



## Deloitte End-to-End M&A

# Deloitte Forensic: Post-Closing M&A Disputes

Within Deloitte’s End-to-End M&A offering, our experienced dispute specialists can assist either buyers or sellers, as well as both parties jointly, with disputes that may arise during the “Post Close” stage of the transaction lifespan.

In the M&A process, buyers and sellers can spend significant amounts of effort and resources performing due diligence and negotiating a sale and purchase agreement (“SPA”) to reduce post-closing risk exposure. Even with the best of intentions, after the deal has closed, the parties may find themselves in disagreement over certain portions of the SPA.

In our experience, the most common types of Post-Closing M&A disputes arise in relation to the following:

- Closing Accounts (or Completion Accounts);
- Contingent Payments;
- Breach of Representations & Warranties.

## Closing Accounts

It is common for acquisitions of privately-held businesses to incorporate a purchase price adjustment following the deal closing to account for the target's changes in net debt and working capital. Conceptually, these purchase price adjustments are made to compensate the parties for any differences between the target's balance sheet as of i) the transaction closing date; and ii) the SPA-defined balance (simply referred to as a 'peg').

To calculate such an adjustment, the SPA typically requires the buyer to prepare and submit to the sellers, within a certain time limit post-closing, the target's balance sheet as of the closing date. Frequently, the SPA will require that the closing balance sheet be prepared in compliance with an accounting 'hierarchy'. For example, the completion accounts might firstly be required to follow specific accounting policies for certain balances, then be prepared in accordance with a defined accounting standard (e.g., the local generally-accepted accounting principles "GAAP"), and lastly, prepared in a consistent manner with the target's prior accounting policies. These seemingly simple requirements can create disagreements between the parties. For example, the buyer may correct previously unidentified errors from the target's prior accounting policies.

The common examples giving rise to a Closing Financial Statement dispute may include:

- Corrections/changes to the target's accounting policies
  - Allowance for bad debt
  - Classification of short-/long-term payables
  - Inventory valuation methods
- Timing of transaction closing date not aligned with typical month-/quarter-/year-end accounting entries
  - Bonus compensation accruals
  - Employee benefits
  - Other missing accruals
- Introduction of new provisions and reserves

## Contingent Payments

Contingent payment, or 'earn-out', clauses can be part of the transaction consideration structure to compensate the seller based on the future performance of the target. Contingent payments are commonplace as they are utilized as a manner to i) bridge differences between the buyer's and seller's outlook of the target's expected financial performance, and/or ii) create financial incentives for the target's post-closing management team.

Such deal terms are referred to as "contingent payments" because the amount of the payment depends on the future performance of the target, which, as any executive knows, is subject to risks and uncertainties.

Common types of contingent payments include:

- Additional compensation to the sellers: typically, based on the future performance of the target, over a specific time-period (e.g. two years post-closing), using financial metrics such as: revenues, gross profits, EBITDA, operating profit, or net income, etc.
- Escrowed funds: a portion of the deal consideration is placed in an escrow account, to be released to the seller if and when the target reaches certain milestones. If such stipulations are not met, then the funds are returned to the buyer.

However, in our experience, contingent payments can lead to disputes arising between the parties post-closing. In the first place, differences in the interpretation of the relevant portions of the SPA is the likely starting ground for disputes. Next, similar to disputes involving closing accounts, changes/corrections to the target's accounting policies can also lead to areas of disagreement. Lastly, and perhaps the most difficult to assess, changes in the direction and management of the target post-closing, which impact the contingent payment, can spawn heated disputes between the parties. Such complexities inherent in contingent payments require trust between the parties while drafting the terms of the SPA as unforeseen circumstances and

unintended consequences may come to light post-closing (e.g., economic impacts from the COVID-19 pandemic).



“...differences of interpretation of the relevant portions of the SPA is the likely starting ground for disputes.”

## Breach of Representations & Warranties

The representations and warranties (R&W's) embedded within an SPA provide disclosures, and thus risk protection, to both the buyer and the seller. Representations are statements of past and/ or existing facts surrounding the target, while warranties are promises that existing and/ or future facts are, or will be, true. One of the more routine sellers' R&W's might illustratively read as follows:

*The target's historical financial statements over the past N fiscal years, provided to the buyer, were prepared in accordance with the LOCAL GAAP, and the target's books and records are fairly stated in all material respects, and all known material liabilities have been disclosed.*

After closing, the buyer, with the rights of control and ownership of the target, along with full access to its books and records, may discover one (or more) of the seller's R&W's to be untrue. If this proves to be the case, the buyer may need to i) fully assess whether the seller's R&W's were in fact breached, ii) whether damages were

incurred by the buyer due to the breach, and iii) if the SPA stipulates whether such damages are indemnifiable by the seller to the buyer (or, perhaps, indemnity is covered by a R&W's insurance policy). Such situations can be more complex as the buyer may have to determine whether the R&W's were presented fraudulently, or merely drafted poorly, and assess which indemnity provisions in the SPA are relevant. Recourse to legal counsel should be considered.

Calculating damages due to the breach usually requires the assistance of forensic professionals who are experienced in using the accepted methodologies, taking the prevailing facts and circumstances into proper consideration of the facts and circumstances. For example, if the breached R&W leads to a permanent impairment of the target's value, a damages assessment may be more akin to a business valuation than a lost profits analysis.

Once damages have been assessed, the SPA's indemnity limitations, if any, must be taken into consideration as well.

“...the buyer may need to i) fully assess whether the seller's R&W's were in fact breached, ii) whether damages were incurred by the buyer due to the breach, and iii) if the SPA stipulates whether such damages are indemnifiable by the seller...”



## Key considerations for assessing Post-closing M&A Dispute Situations



### Key Dispute Resolution Terms in the Purchase Agreement

#### Carefully review the SPA to identify the following factors:

- What options are available for recourse?
- How are indemnity liabilities structured? Are limitations specified?
- Does prior knowledge of breach of warranty impact indemnity claims?
- What are the specified timing and notification requirements for raising claims to the other party?
- What is the specified process for resolving a claim with the other party?



### What Data is Available?

#### Some of the typical sources of data necessary for post-closing M&A disputes include:

- Sale and purchase agreement (and sometimes prior drafts);
- Financial, operational, and environmental due diligence reports;
- Confidential information memorandums (“CIMs”);
- Investment thesis/ memos;
- Target’s financial statements, pre- and post-closing;
- Detailed accounting data, such as: trial balances, consolidating workpapers, access to the general ledger journals/journal entries, audit workpapers and drop review; payroll data, etc.;
- Purchase price allocation of the transaction;
- Evidence supporting claims of breached R&W’s; and
- E-mails and other electronic communications.

Without access to the relevant data, developing a claim can be difficult. If such avenues are available, Deloitte Forensic has a team of e-discovery professionals who can assist with data collection and extraction, email and document review, advanced analytics, and other document production procedures.



### Identify the Key Expertise and Skillset Required

#### Will you need an external financial advisor to assist you? If so, what are the key skillsets and expertise required?

##### Accounting

Will your dispute require specific accounting-standard knowledge, such as IFRS or US GAAP? Will it require financial investigative capabilities?

##### Valuations / Damages

Once the accounting issues have been identified, will damages be quantified based upon those findings? Will the loss calculation be framed as lost profits or business value impairment? Will other securities need to be valued, such as preferred stock, or options?

##### Industry-specific knowledge

Some industries have more in-depth jargon and accounting and financial nuances than others, such as financial institutions or renewable power generation facilities. These nuances can carry over to the quantum calculations and require specific experience and know-how.

##### Testifying experience

Will your advisor be required to testify and defend his/her work in front of a tribunal, judge, or arbitrator?

## Team of experienced experts

The Deloitte Forensic practice in Paris, France has professionals with deep experience assisting parties through all types of post-closing M&A disputes. We are able to assist either party individually develop their stance acting in an advisory role, serve both sides as neutral financial and accounting experts, or act as independent experts to offer an opinion before a judge/ tribunal.



**Battine Edwards**

Partner  
Deloitte Forensic  
+33 1 55 61 54 75  
bedwards@deloitte.fr



**Daniel Patiño**

Director  
Business Valuation & Modeling  
+33 1 55 61 64 19  
danpatino@deloitte.fr

With a team of experienced professionals dedicated to dispute resolution engagements, supported by our Deloitte network (encompassing transaction services professionals, industry experts, and accounting experts across the globe), we can meet your needs to resolve post-closing M&A dispute matters, in both English and French.

# Deloitte.

If you have not yet done so, please confirm with marketing this is the right one to use.

Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited (“DTTL”), its global network of member firms, and their related entities (collectively, the “Deloitte organization”). DTTL (also referred to as “Deloitte Global”) and each of its member firms and related entities are legally separate and independent entities, which cannot obligate or bind each other in respect of third parties. DTTL and each DTTL member firm and related entity is liable only for its own acts and omissions, and not those of each other. DTTL does not provide services to clients. Please see [www.deloitte.com/about](http://www.deloitte.com/about) to learn more. In France, Deloitte SAS is the member firm of Deloitte Touche Tohmatsu Limited, and professional services are rendered by its subsidiaries and affiliates.

Deloitte  
6, place de la Pyramide – 92908 Paris-La Défense Cedex

© October 2021 - Deloitte Finance – A Deloitte network entity  
All right reserved – Studio Design France