Article

Three M&A Points in Three Minutes: Tips for Purchase Price Adjustments

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In most acquisition agreements, the purchase price will adjust for the continued performance of the business before the closing. It the seller's business improves, the purchase price increases; if the business declines, the purchase price decreases.

Here are three tips to consider when negotiating these provisions:

- Define generally accepted accounting principles (GAAP). Although you might think that there's no need to define GAAP, the truth is that buyer and seller often have significant disagreements over how GAAP will be applied. Examples include revenue recognition, reserves for accounts receivable, and inventory valuation. Because these disagreements can produce substantial swings in the purchase price, the parties should define GAAP in those instances where the parties may disagree with how they are applied.
- Conduct a "dry run" of the purchase price adjustment. There will almost always be special exceptions and tweaks to any standard purchase price adjustment provision. And it's difficult to identify all the exceptions and tweaks until you actually do a purchase price adjustment calculation. In my experience, it pays to run a sample purchase price adjustment calculation before the acquisition agreement is signed to smoke out these types of issues. The goal is to eliminate purchase price adjustment surprises after the closing.
- Pick an arbitrator. Most purchase price adjustments punt disputes to an accounting firm that will arbitrate the dispute. Because the arbitrator is so critical to the outcome of the dispute, I often recommend that the parties name an accounting firm arbitrator in the acquisition agreement before there's any dispute. When selecting the accounting firm, confirm that there are no financial connections between the arbitrator and either of the parties or their owners.

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