Resolving M&A disputes

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Our previous article in this series outlined some of the main provisions in transaction documentation which, if inadequately addressed, can lead to disputes in an M&A context. In this article we consider post-acquisition disputes arising between a purchaser and seller. No matter how carefully the parties negotiate and structure their deal, there are often areas of contention which arise after the transaction has signed.

Common sources of disagreement

- **Post-completion price adjustment mechanisms** can give rise to disputes, particularly where these are ambiguously drafted or specialist accounting input was not obtained by the parties during the negotiations. If the purchaser and seller are unable to reach agreement on disputed items, an independent accounting expert will usually make a final determination in accordance with mechanics set out in the acquisition agreement.
- **Earn-out provisions** can often prove to be sources of dispute as the underlying accounting treatment is susceptible to manipulation by a purchaser if sufficient seller protections are not included in the drafting. Disputes in this context will typically be referred to an independent accounting expert in accordance with the earn-out mechanics in the acquisition agreement.
- **Warranties and indemnities** are common sources of post-acquisition claims. Warranty claims will be subject to specific limitations agreed in the transaction documentation (including monetary caps and limitations in time). Warranties will also almost always be qualified by matters disclosed by the seller to the purchaser at signing (and potentially at closing) to the extent such disclosures meet the threshold prescribed in the acquisition agreement. Conversely, indemnity claims are unlikely to be qualified by disclosure or subject to any limitations other than the aggregate cap on liability. A purchaser may seek to have the warranties given on an indemnity basis to provide an alternative basis on which to seek recovery (further considered below).
- **Satisfaction of conditions** by the parties between signing and completion can lead to disagreements where the requirements have not been clearly drafted and inadvertently allow a purchaser to walk away from the deal. The definition of what constitutes a “material adverse change” allowing a purchaser to terminate the acquisition agreement during the period between signing and closing is an example of a provision which must be carefully drafted to avoid ambiguity.

What claim can I bring?

The remedies available will depend on the type of provision which is breached. For example, the seller may have breached a warranty or representation which they had given in the acquisition agreement. Damages will be calculated on a different basis in each case, and whether the representation was breached negligently or fraudulently will also have an impact on that calculation. Usually an entire agreement clause in the acquisition agreement will preclude any misrepresentation claims being brought (to the extent the relevant representation is negligently or innocently given) which relate to pre-contractual negotiations so we will focus here on fraudulent misrepresentation, which cannot be excluded.
the buyer has purchased the company on the basis that it was in a certain state at the time of acquisition, they will need to consider the most appropriate claim to bring; this will usually mean focusing on the provision which is likely to lead to the highest award of damages (if more than one option is available).

How will damages be quantified?

The governing law of the acquisition agreement needs to be considered at the point of quantification, as the damages which can be recovered by the buyer for breach of the acquisition agreement will vary depending on the applicable law. As a starting point:

- In the case of a breach of indemnity, the seller will be liable to reimburse the purchaser for a specific loss, which was indemnified in the acquisition agreement. There should be no disagreement as to the quantification of that loss if liability is established.
- For breach of warranty, damages aim to put the claimant into the position it would have been in had the warranty been true. Generally, this involves deducting the market value of the company post-breach from the market value that the company would have had if the relevant warranties had been true (which is likely to be - but is not always - the price paid for the company). In determining the former, the basis on which the company was bought will play an important factor - for example whether the company was bought on the basis of its profits, or net asset value. Depending on the valuation method adopted, it could be that the breach of a particular warranty would not have affected the valuation of the company (or the price paid for it), or it could be that the breach has a disproportionate impact on its value. The buyer should consider how to mitigate its loss, as its damages may be reduced accordingly for failure to do so.
- A claim in fraudulent misrepresentation may be brought where a seller has induced the purchaser to enter into the transaction by (knowingly, or recklessly) making an untrue statement of fact. If this is established, the buyer would ordinarily be entitled to be put into the position it would have been in had the misrepresentation not been made. The buyer would typically be entitled to recover the difference between the price paid for the target and its actual value at the date of acquisition. They may also be able to recover other losses flowing from the fraud.
- Where the parties disagree on a financial matter and it is to be referred to an independent expert, it will be for the expert to determine the quantum of damages due - based on their interpretation of the provisions of the acquisition agreement and the relevant accounting principles.
- Where one of the parties has failed to satisfy one of the pre-completion requirements under the acquisition agreement, the other party’s claim will be based on their loss suffered as a result of the transaction not proceeding - or if it did proceed, the loss suffered (normally the effect on the purchase price) as a result of the failure to satisfy the condition.

Are any interim remedies available?

Consider what the jurisdiction clause in the agreement contains. If the DIFC or ADGM Courts (directly or as the supervisory courts of an arbitration seated there) have jurisdiction over the dispute, there would be a wide range of interim remedies available to the parties. For example, they could consider obtaining an injunction against an escrow agent, or a freezing order and information request against the seller. However, such remedies would only be easily enforceable against an entity based in the relevant financial free zone and bringing them onshore (or elsewhere in the region) could be problematic. The UAE Courts are able to grant basic forms of interim relief such as attachment orders, so applications for such relief could be made directly to the UAE Courts in relation to an onshore entity.

Some practical considerations

- Completion accounts - Make sure that these accounts are not agreed if you suspect that there has been a breach of warranty. Often the acquisition agreement will provide for an expert to make a determination in the event of a disagreement, and enabling the accounts to be finalised may impact on the buyer’s ability to bring a future warranty claim.
- Disclosure - What was the standard of disclosure agreed in the acquisition agreement? If the disclosures have not met the prescribed threshold they will not serve to qualify the warranties.
- Employment issues - Consider whether the agreed level of disclosure was complied with, and whether the people who made (or failed to make) the relevant representations should have their employment terminated or disciplinary
action taken where errors were made.

- **Privilege** - Consider the material produced around this time. Will it be subject to any form of privilege? If not, are you happy for it to be disclosed in any future proceedings?

- **Financial** - Action will need to be taken at an early stage both to (a) re-assess the company's actual financial position (for example, is it a going concern or does its real position mean that it should be wound up) and (b) assess, on a preliminary basis, the impact of the relevant breaches on your valuation of the company.

- **Notice of warranty claims** - The position on notice requirements will vary depending on the relevant governing law. For example, there have been various cases in the English Courts where the court has considered when the buyer "became aware of the matter", and what constituted valid notice of the claim. It is vital that all notice requirements are reviewed in detail and complied with, or your ability to bring a claim may be compromised.

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