Mergers and Acquisitions (M&As) often play a pivotal role in plans for long-term growth — and they can be a decisive factor in an entity's success. Most deals reach completion smoothly, but when they don't, business leaders can find themselves running afoul of their strategic goals, wrapped up in disputes against the parties they sought to engage with, grow with, and profit with, and floundering amid discordant shareholders or joint venture partners.

Even minor disputes can entangle companies and other stakeholders in years of costly litigation that can eat away at management's time and harm their other business relationships with legal adversaries for the duration of the case. In the interest of limiting these value-draining business interruptions, it's critical to resolve disputes swiftly, effectively, and economically.

No disputing the challenges

Of course, most business leaders would prefer to avoid M&A litigation altogether. This requires a deep understanding of the ins and outs of purchase agreements; this perspective can help identify potential risks before an agreement is finalized. Critical contract clauses regarding accounting and financial reporting issues should be read and analyzed, including:

- Purchase price adjustment clauses
- Earn-out clauses
- Financial representations and warranties
- Dispute resolution clauses

Should a business become ensnared in a dispute over purchase price adjustments, earn-out, or breaches of financial representations and warranties, these steps can mitigate the fallout:

- Evaluating financial exposure — and potential reward
- Identifying and developing the right documentation to support your case and promote your position
- Negotiating effectively
- Establishing appropriate ground rules for the proceeding
- Lining up credible expert witness reports and testimony

It's also important to identify a qualified neutral/arbitrator to the extent the issues are not resolved in litigation. This can give you and those you represent a leg-up in your efforts to establish an appropriate dispute resolution format and process, to attain an objective assessment of party submissions, to perform appropriate follow-up procedures, and to facilitate the arbitrator in reaching the right decisions, informed by the right facts.
Your M&A: Done deal or value-draining dud?
Transaction Dispute Resolution

From vexation to value

By approaching deals with a thorough understanding of potential risk factors upfront, organizations can increase the odds that they'll be able to avoid litigation at the outset. But if a business has already become embroiled in a deal-related conflict, leadership can take action to keep costs down, streamline the process, and even derive value — sometimes millions of dollars worth.

A clear view of the other party's agenda and actions can help the organization and its leadership make informed decisions and credible arguments. Handled effectively, disputes can be resolved in such a way that the entity's credibility can be maintained and favorable rulings can carry the day.

Further, working directly with professionals who have previously served as an arbitrator or ‘accounting neutral’ can enable you to objectively evaluate relevant facts and data and to make stronger arguments by presenting the facts more effectively. In addition to bringing to bear objectivity and credibility, this approach also may resolve disputes more quickly, delivering cost- and time-efficiency in the process.

How PwC can help

We have a well-established practice that focuses on helping organizations prevent and resolve M&A disputes. Our extensive experience in advising on contract language, assisting in the dispute resolution process, and serving as an effective neutral/arbitrator brings valuable insight to those who face legal issues arising from transactions, as well as sound, time-tested solutions for resolving and preventing them. We can help:

- Evaluate contract language for critical accounting and financial reporting-related clauses
- Assist in preparation of or evaluation of the closing balance sheet
- Assess financial reward and exposure
- Assist in negotiations and in identifying documentation needs to support positions
- Assist in selecting neutrals/arbitrators
- Advise on format and ground rules for neutral proceedings
- Evaluate party submissions and conduct follow-up procedures
- Provide expert witness reports and testimony
- Serve as arbitrator or other neutral decision maker
- Render accurate, objective decisions based on a sound and effective presentation of the facts and deep accounting and financial reporting experience

Our professional teams deliver high-quality resources to help conduct negotiations and resolve disputes across industries and geographic regions.

- PwC's combined subject and industry specialists support cases by delivering powerful arguments.
- Our global forensic services capability enables greater coordination of cases that involve international jurisdictions.
- Our experienced, qualified neutrals deliver well-reasoned decisions.
- Our dexterity, deep resources, and rapid deployment help resolve disputes quickly and cost-effectively.
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Cases in point

**Closing balance sheet bickering: From minus $10m to plus $15m**

When a private equity company purchased a $1 billion multi-national manufacturing company, the seller delivered, post-closing, a closing working capital statement claiming a $10 million increase in the purchase price.

PwC evaluated the working capital statement and analyzed the underlying accounts to determine the validity of the proposed adjustments and to identify any offsetting adjustments. We analyzed the accounts of subsidiaries in more than ten countries within the 60-days the purchase agreement allowed, and prepared a formal notice of dispute for delivery to the seller. We also participated in good faith negotiations.

We identified a significant number of errors in the working capital statement and material offsetting adjustments. Using our report and with our help, the client was able to negotiate a $15 million dollar decrease in the purchase price — resulting in a net $25 million benefit to the client’s advantage.

In a similar case, a global automotive supplier purchased a competitor’s business for approximately $1 billion. In finalizing the purchase price through the purchase price adjustment mechanism, the buyer challenged more than 100 balance sheet items and was unsuccessful in reaching a quickly negotiated settlement with the seller. The parties agreed to resolve the disputed items through arbitration, per the purchase and sale agreement.

Disputed issues included pension and other retirement liabilities, warranty liabilities, inventories, loss contract reserves, tooling costs, fixed assets, receivables, workers’ compensation, environmental liabilities, and capitalized software costs. Issues in dispute touched operations in the United States, Germany, Spain, Mexico, Hungary, and China.

In addition to advising the buyer regarding the arbitration process and strategies, we gathered information and led the preparation of written statements of position submitted to the arbitrator.

This work resulted in an award, and to a subsequent purchase price reduction of approximately $70 million.

**Earn-out dispute: Grilling disputed accounting items**

Following the sale of a barbecue grill manufacturing business, the seller asserted that an earn-out payment was due from the buyer. When the parties couldn’t reach agreement, the matter was referred to arbitration pursuant to the terms of the purchase agreement.

PwC evaluated the accounting for numerous disputed accounting items, including inventory obsolescence, accounts receivable reserves, and severance payments, all of which had a direct impact on the agreed-upon earn-out calculation. We prepared expert and rebuttal reports, which were submitted to the arbitrator. We also helped the arbitrator to understand and evaluate the disputed items.

We demonstrated to the arbitrator that no earn-out payment was due to the seller, winning in a favorable ruling and resulting in substantial cash savings for the buyer.
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*Breach of financial representations and warranties: Building a solid case*

In the two months following the acquisition of a construction company, the purchaser experienced unexpected material write-downs on several large projects, resulting in a significant impact to the expected value and profitability of the business.

PwC conducted an investigation into the pre-close accounting and financial reporting associated with numerous long-term construction projects. We obtained hard copy documentation, as well as email, server data, and other electronic files. We also interviewed accounting, finance, and construction management personnel to assess the integrity of the pre-close reporting. Our written report presented significant evidence indicating intentional misreporting of the profitability associated with several large ongoing projects.

The evidence indicated that the financial statements upon which our client, the buyer, relied in pricing the acquisition materially, and perhaps intentionally, overstated the target’s profitability.

With PwC’s assistance, our client successfully negotiated the return of approximately 10% of the purchase price of the business.

*Material adverse change clause: Invoking a purchase price cut*

After entering into an agreement to purchase the assets of a large public technology company, a private equity company learned that the board of directors of the target company had retained outside counsel to conduct an investigation into certain historical accounting practices.

PwC advised the private equity company as to the nature, scope, likely timing, and potential outcomes of the investigation, enabling business leaders to determine if they wished to invoke the agreement’s material adverse change clause.

The private equity company was able to make an informed decision about the potential courses of action they could appropriately take within the terms of the agreement — ultimately reducing the purchase price and increasing contractual protection.

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