The Guide to Mergers and Acquisitions

Editors
Paola Lozano and Daniel Hernández

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First Edition

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Publisher's note

Latin Lawyer is delighted to publish *The Guide to Mergers and Acquisitions.*

Edited by Paola Lozano and Daniel Hernández of Skadden, Arps, Slate, Meagher & Flom LLP and containing the knowledge and experience of more than 40 leading practitioners, it provides guidance that will benefit all practitioners acting in Latin American mergers and acquisitions.

M&A activity in Latin America has grown significantly in recent decades and deals are increasingly complex. This guide draws on the expertise of highly sophisticated practitioners to provide an overview of the main elements of deal-making in a region shaped by its cyclical economies and often volatile political landscape. Its aim is to be a valuable resource for business-people, investors and their advisers as they embark on an M&A transaction.

We are delighted to have worked with so many leading firms and individuals to produce *The Guide Mergers and Acquisitions*. If you find it useful, you may also like the other books in the Latin Lawyer series, including our *Guide to Corporate Compliance and Regulators*, our online tool that provides an overview of the major regulators in Latin America.

My thanks to the editors for their vision and energy in pursuing this project and to my colleagues in production for achieving such a polished work.

Rosie Cresswell, *Deputy Publisher*

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Part IV

Select Topics Critical to Deal-Making

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Indemnity Escrows and Other Payment Guarantees

Luis Burgueño, Alberto Córdoba, Marisol Márquez and Elías Jalife[1]

Type of indemnity or payment guarantees

Indemnification is a contractual remedy and risk allocation mechanism typically used in M&A transactions to compensate a party for damages[2] suffered as a result of misrepresentations and breaches of warranties and covenants that become known or materialise after closing with respect to pre-closing facts, events and circumstances.[3] Indemnification provisions are usually heavily negotiated by the parties, on the one hand, allocating the risk related to the transaction and providing certainty as to which party will be liable for such post-closing issues and, on the other, setting forth the terms, conditions and procedures under which the parties may seek such indemnification under the applicable transaction agreement.

In a traditional M&A transaction, the buyer as the likely indemnified party will negotiate for broad indemnification rights, while the seller as the likely indemnifying party will seek

1 Luis Burgueño and Alberto Córdoba are partners, and Marisol Márquez and Elías Jalife are associates at Von Wobeser y Sierra.

2 The type of damages that are susceptible of being indemnified is highly negotiated in M&A agreements. One point of frequent debate, with varying degrees and nuance depending on the applicable law of the agreement, is the inclusion or exclusion of indirect or consequential damages, '*lucro cesante*' or lost profits and opportunity costs, among others. Often, damages also include any claims and attorneys' fees. Throughout this article, we will refer to 'damages' including damages (*daños*) and losses (*perjuicios*), which under Mexican law are any loss or detriment suffered in the patrimony as a result of the breach of an obligation, and the deprivation of any legal gain, which should have been obtained with the fulfilment of an obligation, respectively.

3 Parties to an M&A transaction may agree on including other 'special' indemnification items, as well as protection against certain types of damages that otherwise may not be protected, such as attorneys' fees.

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to limit the scope, term and amount of its indemnification obligations and may also try to limit the circumstances in which the indemnitee may bring a claim.[4]

A core aspect of indemnification provisions that requires significant negotiation from the parties is how the indemnity will be funded and payment thereof will be guaranteed. In practice, the mechanisms typically used for funding and securing an indemnity are the execution of an escrow agreement, set-offs against future payments, particularly earn-out payments, and a partial holdback of the purchase price.

Notwithstanding the foregoing, all personal and in rem guarantees legally available may be used as indemnification or payment guarantees in M&A transactions. The choice on the payment guarantees will often depend on various factors, including the specific characteristics of the transaction, the governing law, the purchase price of the transaction relative to the contingencies identified during due diligence, the ongoing and future relationship between seller and purchaser, etc. The agreed-upon indemnification provisions and the choice of the indemnity payment guarantees come down to the creditworthiness, credibility and payment capacity from the indemnifying parties.

In the following pages, we will focus on describing the indemnification or payment guarantees more often used and available in M&A practice.

Escrow and hold-back

In M&A transactions, the indemnified party, typically the buyer, will often seek to secure payment of indemnification obligations of the indemnifying party, typically the seller, by setting aside or holding back an amount of cash (typically calculated as a percentage of the purchase price) until the expiration of the survival term of the indemnification obligations, thereby securing liquidity for any payment due. In cases where there are multiple sellers that are jointly and severally liable to buyer for indemnity and other post-closing obligations, the sellers may also prefer to set aside necessary funds in escrow, to reduce the risk of being held accountable for the inability of another seller to fulfil its obligations.

The main difference between an escrow and a holdback is that, in an escrow, the portion of the purchase price set aside is held by a third party (typically an escrow agent but it can also be a trustee or a financial depositary), while in a holdback the buyer or indemnified party directly retains or holds that portion of the purchase price. Naturally, the buyer or indemnified party will prefer a true holdback of the purchase price as it allows it to retain control of the funds, while the seller or indemnifying party will usually prefer the retained amount to be held by a third party, as this mechanism reduces the amount of control the indemnified party has over the funds and increases the likelihood that any funds remaining after payment of indemnification claims and expiration of the relevant term will be promptly released to the indemnifying party.

4 Limitations on the circumstances under which an indemnitee may bring a claim include monetary thresholds such as *de minimis* amounts, baskets and caps, as well as 'anti-sandbagging' provisions, which generally seek to prevent a party from bringing an indemnification claim for breaches of representations and warranties of which such party had actual or constructive knowledge prior to closing.

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When agreeing on an escrow or holdback, parties should consider that the indemnifying party will often seek for such mechanism to be the only post-closing remedy for any indemnification claims and will try to limit the liability to the amount of the holdback or escrow amount, subject to customary exceptions, such as indemnity with respect to breach of fundamental representations or non-waivable rights in the case of fraud. In M&A practice, holdbacks are used far less often than escrows.

Furthermore, depending on the characteristics of the transaction, the parties may explore the possibility of maintaining a single holdback or escrow or separate holdbacks or escrows to secure payment of their indemnification obligations.

Escrow

In essence, an escrow is a segregated account that the parties to an M&A transaction often use for securing payment of their indemnification obligations, where the funds deposited in the account are held by a third party, whether an escrow agent, a trustee or a depositary. An indemnification escrow is typically funded by setting aside and depositing a portion of the cash payable as purchase price with a third party (whether into an escrow account, a trust or a security deposit).

Escrows are usually set forth as a contractual remedy in the main transaction agreements, securing payment of the parties' indemnification obligations, but also must be documented and effected in a separate agreement (ancillary to the acquisition agreement), such as an escrow agreement, a trust agreement or a security deposit agreement, as agreed upon by the parties, which will include the third party's rights and obligations in connection with its role of custodian of the funds. The choice of legal figure through which an escrow will be implemented in a given M&A transaction shall depend on several factors, such as the governing law, the domestic or cross-border nature of the transaction and the parties, the leverage one of the parties may have on the other.

While not prohibited by Mexican law, as is the case in most Latin American jurisdictions, escrow agreements are not regulated and thus, when the transaction is subject to Mexican law, the escrow is usually implemented through the execution of a trust agreement or a security deposit.

Escrow agreement

An escrow agreement is the typical form of implementing an escrow in M&A transactions and such legal figure is not provided or regulated as such under Mexican law and other jurisdictions in Latin America, although there are other legal figures with substantially similar effects, as we will further describe.

The parties to an M&A transaction may agree on the execution of an escrow agreement governed by US law and subject to a forum in the United States, when either the transaction documents are governed by US law and subject to a forum in the United States or one of the parties pushing for US law and forum for the escrow agreement has enough leverage. In this regard, it is very likely that the escrow agent will require that the governing law and forum of the escrow agreement be the one of the jurisdiction in which the escrow agent is located, even if that governing law is different from the other transaction documents.

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The escrow agreement with the escrow agent sets out the terms and conditions under which the escrow agent will hold and release the escrowed funds, in exchange for a fee. Escrow agents are usually banks or other financial institutions that often have their own standard forms of escrow agreements under which they provide their services and that set forth standard terms and conditions for such type of transactions. Although escrow agents are often open to negotiate their forms to accommodate some of the terms and conditions agreed by the parties, it is advisable to involve the escrow agent early on in the process to make sure that the terms negotiated by the parties are agreeable to the escrow agent.

Among the main terms and conditions of the escrow agreement often negotiated with the escrow agent are those regarding the distribution of funds or payments arising from indemnification claims and the rules applicable to the investment of escrowed funds. The parties will want to ensure that the escrow agent has a clear set of rules for the distribution of funds and the escrow agent will want to be released from any liability that may arise therefrom, for which the escrow agent will generally require either a joint written instruction by the parties, or a final decision of a court, arbitral panel, or other third party with authority over the underlying issue, prior to releasing any funds in the escrow. For such purposes, the parties shall agree on the applicable instructions, notices and other procedural rules for the release of funds, including upon expiration of the escrow period.

Additionally, the parties often have to consider if there will be a single or separate escrow accounts covering different risks. The latter may be used when there are various specified identified material, guaranteed obligations or when the escrow will also cover post-closing adjustments agreed under the transaction agreement. The indemnified party will often prefer one account to have more funds available to collect the applicable claims against the indemnifying party, regardless of the underlying indemnification event, while the indemnifying party will usually prefer separate escrow accounts to isolate exposure of the amount in escrow and provide for separate escrow release dates. These considerations by the parties may also arise depending on the agreement of different release dates of the applicable indemnification obligations or other obligations guaranteed by the escrowed funds.

In transactions where the purchase price is represented by stock or a note, it is not uncommon for the parties to place such stock or notes in escrow to guarantee their indemnification obligations. In these cases, aside from the fact that the parties shall pay particular attention to the applicable securities and tax provisions, they should also have to agree and set forth the terms and conditions applicable for the valuation and transfer of such stock held in escrow upon an indemnity claim.

Selecting the escrow agent

When choosing the escrow agent or a trustee or depositary, the parties might consider whether any of them has an existing or strong relationship with such agent to address potential conflicts of interest but also so that they are in a position to negotiate better fees and terms under the escrow agreement (or the applicable guarantee trust or security deposit agreements). Both parties look for a reliable independent party so that it will not be prejudiced towards or against any of them in following the agreed upon rules and procedures, especially regarding release of funds to any of them.

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It is advisable that the parties identify who the escrow agent will as soon as possible be able to negotiate the escrow agreement in good time, as well as to agree on the way the agent's fees will be paid between the parties. Although the parties may negotiate the payment of the escrow agent's fees, it is very common for the escrow agent's fees to be split between the indemnifying party or seller and the indemnified party or buyer. Furthermore, it will give the parties time to determine the rules applicable to the investment of the funds in escrow (or guarantee trust or security deposit).

Escrow amount and term

In M&A transactions, when determining the amount of the escrow (or amount transferred into a guarantee trust or security deposit), the indemnified party will usually try to ensure that the amount is high enough to cover all possible indemnity claims and that the term is equal to the survival period for non-fundamental representations and warranties agreed upon in the transaction agreement, which typically may range from six months to as long as three years (most commonly between 12 and 18 months).

The indemnified party may also take into consideration the effort that may be required to bring an indemnity claim and collect payment thereof, as well as the creditworthiness of the indemnifying party. On the other hand, the indemnifying parties will try to keep the escrow amount and period as small and short as possible.

In M&A transactions, it is common practice for the escrow amount to be agreed upon as a percentage of the transaction value or purchase price; however, this percentage may significantly vary between transactions, typically around 7 to 20 per cent depending on the nature and size of the deal, the depth and results of due diligence. Escrow amounts lower than 10 per cent of the purchase price are typically limited to larger deals or in cases where the escrow is not the exclusive remedy available to the indemnified party or buyer, as other guarantees or insurance may be in place to guarantee payment of indemnity claims or other obligations of the parties under the transaction agreement.

It is also common practice to structure the escrow in tranches that guarantee specific indemnification obligations for contingencies identified during due diligence (for instance, tax claims or pending litigation), with their own set of term and release dates.

Interest accrual beneficiary

In M&A transactions, the determination of which party, whether the indemnified or the indemnifying party, is entitled to receive the accrued interests generated by an indemnity guaranteed amount, if any, is especially important in guarantees in which the guaranteed amount is transferred to another entity and administrated somehow that it generates an interest, as is the case of an escrow, a guarantee trust or a security deposit.

In a holdback whereby the buyer or indemnified party retains a portion of the purchase price, although it may be negotiated otherwise, typically the buyer is required to hold the funds in a separate account and any accrued interest will be for the benefit of the indemnifying party.

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When the payment guarantee is being held in escrow, the indemnifying party is typically the one entitled to receive the accrued interests generated by the guaranteed amount. However, the parties often negotiate whether accrued interest should be distributed to the indemnifying party or should be part of the escrowed funds that may be used to secure the covered obligations. The parties may also agree for the escrow agent to carry out investments under a specific set of rules. Although there is no rule of thumb, the indemnified party is usually more concerned than the indemnifying party with maintaining very conservative investment guidelines, providing for liquid investments that make it easy for the escrowed funds to be available as needed.

Release notices and conditions

In M&A transactions, release of the indemnification payment guarantees are typically subject or linked to the survival term of the indemnification obligations. The general rule is that both the payment guarantees and the indemnification obligations of the parties are released and expire, respectively, by the sole course of time. However, the escrow terms and conditions typically provide for the extension of the release term if an indemnification claim is filed before the expiration of the release term, for the indemnified party to bring its claim to court or arbitration and, once started, until the dispute is settled.

In any case, it is advisable for the parties to an M&A transaction to agree on clear release mechanisms of the escrowed funds. These mechanisms include setting forth the procedure applicable to indemnity claims, including notices from the indemnified party to the indemnifying party upon the occurrence of any misrepresentation or breach of warranty or covenant from the indemnifying party, periods for the indemnifying party to cure any misrepresentation or breach of warranty or covenant, as well as the resolution mechanism applicable in the event of controversy on an indemnity claim (arbitration is typically used in M&A deals in Latin America).

Also, it is key to agree on clear and unequivocal release conditions or triggers. These release conditions or triggers may consist of notices to the applicable agent, which may be agreed to be given jointly by the parties upon settlement of an indemnification claim, or even from a third party such as third-party law firm confirming that the applicable conditions for releasing the funds have been met, or if a party provides a final and non-appealable judgment by competent court or tribunal requiring payment of the relevant sum to the indemnified party. Escrow agents typically prefer joint written instructions by the parties, as they do not want to be caught up in disputes among the parties (e.g., in connection with the calculation of interest payable in accordance with a court order).

Additionally to the agreed release conditions, the parties may consider different or staggered release dates of the escrowed funds, which are typically preferred and negotiated by the indemnifying party or seller, while the indemnified party or buyer will prefer to maintain the escrowed funds for the longest possible period of time. This is more often agreed when the agreed upon escrow term or amount is high compared to market standards, when other obligations or adjustments are covered by the escrowed funds or when the indemnification obligations have different survival terms, in which case a portion of the escrowed amount

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may be released following the applicable adjustments or calculations, and the remaining amount may be released after the expiration of the applicable indemnification term.

Guarantee trust

When the parties to an M&A transaction agree on securing their indemnification obligations under Mexican law, an often used vehicle is a guarantee trust. Under a guarantee trust agreement, the indemnifying party transfers an amount of money (typically a portion of the purchase price) to a trustee, which maintains legal title to such funds and provides its services in exchange of certain fees, until the expiration of the survival term of the relevant party's indemnification obligations under the transaction agreements.

Under Mexican law, only financial institutions such as banks and other authorised legal entities such as SOFOMs (multiple-purpose financial companies) are authorised to act as trustees in guarantee trusts. Applicable laws and regulations provide specific rules applicable to such form of trust and trustees typically have their own standard forms of guarantee trust agreements under which they provide their services and which set forth standard terms and conditions for such type of transactions.

Similar to those provisions available under escrow agreements, under a guarantee trust, the parties may agree on specific rules for distribution of funds or payments arising from indemnification claims, the establishment of the amount of the guarantee trust and the authorised investments of the transferred funds.

Security deposit

Another legally available mechanism commonly used in Mexico to secure payment of indemnification obligations in M&A transactions is a security deposit. A security deposit is an agreement under which the indemnifying party transfers possession of funds (again, typically a portion of the purchase price) to a third party depositary. Under a security deposit agreement, the depositary acts solely as such (unlike the trustee which is transferred the legal title over the funds) and has the obligation to maintain such funds and any proceeds or interests accrued therefrom

Depositaries are usually financial institutions authorised as such under Mexican laws and regulations and provide their services in exchange of a fee. As in the escrow and guarantee trust agreements, the depositaries often have standard security deposit agreements under which they provide their services and which set forth standard terms and conditions for such type of transactions. However, the parties may negotiate certain terms and conditions to abide to the provisions of the transaction agreements.

It is worth mentioning that, depending on the nature of a particular transaction, choosing one of the previously mentioned mechanisms instead of another becomes relevant. The parties have to take several matters into consideration, such as the applicable fees for each mechanism (guarantee trust or security deposit) and even the particular regulation that would apply in the absence of a specific agreement on a particular subject.

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Holdback and set-off rights

As mentioned above, parties to M&A transactions, and specifically the buyer, may seek to secure payment of their counterparty's indemnification obligations by holding back a portion of the purchase price until the expiration of the survival term of the indemnifying party's indemnification obligations.

On the other hand, when an M&A transaction provides for one or more post-closing payments that are contingent on the satisfaction of certain milestones related to future performance, the indemnified party may seek to secure payment of the indemnifying party's indemnification obligations by including a set-off covenant in the applicable transaction agreement.

Holdback of the price by the purchasing party

If a holdback of a portion of the purchase price by the purchasing party is agreed as guarantee of the indemnifying party's indemnification obligations, the indemnified party will directly hold or retain that amount until the expiration of the survival term of the indemnification obligations or shorter period agreed upon. If, upon expiration of the applicable term, no indemnity claim and payments are due or pending, the indemnified party is required to deliver the holdback amount to the seller or target.

Holdbacks are not commonly used as guarantee payments as they give full control of the holdback amount to the indemnified party. Thus, holdbacks are agreed upon when the buyer or indemnified party has substantial leverage over the seller or indemnifying party or when there is a broader long-term business relationship between the parties to the transaction. The foregoing, as usually the seller or indemnifying party will prefer that the funds are held by an independent third party.

Additionally, the parties may agree that a holdback covers both working capital adjustments or other price adjustments and indemnification claims. Under this scenario, it is common to agree the release of a portion of the holdback amount following the final working capital calculation or price adjustments, and the remaining holdback amount to be released after the expiration of the indemnification survival term.

Set-off right against earn-out and other future payments

If the purchase price of an M&A transaction includes certain future or milestone payments or earn-out payments, usually to be paid to the selling or indemnifying party, the parties to such transaction may consider using a set-off mechanism for securing and funding indemnification obligations. Under this mechanism, the parties may agree on certain provisions in the transaction agreement for the purchasing party to withhold the pending milestones or earn-out payments to which the seller or indemnifying party is entitled to as guarantee payment of its indemnification obligations if indemnity claims and payments derived therefrom arise and are due to the indemnified party after the closing of the transaction.

Strictly speaking, a set-off is the reduction of future payments in the amount owed to the indemnified party under the indemnifying party's indemnification obligations. This mechanism may be a good incentive for the indemnifying party to achieve the intended performance; however, the downside is precisely the fact that such future payments are

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often conditional or uncertain to occur. If the target company fails to meet the specified milestones within the agreed periods, the buyer will be released from paying the applicable payment or earn-out to the seller.

Under this mechanism, the buyer or indemnified party will seek to have the right to withhold and offset contingent payments that have materialised for the benefit of the seller, against amounts owed by the seller to the buyer in connection with indemnification claims. In the end, the agreed-upon provision will often depend on the leverage the indemnified party may have over the indemnifying party. Usually, the parties agree on the specific provisions applicable for exercising a withholding and offset right, such as the requirements applicable thereto, notices and dispute resolution mechanisms between the parties. When the parties do not agree on the applicable mechanisms for exercising and settling disputes on these matters, it may be more complicated in practice as they would have to raise such claims before the competent courts and payment derived therefrom may only be collected upon a final and non-appealable judgment.

Other in rem guarantees

There are cases in which the parties' indemnification obligations can be secured by assets different from cash, often related but not within the scope of the transaction. The buyer will seek that the assets used to secure such indemnity payments are of greater value (whether collectively or individually) than the estimate amount of the indemnification amount agreed by the parties. Assets that have an active trading market (such as equity of publicly traded companies) are also preferable. Assets that may provide immediate liquidity like real estate or privately held shares with dividend rights are also appealing. Assets used as guarantee can be owned by the indemnifying party or by a third party (usually related to the indemnifying party). However, involving a third party will necessarily increase the complexity of the negotiations and the execution.

In the event of an indemnity claim, the indemnified party would be entitled to receive payment thereof whether by acquiring title to the collateral or by the amount derived from the execution and sale of such assets, as agreed by the parties.

There are two main types of in rem guarantees, depending on whether the collateral is real estate or personal property, available to parties to an M&A transaction for securing their indemnification obligations. These guarantees are typically required to be granted before notary public and registered before public registries to be valid and perfected, that is, enforceable on third parties.

Mortgage

Security interests over real estate may include mortgages. In that case, the indemnifying party grants a security interest over real estate that is out of the scope of the transaction (i.e., not owned by the target nor sold in an asset deal). Mortgages are seldom used to secure indemnification obligations but can be useful where the purpose of the transaction is liquidity and there are real estate assets related to or carved out of the transaction that can be mortgaged. When the seller or the indemnifying party may not have the liquidity to guarantee its indemnification obligations with cash or other goods, the buyer or indemnified

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party may agree on having its indemnification rights guaranteed by this type of security interest. The liquidity provided by a guarantee over a specified asset other than cash will be dependent on the marketability, value condition and other specific facts of the relevant asset upon possession or foreclosure.

The real estate typically used as security through a mortgage is related or carved out of the scope of the transaction, such as the real estate where a certain facility is located that is owned separately by the selling shareholders rather than by the target company (a common arrangement in privately held companies). That real estate is often leased post-closing to the target company and thus is of particular value to the purchaser.

This guarantee mechanism in Mexico, as is the case in most civil law jurisdictions in Latin America, is perfected through the execution of a mortgage agreement before a notary public and further registered before the public registry of property of the place where the real estate is located. As a result of the mortgage, the indemnified party will have an in rem right to enforce the mortgage in the event of the indemnifying party's failure to comply with its payment indemnification obligations.

Pledge over stock or other personal property

Parties to an M&A transaction may opt for securing their indemnification obligations through a pledge, that is, an in rem guarantee over other personal property, typically related to or carved out of to the transaction.

In general, any personal property can serve as collateral in an indemnity payment guarantee; however, the most common type of pledges are those granted over the indemnifying party's remaining stock in the target company. Pledges over stock are often used when the buyer acquires a controlling interest in the target company and, therefore, the selling party maintains a minority interest in the company.

Pledges of stock are relatively easy to implement in Mexico as in most Latin American jurisdictions, as they are perfected through execution of a pledge agreement, endorsement and delivery of stock certificates and registration in the stockholders' ledger book. No notarisation or registration is required for perfection in Mexico.

Less commonly, the parties to a transaction may agree to secure their indemnification payment obligations with other personal property out of the scope of the transaction (i.e., if the transaction includes the acquisition of the shareholding interest of the target company but not of certain of its assets and the parties agree on a lease thereof, such as equipment, the indemnifying party may guarantee its payment obligations with such assets not subject to the transaction but related to the business).

Personal guarantees

Parties to an M&A transaction may agree that their payment indemnification obligations are guaranteed by a third party, which may or not be related to the parties to the transaction. In these type of guarantees, the person or entity that issues the guarantee undertakes the indemnifying party's payment obligation either directly or in case of default by the indemnifying party, and, as a result thereof, the indemnified party has a direct action against the third party granting the guarantee to collect payment derived from an indemnity claim.

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Below we describe the most common forms of personal guarantees used in M&A transactions to guarantee the parties' payment indemnification obligations.

Parent guarantees and other personal guarantees granted by related parties

In practice, guarantees granted by related parties to an M&A transaction are usually an alternative when the seller is a holding or special purpose vehicle or is otherwise not an operating company with sufficient creditworthiness and thus the parent company or another affiliate has to guarantee the seller's obligations. In contrast, such guarantees are typically not required when the indemnifying parties are stand-alone companies or entities with a substantial balance sheet and operations of their own.

Parent guarantee

A parent guarantee is a payment guarantee granted by a parent or an affiliate company of the indemnifying party to secure any indemnity payment obligation of such indemnifying party. Parent guarantees are common in M&A practice and are often implemented through the inclusion of a specific guarantee clause in the transaction agreement or the execution of a separate surety agreement setting forth the guaranteed obligations, customary waivers to guarantor's legal protections, limitations of guarantor's liability and other terms and conditions of guarantor's obligations.

Depending on the terms and conditions set forth either in the specific guarantee clause included in the transaction agreement or in a separate surety agreement whereby the parent guarantee is granted, the indemnified party will be able to collect the indemnity directly from the parent guarantor or only upon the indemnifying party's default or delay.

Joint and several liability

A fairly used mechanism to secure payment of indemnification obligations in M&A transactions is the joint and several liability of multiple sellers or of a parent company or other affiliate. When there is more than one indemnifying party, it is common that all indemnifying parties guarantee all of their obligations under the transaction agreement, including their indemnification obligations, as joint and several obligors.

Similarly to the parent guarantee, it is common for a parent or affiliate company of the indemnifying party to enter directly into the transaction agreement to act, typically, as a joint and several obligor of the indemnifying party regarding all its the obligations set forth in the agreement, including its indemnification obligations. If a joint and several obligation is undertaken, the indemnified party would be entitled to collect payment of any indemnity amounts from any of the indemnifying parties or its parent or affiliate company, as applicable.

Personal guarantees granted by third parties

Exceptionally, indemnification obligations may be guaranteed by third-party financial institutions, either through a standby letter of credit or a surety bond.

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Standby letter of credit

A standby letter of credit is an instrument whereby a financial institution, acting upon the request and instructions of a client, irrevocably agrees to pay certain amount of money to a third party upon demand and delivery of certain documents. As the letter of credit constitutes a direct obligation of the financial institution, from the indemnified party's perspective the credit risk is shifted from the indemnifying party to the financial institution, and thus is very favourable to the indemnified party, though usually expensive.

In M&A transactions, the standby letter of credit can be a mechanism for securing the parties indemnification obligations, for which the indemnifying party shall obtain such standby letter of credit from a financial institution naming the indemnified party as beneficiary, and such indemnified party is entitled to obtain payment from any damages derived from an indemnification claim directly from the financial institution issuing the standby letter of credit. Standby letters of credit used in M&A transactions are commonly subject to rules issued by the International Chamber of Commerce, such as the ISP98 (International Standby Practices published in 1998) or the UCP 600 (Uniform Customs & Practice for Documentary Credits published in 2007).

This mechanism is often used in M&A transactions when the indemnifying party either (1) previously provides the applicable funds to the financial institution for the issuance of the standby letter of credit; or (2) has an existing line of credit with the financial institution and the standby letter of credit used to secure its indemnity obligations is the means to dispose of that credit. In both cases, the standby letter of credit is irrevocable.

The standby letter of credit may be convenient for the indemnified party as it is easily enforceable and the risk of insolvency of a financial institution is typically low, especially relative to the indemnifying party's; however, the letter of credit may entail a big financial burden to the indemnifying party as it will have to obtain (or use an existing) credit facility with the financial institution and in some cases grant collateral to secure its obligations before that institution and assume restrictive covenants during the term of the credit facility.

Surety bond

Another useful indemnity guarantee granted by a third party is the surety bond. In order to guarantee an indemnity payment through a surety bond, the indemnifying party has to contract with a surety institution, which agrees to pay such party's indemnity payment obligation in case the indemnifying party fails to do so.

The surety bond is typically implemented through the execution of a surety agreement or surety line. It is possible for the parties of a surety agreement to determine the scope of the surety bond; by default, the surety institution has order and excuse benefits in granting a surety bond. Therefore, due to the order benefit, the surety institution is liable before the indemnified party only if the indemnifying party has failed to make the respective payment. Likewise, the surety institution has the excuse benefit, through which it can appoint some or all the indemnifying party's assets to pay for the indemnity amount if such amount is requested to the surety institution by the indemnified party. Both the order and the excuse benefits can be, and in practice are normally, waived by the surety institution, which would

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be more convenient to the indemnified party, since it would have higher collection possibilities against the surety institution.

The surety institution collects a fee, typically calculated as a percentage of the contingent amount, in connection with the secured amount and has recourse against the indemnifying party if the institution has to pay some or all of the indemnity claim. In practice, the surety institution usually requires the indemnifying party to prove its solvency so that the surety institution can validate its creditworthiness. The surety institution may even require the contracting party to guarantee the payment of the secured obligations by some other means (for example, a mortgage).

Promissory note

Although not very commonly used, it is also useful for the parties of a transaction to secure the payment of their indemnity obligations through the execution and delivery of one or more promissory notes. The promissory note is a negotiable instrument that constitutes an unconditional promise of payment made by the indemnifying party should that indemnifying party be bound to pay any indemnity claim to the indemnified party. Promissory notes may be convenient because of their nature as negotiable instruments, which means that, in practice, they can be usually enforced in special judicial procedures that are often faster and give greater collection rights to the indemnified party than other mechanisms, such as the possibility of embargoing assets from the indemnifying party at the beginning of the judicial proceeding. However, a promissory note does not provide security over specified assets and therefore, it does not solve for potential lack of creditworthiness and insolvency of the indemnifying party.

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Appendix 1

About the Authors

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Luis Burgueño is a partner of, with more than 30 years of experience in M&A, corporate matters and transactions in general. He is a member of the executivecommittee of the firm and is co-leader of our Energy and Natural Resources Industry Practice Group.

His corporate practice is diverse, focusing on mergers and acquisitions and corporate and commercial transactions in general, including mergers, spin-offs, strategic alliances and IT transactions, both domestic and transnational, with emphasis on the consumer goods, energy and technology sectors.

His clients include public companies on the Dow Jones, S&P, DAX, Nikkei and BMV indexes, some of the most profitable Forbes 100 Top Brands, and some of the largest and most innovative private capital and risk capital funds. He has performed a key role in some of the most innovative and complex M&A matters and transactions taking place recently in Mexico and Latin America.

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Alberto Córdoba is a partner of Von Wobeser y Sierra, with more than 15 years of experience in M&A, corporate matters and transactions in various industries, including oil and gas, energy, the media, heavy and light manufacturing, retail and private capital. He is a member of the corporate and mergers and acquisitions practices and of the Energy Industry Group.

His practice focuses primarily on mergers and acquisitions and corporate matters. His experience includes, mergers, asset transfers, strategic alliances and joint ventures, both nation and transnational.

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Within the mergers and acquisitions practice he regularly advises large national and multinational companies and global private capital investors in acquisitions and investments in multiple industries in Mexico.

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Marisol Márquez is an associate of Von Wobeser y Sierra, mainly engaged in the M&A, corporate and banking and finance practices. With over 9 years of experience, she has participated in complex cross border transactions and advised clients pertaining to all kinds of industries, including financial services and consumer goods, among others. Aside from her core practice in M&A and all aspects related thereto, her experience includes matters related to corporate governance, private equity, commercial contracts, banking, data privacy, IT transactions and financing. Her experience in a wide range of transactions allows her to provide creative solutions to the transactions she is involved in. She also advises clients in the merchant acquiring business and has participated in the filing before the Mexican authorities to register the first non-bank acquirer in Mexico. Additionally, she has been involved in several projects related to telecommunications, energy & natural resources, oil and gas and restructurings.

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Elías also has broad experience in the review, drafting and negotiation of civil, commercial and IT contracts. In the firm, Elías has advised companies in general legal matters on the proper compliance with their corporate, regulatory and financial obligations. Elías has also advised companies whose primary purpose consists of the production and marketing of consumer goods, and therefore he actively participates in the Consumer Goods Industry Group.

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M&A activity in Latin America has grown significantly in recent decades and deals are increasingly complex. This guide draws on the expertise of highly sophisticated practitioners to provide an overview of the main elements of deal-making in a region shaped by its cyclical economies and often volatile political landscape. Its aim is to be a valuable resource for business-people, investors and their advisers as they embark on an M&A transaction.

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