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Purchase Price Adjustment Disputes in Post M&A Arbitration

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Conference on Dispute Resolution in
M&A Transactions

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Why purchase price adjustments?

- Determination of the purchase price plays a major role in every M&A transaction
- **Purchase price adjustments** result in inherent uncertainty as to the final purchase price when the transaction agreements are entered into by the seller and the buyer.
- As a result, the purchase price may be adjusted upwards or downwards depending on the final closing date accounts.
- Alternative concept: **locked box mechanism**
- Main difference: **point of transfer of the economic risk of the target's business performance**
- Whereas a purchase price adjustment is (in general) buyer-friendly, a locked box mechanism is (in general) seller-friendly.

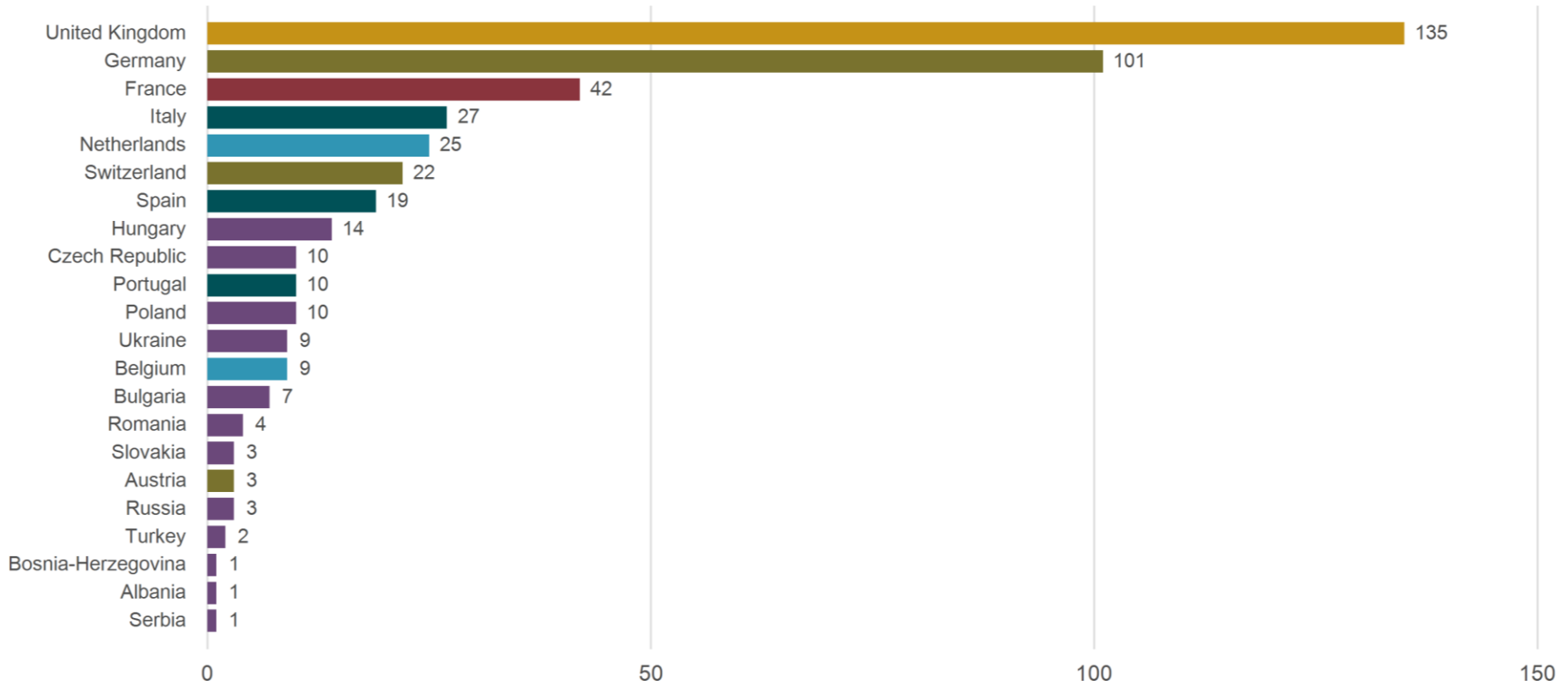
Why disputes arise

- Usually, the SPA provides for a detailed description of the calculation of the purchase price adjustment.
- In general, the purchase price adjustment is calculated based on a comparison between the preliminary closing date accounts and the final closing date accounts.
- **Problem:** usually, it is the seller who prepares the preliminary closing date accounts and the buyer who prepares the final closing date accounts.

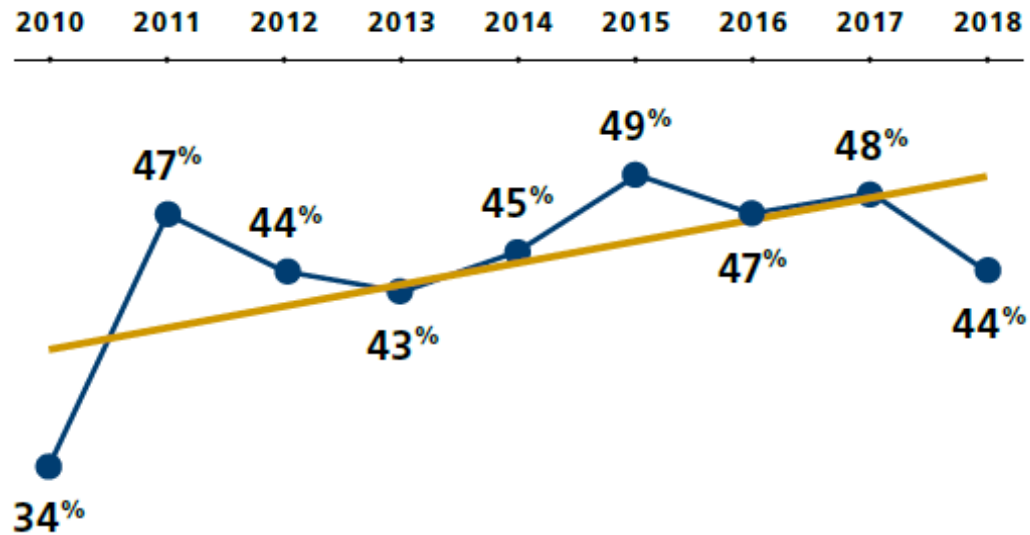


This field of tension leads to many disputes

CMS European M&A study 1/4 – Transactions analysed



CMS European M&A study 2/4 – Trend



● Deals with PPAs — Trend

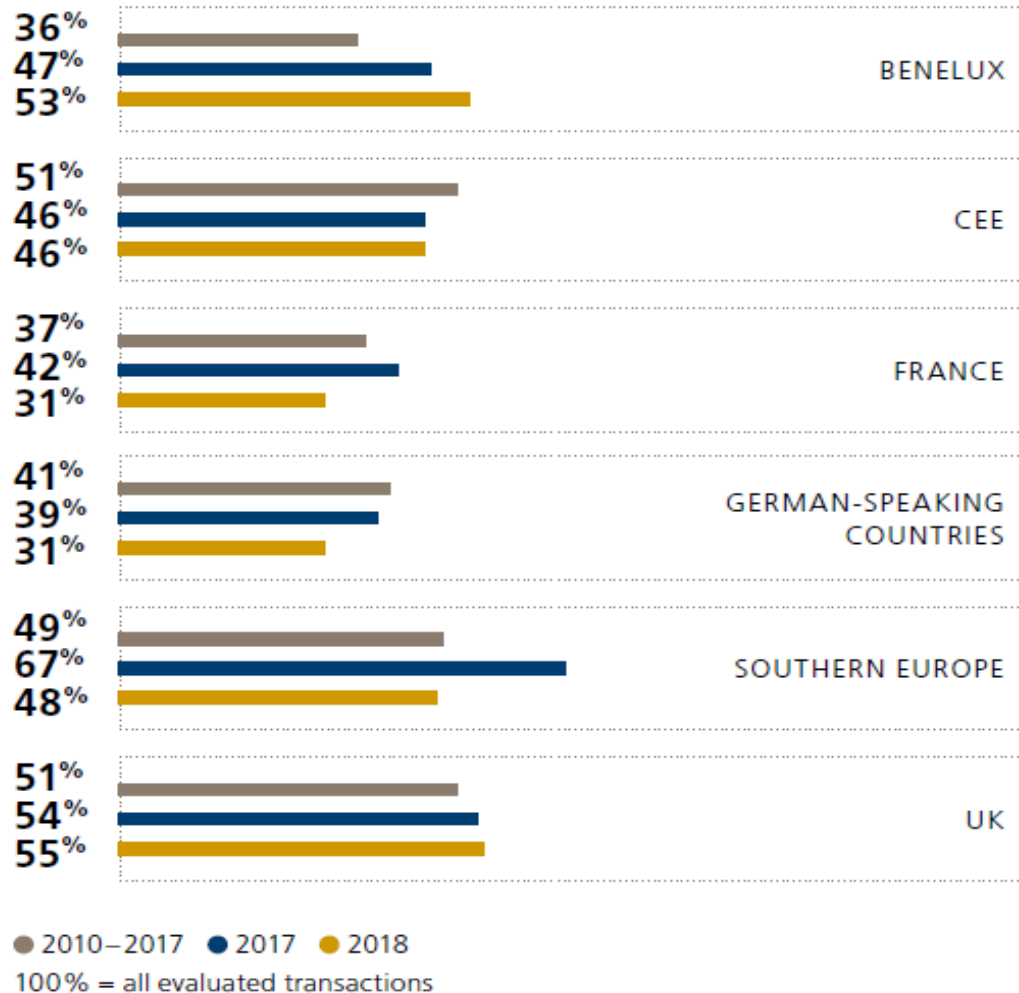


RECENT TREND



OVERALL TREND

CMS European M&A study 3/4 – Regions



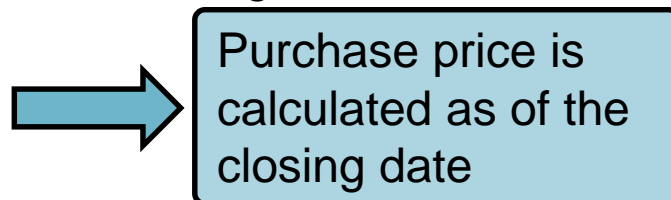
CMS European M&A study 4/4 – Summary

- There were fewer deals with purchase price adjustments and an increase in the application of locked box structures as compared to 2017.
- Purchase price adjustments appear, unlike in 2017 (where there was a consistent spread), much more frequently in large deals (52%) than in smaller deals (41%).
- Where there is no purchase price adjustment, the use of locked box mechanisms is more frequent in large deals although the frequency in large deals fell significantly in 2017 (63% as compared to 88%), but increased in small deals (56%, from 39%).

Purchase price adjustment vs. locked box mechanism

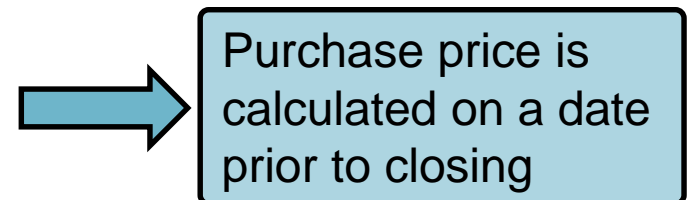
– Purchase price adjustment

- Preliminary closing date accounts and final closing date accounts
- Specific provisions regarding the calculation of the purchase price
- Payment of a preliminary purchase price
- Adjustment of the preliminary purchase price according to the final closing date accounts



– Locked box mechanism

- Fixed purchase price without any adjustment
- Covenants, no leakage
- Buyer is entitled to all profits as of a reference date, e.g. the date of the last financial statement
- Seller is entitled to an interest payment until closing



Case study (1/2)

- A private equity company acquired all of the shares in a limited liability company in the automotive sector from a strategic investor.
- The parties agreed in the SPA that a preliminary purchase price was to be paid.
- The final purchase price was to be determined as of the closing date according to final closing date accounts. Such closing date accounts were to be prepared by the buyer.
- The SPA provides for an expert determination regarding the purchase price adjustment and a general dispute resolution clause.
- The seller did not agree with the closing date accounts provided by the buyer and, thus, filed a notice of disagreement.

Case study (2/2)

- As the parties could not agree on the (final) purchase price adjustment, the seller initiated expert determination proceedings.
- The expert confirmed the final closing date accounts provided by the buyer, however, **without** taking several of the main arguments raised by the seller in its notice of disagreement into account
- Seller initiated arbitration proceedings



Is the arbitral tribunal entitled to review the expert's decision?

Expert determination vs. arbitration clause

- In many cases: SPA provides for an expert determination in relation to the purchase price adjustment **and** for a broad arbitration clause (standard institutional clause).
- No *res iudica* effect of the expert's determination as it is no judgment.
- Binding effect on the parties results from the SPA.
- The arbitral tribunal will have jurisdiction to decide whether to set aside the expert's decision and to review the decision, in particular if:
 - legal interpretation without having the necessary legal background
 - the expert's decision is only in favour of one party
 - the expert did not observe the arguments of the other party
 - excess of mandate, blatant error or fraud

Thank you



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