

Negotiating M&A Escrow Agreements Checklist

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This Checklist sets out the key negotiated issues between a buyer and seller in an escrow agreement entered into in connection with an M&A transaction. It also outlines the main issues often raised by escrow agents.

A buyer in an M&A transaction generally requires a portion of the purchase price to be held back until a later date (such as the first anniversary of the closing of the transaction) to satisfy the seller’s post-closing obligations (including purchase price adjustments payable to the buyer and potential indemnification claims) if:

- The buyer has concerns about the seller’s ability to pay its post-closing obligations.
- There are multiple sellers (to ease the burden of having to track down each seller when claims arise).
- The buyer wishes to streamline the process of obtaining amounts for post-closing obligations.

Sellers typically prefer that these held back amounts be placed into escrow with a third party escrow agent rather than being retained by the buyer. To establish the escrow, the parties enter into an escrow agreement with an escrow agent to set out the terms and conditions by which the escrow agent holds and distributes the escrowed funds. In most M&A transactions, the escrow agent is a bank or other financial institution that often has its own set of standard terms and conditions for the escrow agreement. In some

cases, the escrow agent may want to use its own form of escrow agreement.

Issues and delays may arise if any of the escrow agent’s standard terms and conditions (or form of escrow agreement) conflict with the terms and conditions negotiated between the buyer and seller. The buyer and seller may want to involve the escrow agent in the negotiation process as early as possible to avoid any delays in completing the underlying acquisition.

At a minimum, the parties should determine who will act as escrow agent and request their form of agreement before drafting the escrow agreement. When choosing the escrow agent, the parties might consider whether a party has a strong relationship with the escrow agent (for example, whether either the buyer or seller is a large customer of the escrow agent) so that the party with the relationship can negotiate better pricing and terms under the escrow agreement.

This Checklist sets out key issues negotiated between the buyer and seller once they agree to establish an escrow of a portion of the purchase price, along with the typical positions or concerns of each party regarding these issues. It also describes key considerations for escrow agents, including both negotiated and non-negotiated points.

For an example of an escrow agreement, see Standard Document, Escrow Agreement ([1-386-3603](#)).

BUYER AND SELLER ISSUES

The buyer and seller often negotiate the key terms of the escrow agreement between themselves before involving the escrow agent.

Issue	Buyer’s Position	Seller’s Position
Obligations Covered by Escrow	<ul style="list-style-type: none"> ■ Include any post-closing obligations the seller may have, such as purchase price adjustments and indemnification obligations. ■ If the buyer has particular concerns about certain potentially significant liabilities (such as environmental liabilities or major litigation), consider establishing a separate escrow just for those liabilities. 	<ul style="list-style-type: none"> ■ Limit the obligations covered by the escrow to specific, potential liabilities (for example, a particular litigation claim, uncollected accounts receivable, or tax liabilities).

Issue	Buyer's Position	Seller's Position
Consolidated or Separate Accounts	<ul style="list-style-type: none"> ■ Hold all escrow funds in one account, even if they are securing multiple obligations, to ensure all escrow funds are available to satisfy the seller's obligations. ■ If the buyer agrees to multiple accounts, ensure that escrow funds from one account can be used to satisfy obligations that may be secured by another account. For example, if there are separate accounts for purchase price adjustment and indemnification claims, the buyer may want escrow funds in the indemnification escrow account available to satisfy any purchase price adjustment in excess of the amount held in the purchase price adjustment escrow account. 	<ul style="list-style-type: none"> ■ Hold escrow funds in separate accounts with different escrow amounts and disbursement dates if there are multiple obligations secured by the escrow. ■ Expressly state that escrow funds held in one account are not available to cover liabilities that are covered by another account.
Amount of Escrow	<ul style="list-style-type: none"> ■ Seek as high an escrow amount as possible to cover any purchase price adjustment and liabilities that the buyer knows may arise, and to protect against unknown liabilities. 	<ul style="list-style-type: none"> ■ Limit the escrow amount as much as possible. Try to limit it to amounts necessary to cover only those liabilities that are reasonably likely to arise.
Investment of Escrow Funds	<ul style="list-style-type: none"> ■ Require any investments of escrow funds to be in conservative, highly liquid, short-term investments so that escrow funds are available when needed to cover potential claims. ■ Ensure interest and other income earned on the escrow amount are added to the escrow funds and available for claims made by the buyer. 	<ul style="list-style-type: none"> ■ Consider seeking riskier investments that have potentially better returns. ■ Ensure interest and other income earned on the escrow amount are distributed to the seller. However, the seller should consider the tax consequences of receiving such distributions.
Length of Escrow Period	<ul style="list-style-type: none"> ■ If there is a longer survival period for certain indemnification claims, require a portion of the escrow to be held for this longer period. 	<ul style="list-style-type: none"> ■ Limit the escrow period to the general survival period of indemnification claims.
Payment of Buyer's Claims	<ul style="list-style-type: none"> ■ Provide for escrow funds to be released to the buyer after the buyer delivers a written claim notice and the seller fails to object to this notice within a specified period of time. ■ If the seller delivers an objection notice for part of a claim, provide that the escrow agent will distribute the undisputed portion to the buyer and hold back disputed amounts until it receives joint written instructions from the seller and the buyer, a court order, or an arbitration award. 	<ul style="list-style-type: none"> ■ Provide for escrow funds to be released to the buyer only upon joint written instructions from the seller and the buyer.
Release of Escrow	<ul style="list-style-type: none"> ■ Release remaining escrow funds not subject to unresolved claims (or subject to resolved claims that have not yet been released from escrow) to the seller only at the end of the escrow period and with joint written instructions. ■ Ensure unresolved claims include claims submitted by the buyer that are disputed by the seller and for which the dispute period has not expired. 	<ul style="list-style-type: none"> ■ Release portions of the escrow fund in intervals so that the entire amount is not tied up for the entire escrow period, especially if the amount of the escrow is large or the length of the escrow period is long. ■ Provide for escrow funds in excess of any unresolved claims to be automatically released to the seller at the end of the escrow period.
Allocation of Escrow Agent's Fees	<ul style="list-style-type: none"> ■ Require the escrow agent's fees and expenses to be split evenly between the buyer and seller. 	<ul style="list-style-type: none"> ■ Require that the buyer pay all of the escrow agent's fees and expenses because the buyer is requesting the escrow. ■ Provide that the seller's portion of the escrow agent's fees and expenses is deducted from the escrow account.
Ownership of Escrow for Tax Purposes	<ul style="list-style-type: none"> ■ Specify that the seller be treated as the owner of the escrow fund for tax purposes so that any taxes on the income earned on, or derived from, the escrow amount are the seller's responsibility. However, if the seller is treated as the owner of the escrow fund and it declares bankruptcy during the escrow period, the escrow may be claimed by the seller's bankruptcy estate. ■ If the buyer agrees to be treated as the owner of the escrow fund for tax purposes, require that a portion of the income that is earned on the escrow amount be distributed to the buyer to cover the taxes payable on that income. 	<ul style="list-style-type: none"> ■ Specify that the buyer be treated as the owner of the escrow fund for tax purposes so that the escrow amount is not treated as income earned by the seller at the time the escrow amount is deposited in the escrow account and so that any taxes on the income earned on, or derived from, the escrow amount are the buyer's responsibility. However, if the buyer is treated as the owner of the escrow fund and it declares bankruptcy during the escrow period, the escrow may be claimed by the buyer's bankruptcy estate.

Issue	Buyer's Position	Seller's Position
Minimum Qualification of Successor Escrow Agent	<ul style="list-style-type: none"> Require any successor escrow agent to meet certain minimum qualifications or be reasonably satisfactory. 	<ul style="list-style-type: none"> Same position.
Removal of Escrow Agent	<ul style="list-style-type: none"> Include the right to remove and replace the escrow agent with or without cause either unilaterally or upon mutual agreement of the buyer and seller. 	<ul style="list-style-type: none"> Same position.

ESCROW AGENT ISSUES

Once the buyer and seller resolve their issues, the escrow agent reviews the escrow agreement to ensure that:

- All of its duties and responsibilities are clearly set forth in the agreement.
- It is protected from any liability incurred in the performance of its duties (other than for direct losses caused by its willful misconduct, fraud, or gross negligence, which is the current industry standard).
- Its operational requirements and procedures are incorporated into the escrow agreement (such as requirements for designating

authorized representatives and funds transfer security procedures).

Understanding why escrow agents tend to push back on certain provisions and not others is paramount to a successful transaction, saving time and avoiding frustration when escrow agreement comments are received. However, there may be some terms and conditions that the buyer and seller may be unwilling to accept. In these cases, the buyer and seller can try to negotiate with the escrow agent to either delete or limit the requested term or condition.

The following are examples of actual negotiated and non-negotiated issues that arise in escrow negotiations:

NEGOTIATED ISSUES

Issue	Escrow Agent's Position	Buyer's/Seller's Position
Buyer's and Seller's Indemnification Obligations to Escrow Agent	<ul style="list-style-type: none"> Ensure the buyer and the seller provide indemnification to the escrow agent on a joint and several basis. Alternatively, in complex structures, require parties to grant first lien and right of set-off against the escrow account for indemnifiable losses. 	<ul style="list-style-type: none"> Require several but not joint liability for the buyer and seller. Each of the buyer and seller will only be responsible for losses it causes. In some cases, the buyer and seller may agree to allocate their responsibility for losses in accordance with set percentages. Resist granting lien or right of set-off against the escrow account for any indemnification obligations to the escrow agent.
Compensation and Right of Set-Off	<ul style="list-style-type: none"> Require payment of initial fees (typically nominal) upon execution of the escrow agreement or require parties to grant a first lien and right of set-off for unpaid compensation. 	<ul style="list-style-type: none"> Resist granting lien or right of set-off against the escrow account for unpaid compensation.
Resignation of Escrow Agent	<ul style="list-style-type: none"> Secure the escrow agent's ability to resign upon prior written notice to the buyer and the seller and negotiate for a short notice period (generally 30 days or less). Provide for termination of all obligations upon resignation but preserve any rights to compensation, indemnification, or related first liens and rights of set-off. Ensure the resignation becomes effective regardless of whether a successor escrow agent has been engaged. 	<ul style="list-style-type: none"> Require a notice period for the escrow agent's resignation long enough for the buyer and the seller to engage a successor escrow agent (generally 60-90 days). Ensure the escrow agent's resignation does not become effective until a successor escrow agent has been engaged.
Ability to Assign the Escrow Agreement	<ul style="list-style-type: none"> Limit each party's ability to assign its rights and obligations under the escrow agreement without the escrow agent's consent which shall not be unreasonably withheld, provided the documents and information required under the escrow agent's Know Your Customer (KYC) program are complete and approved for each assignee. 	<ul style="list-style-type: none"> Include the right to freely assign each party's rights and obligations under the escrow agreement without the escrow agent's consent. If parties are unable to negotiate a general assignment right, negotiate the right to assign to certain permitted assignees (such as subsidiaries of the parties or lenders or for estate planning purposes).

Issue	Escrow Agent's Position	Buyer's/Seller's Position
Tax Reporting	<ul style="list-style-type: none"> ■ Incorporate the escrow agent's standard tax reporting language applicable to the underlying transaction and related escrowed assets (generally limiting the escrow agent's responsibility to reporting income earned on the escrowed property during the escrow period to either the buyer or the seller). ■ Ensure the agreement includes necessary representations from parties excluding any tax reporting that would appear to be required given the underlying transaction. ■ Ensure the escrow agent is entitled to withhold taxes in the event of incomplete tax documentation. 	<ul style="list-style-type: none"> ■ Ensure the escrow agent provides all tax reporting that would appear to be required for the underlying transaction. If the escrow agent does not provide all required tax reporting, consider alternate arrangements. ■ Be able to provide representations required by the escrow agent.
Jurisdiction and Venue	<ul style="list-style-type: none"> ■ Require the law governing the escrow agreement and the forum for any disputes to be that of the state of the escrow agent's principal place of business or Delaware. 	<ul style="list-style-type: none"> ■ Require the law governing the escrow agreement and the forum for any disputes to be the same as those provided in the principal transaction document.

NON-NEGOTIATED ISSUES

Issue	Escrow Agent's Position
Escrow Agent's Rights, Duties, and Obligations	<ul style="list-style-type: none"> ■ Include all terms related to the escrow, particularly the escrow agent's rights, duties, and obligations, and any defined terms, in the escrow agreement without reference to a separate document (including the principal transaction document between the buyer and seller). ■ Disclaim any fiduciary or other implied duties or obligations or any knowledge of terms of other agreements between the parties. ■ Ensure the escrow agent is able to rely and act in good faith on the written instructions received from designated authorized representatives of the parties. ■ Set forth a contractual right to retain and consult with counsel and other professionals. ■ Specify the escrow agent's obligations in the event it receives conflicting or non-compliant instructions under the escrow agreement.
Escrow Account	<ul style="list-style-type: none"> ■ Avoid statements in the escrow agreement characterizing escrowed assets as being held in trust or that the escrowed assets are not subject to lien, attachment, bankruptcy, or judicial process.
Investments	<ul style="list-style-type: none"> ■ Disclaim any obligation or duty to advise, recommend, or make investment decisions. ■ Disclaim any liability for losses sustained by the parties related to their investment choices. ■ Disclose use of affiliates or related operations groups needed to deliver any investments and any related compensation. ■ Have authority to liquidate investments prior to maturity to provide funds required for payments under the escrow agreement. ■ Have the ability to revise rates on the investment.
Account Mechanics	<ul style="list-style-type: none"> ■ Require all instructions to the escrow agent to be in writing and signed by designated authorized representatives of the applicable party or parties, whether the agreement requires joint instruction from the buyer and the seller, receipt of a unilateral instruction or an automatic release on reaching a milestone date. ■ For court orders or arbitration awards, require certification by the delivering party as to their finality and reliability.
Limitation of Liability for Direct Losses	<ul style="list-style-type: none"> ■ Incorporate the escrow agent's terms related to standard of care, with liability for direct losses limited to those caused by its willful misconduct, fraud, or gross negligence.
Limitation of Liability for Consequential Losses	<ul style="list-style-type: none"> ■ Specify that the escrow agent is not liable for any indirect, punitive, or consequential losses or damages.

ESCROW AGREEMENT PRECEDENTS

Sign on to the Business Law Center on Westlaw to access recent examples of escrow agreements for M&A transactions. This list of precedents has been generated for you by Practical Law editors and can be further filtered or modified.

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