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Scheduled Litigation: Tips to Manage Third-Party Lawsuits

Avoid common post-closing disputes and streamline scheduled litigation challenges with these tips for your next M&A deal.

1. Settle Before Closing

- Managing scheduled litigation requires aligning multiple stakeholders whose interests do not always sync naturally. Avoid scheduled litigation altogether, if possible.
- Litigation may become more difficult and costly to settle after the acquisition closes.
- Settling litigation is wise even where there is not a substantial risk the litigation's settlement value will increase after closing.

2. Determine Who Controls the Litigation

- If the matter cannot be settled, determine who will control the conduct of the litigation after the acquisition closes: the buyer, or the sellers through the shareholder representative.
- The buyer may insist on control if:
  - They are sensitive to reputational concerns.
  - There is a prospect of setting a bad precedent.
  - They risk losing critical intellectual property.
  - They are unwilling to cede command of a lawsuit naming a company they now own.
- If the sellers' representative controls, the sellers should negotiate the right to tap escrow funds for reimbursement of legal expenses, particularly if the expense fund set aside at closing is not "trial sized."

3. Consider a Dedicated Escrow

- Set up a dedicated escrow to secure indemnified losses to help the parties define the scope of indemnity and set expectations while protecting other escrowed funds.
- With a segregated escrow in place, general indemnity escrow funds may be released to the sellers even as the scheduled litigation goes on (and on, and on).
- Buyers remain protected from the risk of the litigation while sellers secure some of their consideration, creating an early and easy win for both M&A deal parties.

4. Identify Counsel and Settlement Amount

- Sellers should understand that it will be difficult to successfully resist indemnification of the buyer's legal expenses incurred in defending the scheduled litigation.
- Designate specific outside counsel to represent the acquired company in the scheduled litigation matter after closing.
- Determine in advance what amount of legal fees incurred by the designated counsel may be "deemed reasonable" without further justification.

5. Set a Cap and Floor, and Share Loss Details

- Set a reasonable worst-case scenario determined prior to closing. Buyers may be reluctant to set a cap, but with proper due diligence, litigation losses should not exceed the set amount.
- Carefully examine the scheduled litigation's value and potential exposure before closing—this will help set expectations and reduce unpleasant surprises.
- Identify a floor where the indemnification of losses begins for deal parties and share the exposure to any losses.

6. Offer Transparency and Cooperation

- Savvy buyers provide visibility to the seller's representative throughout the litigation to help allay concerns about how the litigation was conducted and help the sellers understand why it settled or went to trial.
- Sellers should negotiate the right to be apprised of material developments in the scheduled litigation.
- Buyers should be obligated to obtain the sellers' approval of any settlement.
- To retain the attorney-client privilege, buyers and seller representatives may wish to enter into a joint defense or common interest agreement after closing.

As shareholder representative on more than 2,650 deals, the team of experts at SRS Acquiom can help M&A professionals holistically manage post-closing issues and solve problems on deals before they start.

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