

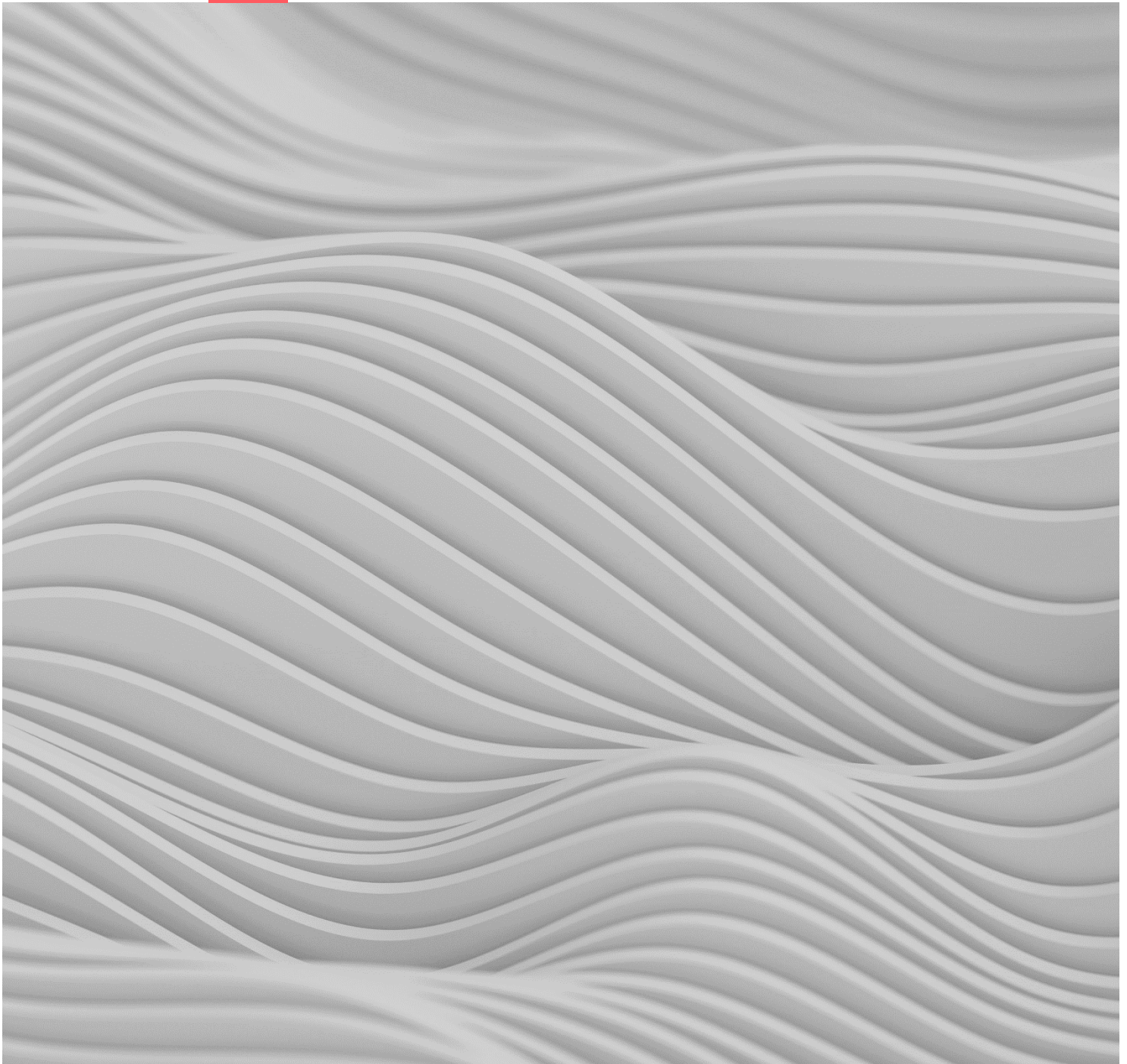


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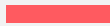
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10 KEY ISSUES IN M&A LITIGATION

Keys 2 and 8. Price and expert determination



10 KEY ISSUES IN M&A LITIGATION



Company acquisitions through the purchase of stock are complex transactions that can lead to disputes between buyers and sellers. In the absence of agreement, these disputes will be settled before a court or an arbitral tribunal.

Based on our litigation and arbitration experience, we are outlining the 10 main disputed issues and some solutions to prevent them through the following “information pills.”

The first pill, on breaching preliminary agreements, is available at [Key 1. Preliminary agreements. Breach.](#)

This document addresses both a substantive issue (price determination) and a procedural issue (third-party determination of contractual elements).

In the following sessions of this cycle, we will continue to address the substantive and procedural issues listed at the end of this document.



Key 2

Price

The price mechanism plays a fundamental role in transactions as complex as company acquisitions. Rather than fixed prices, the most common mechanisms are price adjustments (pro-buyer) or locked-box structures (pro-seller).

Under price adjustment mechanisms, the price is determined after the closing date, based on the company's financial statements and a calculation of the relevant financial parameter(s) prepared by the buyer (generally, net financial debt and working capital). Therefore, the economic risk is transferred to the buyer on the closing date.

Under locked-box structures, the price is calculated based on the company's most recent balance sheet prior to the date of the contract. The price is not subject to subsequent adjustment, unless there is some type of leakage as defined in the contract. Therefore, the economic risk is transferred to the buyer on the date of the reference financial statements.

In recent years, locked-box structures have overtaken price adjustments as the most common mechanism.

Another possibility is agreeing to an earn-out, consisting of a variable deferred consideration (usually in combination with a price to be paid on the closing date). It is calculated based on certain contractual parameters, either financial or non-financial. However, the price is usually conditional on the future profits of the target company (most commonly EBITDA).

Whatever the mechanism agreed, the contract should determine the price to the greatest extent possible, linking the remaining part to clear and objective parameters to minimize disputes over its calculation. If the contract provides for expert determination in the event the parties fail to reach an agreement, it is advisable to follow the recommendations set out in the next key.

Furthermore, the seller should ensure it has access to the necessary information to check or determine the amount pending calculation. Also, during the period of accrual of the variable price (as the case may be), the buyer should be required to comply with certain obligations (to do or not to do) aimed at maximizing it.



Key 8

Third-party determination of contractual elements

Where not all contractual elements are determined at the time of closing, it is common for the parties to appoint a third party for this purpose. In some cases, the third party will determine these elements directly, while in others it will only do so when the parties fail to reach an agreement (e.g., on the price adjustment mechanism).

Experts are often appointed to determine part of the purchase price based on certain parameters, which should be as clear and objective as possible.

The contract should specify the expert's identity to avoid discussions on the appointment. In this regard, it is advisable to include more than one to cover the eventuality that the first candidate cannot take on the assignment for any reason (such as a conflict of interest), but the relevant clause should clearly state the order the experts will be called. It is also advisable to consider reserving the right to initiate the dispute resolution process under the contract in case of disagreement with the valuation.

Depending on the circumstances, it may also be advisable to expressly establish the mechanism for contacting the expert, possibly including the letter of engagement as an annex to the contract. The relevant clause may also determine how the expert will receive the information and communicate with the parties—for instance, whether both parties will receive a copy of all the documentation and whether all communications will be addressed to both parties. If the contract establishes a deadline for the expert's opinion, it should also specify the consequences for non-compliance.

Where the parties have so agreed, the decision of the third party will be binding. However, this does not preclude that in certain circumstances such decision may be reviewed in judicial or arbitration proceedings—especially if it departs from the parties' instructions.



To avoid undesired consequences for the parties, it is important to have specialized legal advice in the negotiation of the purchase agreement and the price clause. In particular, it is especially important to:

Determine the price to the greatest extent possible, linking the remaining part to clear and objective parameters.

Specify the expert's identity in the agreement, including more than one in a clear order.

Consider reserving the right to initiate the dispute resolution process under the contract in case of disagreement with the valuation.

Consider establishing the mechanism for contacting the expert and for providing the information.

Establish the consequences for the expert's failure to comply with the deadlines.



Our brochures address the following issues:

Key 1	Preliminary agreements. Breach
Key 2	Price
Key 3	Representations and warranties
Key 4	Specific indemnities
Key 5	W&I insurance: A growing trend
Key 6	The impact of the buyer's knowledge on the seller's liability
Key 7	Contractual prior claims procedure
Key 8	Third-party determination of contractual elements
Key 9	Expert evidence
Key 10	Dispute resolution procedures—court or arbitration? Mediation as an alternative

For additional information, please contact our [Knowledge and Innovation Group](#) lawyers or your regular contact person at Cuatrecasas.

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