the final disclosure schedules, and the diligence data room. Export the data room. They get shut off.
- Write down, in one page, who the indemnifying parties are, where the money is, and what the notice provision requires. You will not remember in fourteen months.

Ongoing:

- Log potential claims as they surface, with dates and dollar estimates, even the small ones. That log is how you know when you are approaching the basket.
- Reconcile the log against the de minimis and basket quarterly. Small claims are only worthless individually.
- At 45 days before escrow release, review the log with counsel and decide whether to notice anything.
- At 60 days before each survival date, do the same. This is the meeting that saves claims.

The single most valuable habit

Keep a running claim log from day one. Most buyers reconstruct one under pressure at month sixteen, from memory and email search, after the number got big enough to care about. By then the small claims that would have tipped the basket are undocumented and gone.



Glossary

Term	What it means
Anti-sandbagging clause	A provision barring a claim for breach of a rep the buyer knew was false before closing.
Basket	An aggregate threshold that qualifying losses must exceed before the buyer recovers anything. Comes in deductible and tipping forms.
Cap	The ceiling on total indemnification recovery, often different for standard and fundamental reps.
Covenant	A promise about what a party will or will not do, before or after closing. Non-competes and transition obligations are covenants.
Condition precedent	Something that must happen before a right arises. Notice provisions are sometimes drafted this way, which means failing them can forfeit the claim rather than merely reduce it.
De minimis, or mini-basket	A per-claim minimum. Losses below it are ignored entirely and do not count toward the basket.
Duty to mitigate	An obligation on the buyer to take reasonable steps to limit its losses, which the seller can use to argue for a smaller payment.

Term	What it means
Disclosure schedules	Attachments to the purchase agreement listing exceptions to the representations. Each item narrows a promise you are relying on.
Escrow	A portion of the purchase price held by a neutral third party after closing as a source of recovery.
Indemnified parties	Everyone entitled to bring a claim. Should extend past the buyer entity to affiliates, the acquired company, and their officers, directors, and representatives.
Exclusive remedy provision	A provision making indemnification the sole post-closing remedy, usually with a fraud carve-out.
Fundamental representations	The short list of reps so basic to the deal that they receive longer survival and a higher cap. Ownership, authority, title.
Holdback	A portion of the purchase price the buyer retains directly rather than placing with an escrow agent.

Glossary

Term	What it means
Line item indemnity	A standalone indemnity for a specific known issue, on its own terms, separate from the general reps.
Joint and several liability	Each indemnifying party is liable for the whole loss. Several but not joint means each is liable only for its pro rata share.
Losses	The defined term setting what is recoverable. Exclusions here often matter more than the cap.
Materiality scrape	A provision reading materiality qualifiers out of the reps. A double scrape applies to both determining breach and calculating losses; a single scrape applies only to calculating losses.
Non-reliance provision	A provision stating the buyer relied only on the reps in the agreement, which limits claims based on anything said outside it.
Pro-sandbagging clause	A provision preserving the buyer's claim regardless of what the buyer knew before closing.

Term	What it means
R&W insurance	A policy, usually bought by the buyer, covering losses from breaches of the seller's representations. Where it exists, the seller's indemnity is typically much smaller or absent.
Rescission	The remedy that unwinds a closed transaction. Extraordinary, rarely granted, and usually waived in the agreement.
Set-off	The right to reduce what the buyer owes the seller, typically on a seller note, by the amount of a claim.
Standby (full standby)	An SBA requirement that no principal or interest be paid on a seller note for a specified period.
Straddle period	A tax period that begins before and ends after the closing date, requiring an allocation between the parties.
Successor liability	Doctrines and statutes that attach a seller's liabilities to an asset buyer notwithstanding the structure of the deal.

The Bottom Line

None of this turns a bad business into a good one, or a bad operator into a good one. That is not what indemnification is for, and no clause in a purchase agreement will save a deal you should not have done.

What it does is protect you on the margins, and the margins are where first acquisitions get decided. When something goes wrong, and in a business with fourteen employees and a decade of history something will go wrong, the strength of your indemnification section determines whether you have a real path to recovery or a nicely typed promise.

Look back at Coastal Pest. The buyer had a reasonable, market-standard agreement. Over eighteen months they faced \$18,900 in small claims, a \$47,000 misclassification problem, an \$85,000 tax assessment, a \$120,000 disclosed lawsuit, a customer worth \$275,000 in purchase price, and a \$210,000 environmental issue. Every one of those outcomes turned on a clause negotiated months earlier, usually in the last week, usually by someone who was tired.

That is the whole argument for having deal counsel who does this work as their core practice rather than as a side project. Not because the law is exotic. Because the person across the table has seen it a hundred times and you have seen it once.

BRING YOUR DEAL

M&A Office Hours. Every other Thursday at 3:00 PM ET. Bring your actual indemnification section and we will walk it with you, clause by clause, on the call.

Main Street Deals podcast. A two-part conversation on this topic. Part 1 covers survival, caps, and baskets. Part 2 covers how buyers actually get paid.



Want to go deeper?

Our Main Street Deals podcast covers this in a two-part conversation.

Part 1 covers indemnification fundamentals: survival periods, caps, and baskets. **Part 2** covers how buyers actually get paid: escrow, holdbacks, and set-off rights.



About SMB Law Group

SMB Law Group was established by three former Big Law attorneys to provide specialized legal services to small and medium-sized businesses. The firm began with a mission to offer practical, results-driven solutions tailored to the challenges business buyers and sellers actually face.

Since then we have closed more than 400 acquisitions representing over \$1.9 billion in transaction value, the large majority of them for searchers, independent sponsors, and holdco buyers doing exactly the kind of deal this guide describes. Buy-side M&A is our core practice, not a side project, and it is why the examples in this guide are specific rather than general.

We work on a defined process: a client questionnaire before kickoff, a kickoff call, a shared checklist you can see at all times, weekly fifteen-minute check-ins, a diligence memo, issue lists in response to every markup, and a post-closing toolkit. You always know where your deal stands.

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