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Purchase price adjustment disputes in mergers and acquisitions: an intersection of different dispute resolution procedures and a war of jurisdictions

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ABSTRACT

Frequently included in mergers and acquisitions (M&A) contracts purchase price adjustment clauses allow for upward or downward adjustments to the purchase price depending on a selected metric to help the parties of a transaction to overcome the information asymmetry about financial variables caused by the time lag between signing and closing. As a complex weave of technical accounting, financial, and legal issues, regardless of how objectively and meticulously conceived and drafted, it is quite often that disruptive issues arise in connection the with these clauses. In addition to the general arbitration clause typically contained in the M&A contracts, as a common practice, parties agree to submit any dispute concerning the values reported in the financial schedules to calculate the amount of an adjustment to an independent accounting firm for an expert determination. Since most of the time contracts do not provide any particular provision as to the relation between these two mechanisms, the practice shows that neither the demarcation of the two from each other nor the interaction between them is always unproblematic. This article, after explaining the price adjustment clauses, discusses the potential problems of which the parties should be well aware and address considering the case law and different approaches.

'Notwithstanding Shakespeare's suggestion that what we call something does not matter, it makes a significant difference whether a contractually designated decision-maker is characterized as an arbitrator, or in the alternative an expert'.[1]

—William W Park

1. INTRODUCTION

Carrying a deliberate transfer of control and ownership of a business organized in one or more corporations at their cores, mergers and acquisitions (M&A) indicate two distinct kinds of transactions.[2] A merger occurs when multiple companies combine forces to form an entirely new company and indicates the legal consolidation of two entities into one entity, whereas an acquisition or takeover is simply the purchase of one company by another, rather than a new formation.[3]

Due to the complex and lengthy nature of M&A, most of the effects of a transaction, such as the transfer of property, are in many instances reserved until a later stage of the process referred to as the 'closing', after fulfilment of certain requirements previously determined by the parties.[4] Typically and ideally, before signing

1 William W Park, *Arbitration of International Business Disputes* (2nd edn, OUP 2012) 767.

2 John C Coates IV, 'Mergers, Acquisitions and Restructuring: Types, Regulation, and Patterns of Practice' in Jeffrey N Gordon and Wolf-Georg Ringe (eds), *The Oxford Handbook of Corporate Law and Governance* (OUP 2008) 570, 571–72.

3 Andrea Carlevaris, 'Arbitration of Disputes Relating to Mergers and Acquisitions: A Study of ICC Cases' (2013) 24(1) ICC International Court of Arbitration Bulletin 19, 20.

4 ibid 20.

the contract, a party conducts full due diligence for the purpose of assessing all pertinent financial aspects of the target company and drafting the appropriate representation and warranty provisions. Then, the closing of the transaction arrives, the moment when the shares or title documents are delivered against payment.[5] In many M&A deals, whether asset purchase agreement, stock purchase agreement, or merger agreement, there is a purchase price adjustment mechanism that allows for upward or downward adjustments to the purchase price depending on a predetermined metric.[6] Frequently included in the definitive purchase agreements which govern the sale of private companies in both cross-border and domestic transactions, these provisions providing for a post-closing alteration of the purchase price are commonly called the 'Purchase Price Adjustment Clauses' in M&A contracts. [7]

There may be a variety of incentives that would lead the parties to include purchase price adjustment clauses in acquisition agreements. Such a mechanism helps the parties to abate the potentially adverse effect of a flat price established upon stale pre-closing information.[8] In addition to the delay generally caused by tax considerations as well as competition law problems, the time spent for the necessity of obtaining consent from third parties or from the board of directors, and the need for confirmatory due diligence result in a non-negligible time lag between the execution of the purchase agreement and the closing. Since the provisional purchase price is determined in consideration of the balance sheet which is created well before closing, there will beyond doubt be changes by the time of closing unless the target company is a static enterprise.[9] By virtue of a contractually provided purchase price adjustment mechanism, the parties are able to modify the purchase price to reflect more accurately the seller's financial condition as of the closing date and, thus, overcome the information asymmetry about financial variables between signing and closing by

5 Cahit Ağaoğlu, 'Arbitration in Merger and Acquisition Transactions: Problem of Consent in Parallel Proceedings and in the Transfer of Arbitration Agreements in Merger and Acquisition Arbitration' (DPhil thesis, Queen Mary University of London 2012) 83–84 <https://qmro.qmul.ac.uk/jspui/handle/123456789/8363> accessed 14 September 2018.

6 A Vincent Biemans and Gerald M Hansen, *M&A Disputes: A Professional Guide to Accounting Arbitrations* (John Wiley & Sons 2017) 14.

7 The Committee on International Commercial Disputes of the Association of the Bar of the City of New York, *Purchase Price Adjustment Clauses And Expert Determinations: Legal Issues, Practical Problems And Suggested Improvements Report*, June 2013, 1 <https://www2.nycbar.org/pdf/report/uploads/20072551-PurchasePriceAdjustmentClausesExpertDeterminations--LegalIssuesPracticalProblemsSuggestedImprovements.pdf> accessed 14 September 2018; Daniel Avery and Gregory Kaden, 'Trends in M&A Provisions: Purchase Price Adjustment Provisions' (*Bloomberg Law, 2018*) <https://www.goulstonstorrs.com/publications/trends-in-ma-provisions-purchase-price-adjustment-provisions> accessed 14 September 2018; see also Kenneth Mathieu and Vincent Schmeltz, 'Dispute Resolution as a Part of Your Merger or Your Acquisition Agreement' (2012) 1(1) Michigan Journal of Private Equity & Venture Capital Law 301.

8 American Bar Association Committee on Negotiated Acquisitions, *Model Asset Purchase Agreement: With Commentary* (ABA Book Publishing 2001) 59.

9 Ağaoğlu (n 5) 92–93; see also Leigh Walton and Kevin Kreb, 'Purchase Price Adjustments, Earnouts and Other Purchase Price Provisions' (American Bar Association Business Law Section Spring Meeting, Washington, DC, March 2005).

means of reconciliation of changes in specific aspects of the target's financial condition.[10] For instance, a buyer may benefit from the price adjustment provision as a way of mitigating its risk of suffering from the target company's financial deterioration in the event that the seller should fail to manage the company efficiently until the closing of the transaction, whereas a seller may expect to be paid more in the case it delivers the target with additional amount of selected financial targets gained between signing and closing.[11]

Purchase price adjustments are based on book values of the target on the closing date and the type of selected adjustment mechanism depends upon the structure of the transaction as well as the nature of the target company's business. There are various touchstones available to select as the basis of a post-closing adjustment to the nominal purchase price.[12] Depending on the form of the transaction and the nature of the seller's business, a non-exhaustive list of financial targets might include working capital, net assets, net debt, book value, and shareholders' equity.[13] Moreover, in some cases, selection of multiple adjustment metrics may offer a more accurate way to adjust the purchase price. In a retail sales business, for instance, it may be beneficial to calculate variations in both sales and inventory.[14]

To cite but one simple example, if on 1 January, a transaction is valued, or priced at USD 50,000,000 when the target has inventory worth USD 400,000, and if, when the transaction closes the seller delivers the target with USD 1,000,000 of inventory, the seller will expect to be paid (generally dollar-for-dollar) for the additional USD 600,000 of added, measurable value, assuming that all other financial metrics are equal. Alternatively, should the target's inventory be valued at USD 100,000 at the time of closing, the buyer would expect a USD 300,000 discount in the purchase price due to the depleted inventory value.[15] Given the fact that the idea behind purchase price adjustment provisions is to put the parties on an equal footing as of the closing process, these provisions are in principle considered neutral as between the parties, rather than benefitting or favouring the buyer or the seller.[16]

10 Christel Karsten, Ulrike Malmendier and Zacharias Sautner, 'M&A Negotiations and Lawyer Expertise' (2014) 20 <https://eml.berkeley.edu/~ulrike/Papers/Full_Takeover_Negotiations_29oct2014.pdf> accessed 14 September 2018.

11 Peter Wolfgang, 'Arbitration of Mergers and Acquisitions: Purchase Price Adjustment Disputes' (2003) 19(4) Arbitration International 491, 495; Ağaoğlu (n 5) 92–93.

12 Karsten, Malmendier and Sautner (n 10) 19; American Bar Association Committee on Negotiated Acquisitions (n 8) 59.

13 Boris J Steffen, 'Understanding the Purchase Price-adjustment Clause' (2017) 36 ABI Journal 22, 22 [according to the ABA study on year 2017, working capital is the most common purchase price adjustment metric, included in 89% of deals from 2017. With the exception of the 69% reported in the 2007 ABA study, working capital has been used as an adjustment metric in more than 75% of the reported deals in each ABA study—83% (2015), 91% (2013), 79% (2011), and 77% (2009)]; M&A Market Trends Subcommittee of American Bar Association Business Law Section Mergers & Acquisitions Committee, '2017 M&A Carveout Transactions Deal Points Study' (2017) 35–45.

14 American Bar Association Committee on Negotiated Acquisitions (n 8) 59–60.

15 Avery and Kaden (n 7).

16 In addition to purchase price adjustments calculated at the time of closing, it is also possible that an acquisition agreement provides for a portion of the purchase price to be paid in the future contingent on the financial performance of the company after closing. Often referred to as 'Earn-Out Clauses' this mechanism is a particular kind of price adjustment based on earnings. Unlike a price adjustment based on net asset value, earn-outs are at least partly subject to the target company's future earning capacity.

The frequent involvement of purchase price adjustments in M&A transactions are examined every year by the annual studies of the American Bar Association. According to the 2017 study, price adjustment provisions were included in 86 per cent of the reported deals. The percentage was unchanged from 86 per cent in 2015 and up from previous years: 85 per cent (2013), 82 per cent (2011), 79 per cent (2009), and 68 per cent (2007).[17]

2. PURCHASE PRICE ADJUSTMENT CLAUSE

As a complex weave of technical accounting, financial and legal issues, regardless of how objectively and meticulously conceived and drafted, a lot of transactions give birth to potentially disruptive issues that arise in connection the with price determination related to the interpretation and calculation of purchase price adjustments.[18] For instance, Coates reports that 60 per cent of M&A practitioners surveyed reported having had clients have a dispute arising out of indemnities and price adjustment clauses in M&A contracts.[19] The ambiguity in the definition of the accounting elements to be factored into the price determination or the absence of certainty over the valuation standards and accounting principles to be applied in the adjustment process, such as Generally Accepted Accounting Principles (GAAP) or past practices, are potential sources of these disputes.[20] In addition, there may also be allegations of manipulation of accounts by one or other of the parties by means of an artificial variation in receivables, inventories, or liabilities and the nature and extent of the cooperation expected of the parties during the price adjustment process may be a further ground for disputes.[21]

Similarly to Purchase Price Adjustment Clauses, it is not uncommon for Earn-Out Clauses to provide for any dispute to be submitted to an independent accounting firm for a final and binding determination. Moreover, there are other mechanisms that allow for post-closing variations in payments, such as escrows, holdbacks, contingent value rights (CVRs), and even debt financing. The Committee on International Commercial Disputes of the Association of the Bar of the City of New York (n 7) 1; Albert H Choi, 'Facilitating Mergers and Acquisitions with Earnouts and Purchase Price Adjustments' (2017) 2(1) Journal of Law, Finance & Accounting 1, 2ff. Carlevaris (n 3) 29–30; for cases related to earn-outs, see *Fit Tech, Inc v Bally Total Fitness Holding Corp* (2004) 374 F 3d 1 (1st Cir); *Costello v Patterson Dental Supply, Inc* (2007) No 5:06-CV-213, 2007 WL 1041128 (WD Mich); *Viacom Int'l, Inc v Winshall* (2012) Civil Action No 7149-CS, 2012 WL 3249620 (Del Ch); *ES Originals Inc v Totes Isotoner Corp* (2010) 734 F Supp 2d 523 (SDNY); see also Wolfgang (n 11) 493.

17 However, it is useful to keep in mind that not all transactions contain purchase price adjustment mechanisms. Given the fact that these mechanisms are complex in nature and are generally a reason for vexed negotiations, the parties may also rely on other solutions in many cases, such as resorting to claims for breach of representations and warranties, indemnification rights, and walk-away or termination provisions to achieve their objectives. American Bar Association Committee on Negotiated Acquisitions (n 8) 59.

18 Alice Broichmann, 'Disputes in the Fast Lane: Fast-track Arbitration in Merger and Acquisition Disputes' [2008] 4 International Arbitration Law Review 143, 149; Steffen (n 13) 22; the amount of dispute in issues related to price adjustments may be substantial, see *Chicago Bridge & Iron Company NV. v Westinghouse Electric Company LLC*, No 573, 2016 (Supr Ct, 27 June 2017) (as corrected on 28 June 2017).

19 John C Coates IV, 'M&A - Evidence-based M&A: Less Can Be More When Allocating Risk in Deal Contracts - The Varied Use of Risk Allocation Provisions' (2012) 27(11) Butterworths Journal of International Banking and Financial Law 708.

20 Carlevaris (n 3) 29.

21 ibid 29.

Bearing in mind these concerns, parties of a transaction generally foresee a solution in the purchase agreement in the event that they have difficulties as to the implementation of the purchase price adjustment previously agreed upon. As a standard practice, a Purchase Price Adjustment Clause contains its own dispute resolution mechanism. Given the fact that price adjustment disputes are often quite complex and highly technical, it is a common practice to agree that any dispute concerning the values reported in the financial schedules used by the parties to calculate the amount of any price adjustment is to be submitted to an independent accounting firm for a final and binding expert determination.[22]

To cite an example, a Purchase Price Adjustment Procedure Clause where the Working Capital is chosen to be used as the metric may be as follows:

> If within thirty (30) days following delivery of the Closing Financial Statements and the Closing Working Capital calculation Seller has not given Buyer written notice of its objection as to the Closing Working Capital calculation (which notice shall state the basis of Seller's objection), then the Closing Working Capital calculated by Buyer shall be binding and conclusive on the parties and be used in computing the Adjustment Amount.
>
> If Seller duly gives Buyer such notice of objection, and if Seller and Buyer fail to resolve the issues outstanding with respect to the Closing Financial Statements and the calculation of the Closing Working Capital within thirty (30) days of Buyer's receipt of Seller's objection notice, Seller and Buyer shall submit the issues remaining in dispute to _____, independent public accountants (the 'Independent Accountants') for resolution applying the principles, policies and practices referred to in Section _____. If issues are submitted to the Independent Accountants for resolution, (i) Seller and Buyer shall furnish or cause to be furnished to the Independent Accountants such work papers and other documents and information relating to the disputed issues as the Independent Accountants may request and are available to that party or its agents and shall be afforded the opportunity to present to the Independent Accountants any material relating to the disputed issues and to discuss the issues with the Independent Accountants; (ii) the determination by the Independent Accountants, as set forth in a notice to be delivered to both Seller and Buyer within sixty (60) days of the submission to the Independent Accountants of the issues remaining in dispute, shall be final, binding and conclusive on the parties and shall be used in the calculation of the Closing Working Capital; and (iii) Seller and Buyer will each bear fifty percent (50%) of the fees and costs of the Independent Accountants for such determination.[23]

22 The Committee on International Commercial Disputes of the Association of the Bar of the City of New York (n 7) 1.

23 Extract from American Bar Association Committee on Negotiated Acquisitions (n 8) 60–61.

3. THE CHOICE BETWEEN THE ALTERNATIVE DISPUTE RESOLUTION METHODS

While parties can undoubtedly agree otherwise and explicitly note that any dispute before an independent accountant shall be resolved by arbitration and, thus, take the formal form of an accounting arbitration, this does not seem to be the general intent.[24]

In an expert determination, the general tendency of the parties is for the accounting firm to possess the authority of an expert, a limited authority instead of the broad powers that an arbitral tribunal has.[25] In arbitration, the parties normally have the intention of delegating to the decision maker full authority to rule on all necessary legal and factual issues in order to put an end to all claims that fall within the scope of the arbitration clause; thus, the grant of authority to an arbitrator can be said to be analogous to the powers of a judge.[26] On the contrary, the authority delegated to an expert in a typical expert determination is no more than its mandate to decide on a specific factual disagreement related to an issue within the special expertise of the decision maker, frequently about an issue of valuation.[27]

The procedures typically followed in the determination process also support the preference given to expert determination in price adjustment disputes before independent accountants.[28] The adversarial model followed in arbitration, where the duty of the arbitral tribunal is to rule on legal claims based only on the factual information presented at a relatively antagonistic hearing is normally not used in purchase price adjustment proceedings.[29] Normally an arbitrator may not engage in any independent investigation, hear evidence outside the presence of the parties, and should generally avoid participating in any ex parte communication with the parties which might create the appearance of partiality.[30] However, in an expert determination process, such clear procedural principles do not automatically apply.[31] Subject to any limitations imposed by the parties in the agreement, experts are expected to act on the basis of their own special knowledge and allowed to gather information from any source that in their judgment is necessary for a successful determination by means of independent investigations as well as ex parte communications.[32] Thus, not all the evidence an expert may consider must be submitted in the presence of the parties.[33]

24 Vincent and Hansen (n 6) 11; The Committee on International Commercial Disputes of the Association of the Bar of the City of New York (n 7) 7.

25 ibid.

26 Steven H Reisberg, 'What Is Expert Determination? The Secret Alternative to Arbitration' (2013) 250(115) New York Law Journal. https://www.willkie.com/~/media/Files/Publications/2013/12/What%20is%20Expert%20Determination%20The%20Secret%20Alternat__/Files/NYLJWhatIsExpertDeterminationPDF/FileAttachment/NYLJ_What_Is_Expert_Determination.PDF

27 ibid.

28 The Committee on International Commercial Disputes of the Association of the Bar of the City of New York (n 7) 7.

29 ibid.

30 Julian DM Lew, Loukas A Mistelis and Stefan Kröll, *Comparative International Commercial Arbitration* (Kluwer Law International 2003) ch 12.

31 Crenguta Leaua, 'Independence and Impartiality of Experts in Expert Determination Proceedings' in Filip De Ly and Paul A Gélinas (eds), *Dispute Prevention and Settlement*, Publication No 792E (ICC 2017) 54.

32 Lew, Mistelis and Kröll (n 30) 10; Reisberg (n 26).

33 ibid.

On the bright side, this flexibility and informality clearly allow for an expert determination to be structured so as to be much faster, more focused, more flexible, and substantially less expensive than arbitration.[34] Moreover, since it is generally less antagonistic than arbitration, expert determination may be an advantageous way of dispute resolution for parties sharing the purpose of preserving a long-term business relationship.[35]

On the other hand, in all modern arbitration laws, it is not even necessary to confirm that there are principles which constitute the procedural 'magna carta of arbitration' stipulating that the parties will be treated equally, and each have an opportunity to be heard.[36] Expert determination, however, is not build on these strict due process requirements. As a consequence, it is not uncommon for parties to experience conflicts with one another and with the expert over whether the expert has violated due process, for instance, by interrogating one party in the absence of the other.[37] In order to circumvent this kind of potentially disruptive and protracted problems, a clear and detailed definition of the procedural framework for expert determination as in the following model may have utmost importance for the parties of M&A transactions:

> If, after Seller has raised, within the time allowed, written objections to the Effective Date Accounts (herein 'Objections'), and Seller and Purchaser cannot agree on the changes to the Effective Date Accounts within four (4) weeks following the delivery of the Objections to Purchaser, each of Seller and Purchaser shall be entitled to refer such dispute for decision to an independent international leading firm of public accountants (big five) other than Seller's Auditor and Purchaser's Auditor (herein 'Expert'), which shall determine the correct amount of _____ [for example: the Intercompany Debt, the Financial Debt, the Cash and the Working Capital], if and to the extent that there are differences between the positions of Seller and Purchaser and within the limits set by Seller and Purchaser. If the Parties cannot agree within two (2) weeks on the person of the Expert, the [fill in the appointing authority] shall appoint such Expert. The Expert shall decide as expert (and not as an arbitrator) on the issues in dispute in accordance with the principles set out in Section _____ above. The Expert shall give Sellers and Purchaser adequate opportunity to

34 Anke Sessler and Corina Leimert, 'The Role of Expert Determination in Mergers and Acquisitions under German Law' (2004) 20 Arbitration International 151; Broichmann (n 18) 150; Lew, Mistelis and Kröll (n 30) 10.

35 Martin Valasek and Frédéric Wilson, 'Distinguishing Expert Determination from Arbitration: The Canadian Approach in a Comparative Perspective' (2013) 29 Arbitration International 63, 64; John Kendall, James Farrell and Clive Freedman, *Expert Determination* (4th edn, Sweet & Maxwell 2008) 103; however, subject to the type of procedure selected, the arbitration process may also be less adversarial, Douglas S Jones, 'Expert Determination and Arbitration'(2001) 67(1) Arbitration 17, 28; Ozlem Susler, 'Jurisdiction of Arbitration Tribunals: A Comparative Study' (SJD thesis, La Trobe University 2012) 57.

36 Lew, Mistelis and Kröll (n 30) 95; Nigel Blackaby and others (eds), *Redfern and Hunter on International Arbitration* (6th edn, OUP 2015) 22.

37 Klaus Sachs, 'Solving Tensions Between Expert Determination and Arbitration under M&A Contracts' in Eric A Schwartz and others (eds), *International Arbitration under Review Essays in Honour of John Beechey*, Publication No 772E (ICC 2015) 363, 367.

> present their views in writing and at a hearing or hearings to be held in the presence of Sellers and Purchaser and their advisors. The Parties shall jointly instruct the Expert to deliver its written opinion to them no later than four (4) weeks after their outstanding differences are referred to it. The Expert shall give reasons for its decision in writing and on all issues which are in dispute between Sellers and Purchaser. The costs and expenses incurred by the Expert shall be borne equally by Sellers and Purchaser. The Effective Date Accounts as determined by the Expert shall be final and binding on the Parties. Each Party shall give the Expert full access to information required for its decision.[38]

The parties also have the opportunity to refer to existing institutional rules, such as the ICC Rules for the Administration of Expert Proceedings or WIPO Expert Determination Rules.[39]

Another main difference between expert determination and arbitration is that these proceedings are subject to different standards in terms of enforceability. In USA, for instance—one of the most significant jurisdictions for M&A transactions[40]—while an arbitration award is enforceable under the New York Convention, expert determinations would not be granted the benefit of the New York Convention as they are regulated solely by state laws.[41] Located in a particularly well-developed jurisdiction with regards to expert determinations, New York state courts, for instance, have repeatedly affirmed determinations made by independent accounting firms in purchase price adjustment disputes under the statutory authority of New York Civil Practice Law and Rules section 7601, a provision precisely enacted to clarify that judicial enforcement of expert determinations is separate and distinct from arbitration, while at the same time recognizing and explaining why such proceedings are not arbitrations and not governed by arbitration law.[42]

There are also substantial differences in the standard of review. Again, focusing on the USA, the Federal Arbitration Act (FAA) governs the review of an arbitration award and provides a limited number of grounds for the vacatur of an arbitration award.[43] In addition to the fact that an arbitration award will not be reviewed by the

38 Extract, Sachs (n 37) 367–68.

39 ibid 368–69; Lew, Mistelis and Kröll (n 30) 10; The ICC Rules for the Administration of Expertise Proceedings <https://iccwbo.org/dispute-resolution-services/experts/administration-experts-proceedings/rules-for-the-administration-of-expert-proceedings/> accessed 14 September 2018; WIPO Expert Determination Rules, <http://www.wipo.int/amc/en/expert-determination/rules/index.html> accessed 14 September 2018.

40 Coates IV (n 2) 571; Thomson Reuters, 'Mergers & Acquisitions Review: Full Year 2017' (2017) <http://share.thomsonreuters.com/general/PR/MA_2Q_2017_E.pdf> accessed 14 September 2018.

41 Reisberg (n 26); The Committee on International Commercial Disputes of the Association of the Bar of the City of New York (n 7) 16.

42 Reisberg (n 26); See *Westmoreland Coal v Entech* (2003) 100 NY 2d 352 (petition pursuant to CPLR s 7601 to compel party to submit purchase price dispute to independent accounting firm); *Doosan Infracore Co v Ingersoll-Rand Co* (2011) No 652170/2010 (NY Sup Ct) (confirming accounting firm's purchase price adjustment).

43 According to 9 USC s 10(a), a court may vacate an arbitration award under the following four circumstances: (i) where the award was procured by corruption, fraud, or undue means, (ii) where there was arbitrator bias, (iii) where there was arbitrator misconduct, or (iv) where the arbitrator exceeded his or her powers.

courts for the arbitrator's possible error of law or mistake of fact, the standard of review enacted in the FAA cannot be altered by the parties' agreement.[44] Au contraire, since expert determinations are not regulated by FAA, under many state laws the standard of review stipulates that such determinations will be binding on the parties except in the case of 'fraud, bad faith or palpable mistake'.[45] Furthermore, parties can contractually determine the standard to be applied in reviewing the determination of the expert and can specify, for example, that the expert's determination shall be final and binding on all parties, in the absence of 'manifest error'.[46]

However, at this exact point, it may be useful to clear out three main points related to the customary wording 'final and binding' used in the price adjustment procedures.

First of all, in various jurisdictions and a wide range of fields in addition to M&A, such as construction or real estate, there are a large number of cases where parties needed the decision of the relevant state court upon the proper interpretation of contractual clauses to determine whether the provided dispute resolution mechanism was expert determination or arbitration.[47]

For instance, in 2016, the Brazilian High Court of Justice ruled on a litigation case involving the exercise of a Put Option.[48] According to the relevant article of the contract, in case the parties fail to reach an agreement on the company's market value once the option was exercised the following procedure was to be followed:

> In case such value is not agreed upon within thirty (30) days, both parties will appoint two experts (one expert chosen by each party), who, if necessary, will appoint a third one, and shall present the enterprise market value in the maximum term of sixty (60) days. The experts' decision will be final, definitive and observed by the parties.[49]

In its decision, the High Court initially noted that the terminology (the word 'expert') used in the contract has little significance in the determination of the legal nature of the third person role.[50]

Then, it focused on the expression used in the last sentence of the provision stating that 'the experts' decision will be final, definitive and observed by the parties'.

44 Reisberg (n 26).

45 ibid; see *Liberty Fabrics v Corporate Props Associates* (1996) 5, 636 NYS 2d 781 (1st Dept).

46 Clive Freedman, 'Expert Determination' in De Ly and Gélinas (eds) (n 31) 27.

47 *City of Omaha v Omaha Water Co* (1910) 218 US 180; *Advanced Bodycare Solutions, LLC v Thione Int'l, Inc* (2018) 524 F 3d 1235, 1239 (11th Cir); *Omni Tech Corp v MPC Solutions Sales, LLC* (2005) 432 F 3d 797 (7th Cir); *Portland General Electric Co v US Bank Trust NA* (2000) 218 F 3d 1085 (9th Cir); *Evanston Insurance Co v Cogswell Properties, LLC* (2012) 683 F 3d 684 (6th Cir); *Hartford Lloyd's Ins Co v Teachworth* (1990) 898 F 2d 1058 (5th Cir); *Fletcher Construction Australia Limited v MPN Group Pty Ltd* (1997) NSW Sup Ct; *Baulderstone Hornibrook Engineering Pty Ltd v Kayah Holdings Pty Ltd* (1998) 14 BCL 277; *Badgin Nominees Pty Ltd v Oneida Ltd. & Anor* [1998] VSC 188.

48 RE no 1.569.422 – RJ (2015/0177694-9).

49 Mauricio A Prado, 'Challenges of Expert Determination in M&A Transactions' in De Ly and Gélinas (eds) (n 31) 39, para 6.

50 ibid, para 7; see contra Park (n 1) 767 (notwithstanding Shakespeare's suggestion that what we call something does not matter, it makes a significant difference whether a contractually designated decision maker is characterized as an arbitrator, or in the alternative an expert).

From the Court's perspective, this would have been considered as a typical expert determination case if the third person had been empowered a 'non-binding' force.[51] However, on the ground that a final and binding authority sets too narrow limits in case of a review, the Court noted that the clause had the legal nature of an arbitration agreement and consequently referred the parties to arbitration.[52] One of the judges, who was in the same view with the presiding judge, in his reasoning relied upon the idea that if there is doubt as to the existence of an arbitration agreement, such matter must first be decided through arbitration in compliance with the doctrine of *Kompetenz-Kompetenz*, the power of a neutral to rule on the scope of his or her own jurisdiction. [53]

On the other hand, it is very well observed that the interpretations of different courts in different jurisdictions may very well differ while determining whether a proceeding is an arbitration or an expert determination.

In *Evanston Insurance Co v Cogswell Properties,*[54] for instance, the insurance policy stated as follows:

> If we and you disagree on the value of the property or the amount of loss, either may make written demand for an appraisal of the loss. In this event, each party will select a competent and impartial appraiser. The two appraisers will select an umpire. If they cannot agree, either may request that selection be made by a judge of a court having jurisdiction. The appraisers will state separately the value of the property and amount of loss. If they fail to agree, they will submit their differences to the umpire. A decision agreed to by any two will be binding. Each party will:
> a. Pay its chosen appraiser; and
> b. Bear the other expenses of the appraisal and umpire equally.
> If there is an appraisal, we will still retain our right to deny the claim.[55]

The Sixth Circuit initially noted that it was necessary to determine whether the appraisal remedy in the case constituted an arbitration under the FAA. It then held that 'under federal law, whether the appraisal provision in this case is "arbitration" under the FAA depends upon how closely it resembles classic arbitration'.[56] The Court noted that the common incidents of classic arbitration include a final, binding

51 Prado (n 49) para 8.

52 ibid.

53 ibid; Valasek and Wilson (n 35) 69.

54 *Evanston* (n 47).

55 ibid 686.

56 ibid 693; for a comparative analysis of the regulation in Germany, see Jürgen J Witte and Kim L Mehrbrey, 'Variable Kaufpreisregelungen in Unternehmenskaufvertragen im Geflecht von Schiedsgutachtervereinbarungen und Schiedsgerichts-klauseln' [2006] NZG 241; for a comparative analysis of the regulation in France, see Klaus Sachs, 'Die rechtliche Abgrenzung des Schiedsgutachtens vom Schiedsverfahren am Beispiel des Unternehmenskaufvertrages: zugleich ein deutsch-französisches Rechtsvergleich' in Birgit Bachmann and others (eds), *Grenzüberschreitungen: Beiträge zum Internationalen Verfahrensrecht und zur Schiedsgerichtsbarkeit; Festschrift für Peter Schlosser zum 70. Geburtstag* (Mohr Siebeck 2005) 805; for a comparative analysis of the regulation in Switzerland, see Michael Schöll, 'Reflexions sur l'Expertise-Arbitrage en Droit Suisse' (2006) 24 ASA Bulletin 621.

remedy by a third party, an independent adjudicator, substantive standards, and an opportunity for each side to present its case.[57] It further stated that the essence of arbitration is that when the parties agree to submit their disputes to it, they have agreed to arbitrate these disputes through to completion, that is to say a third party authorization for the purpose of rendering a decision which will end in a complete resolution of the dispute.[58]

In the eyes of the Court, when this definition is followed, the provision in question should not be considered as arbitration for purposes of the FAA.[59] First, although the appraisal provision stated that a decision agreed to by any two umpire and appraisers would be binding, it also noted that if there is an appraisal, Evanston Insurance would still retain its right to deny the claim.[60] Secondly, the Policy did not suggest that a hearing-type appraisal process was required. Furthermore, The Sixth Circuit noted that the appraisal at issue was limited to 'the determination of the amount of loss and the value of the Building' and reserving the question of whether the insurance company was liable for the loss by not addressing any issues of liability.[61] In other words, the decision of the third party was final and binding only for a single element of the dispute: the valuation of the loss. The third parties were not empowered to rule on legal liability according to the contract.[62]

Consequently, contrary to the Brazilian High Court, the Sixth Circuit did not refer the parties to arbitration clarifying that the appraisal provision did 'not provide for a final and binding remedy by a neutral third party'.[63]

Therefore, in order not to cause any ambiguity open for interpretation as well as not to run the risk of an additional dispute to originate and become subject to litigation as in the examples above, a large number of Purchase Price Adjustment Clauses expressly state that the independent accounting firm shall 'act as experts, and not as arbitrators'.[64]

Secondly, even if there is no contractual standard explicitly allowing for an exception, in most jurisdictions, the wording 'final and binding' used in contracts to describe the effect of the expert determination at law does not necessarily mean that the determination cannot be challenged.[65] Concurred by various laws all more or less, the way to challenge expert determinations is open for the parties in the event

57 *Evanston* (n 47) 693.
58 ibid 693–94.
59 ibid 693.
60 ibid 693.
61 ibid 696.
62 The Committee on International Commercial Disputes of the Association of the Bar of the City of New York (n 7) 26.
63 *Evanston* (n 47) 694–95.
64 *Omni Tech Corp* (n 47) ('to [an independent accounting firm that] shall, acting as experts and not as arbitrators'); *Luxottica Grp, SpA v Bausch & Lomb Inc* (2001) 160 F Supp 2d 552, 554 (SDNY) (CPA Firm 'shall, acting as experts in accounting and not as arbitrators'); *Doosan Infracore Co* (n 42) Slip Op, 4 ('to act as experts in accounting and not as arbitrators'); *Terex Corp v Bucyrus Int'l, Inc* (2011) No 651889/2010, Slip Op 9 (NY Sup Ct) ('acting as experts in accounting and not as arbitrators'); *Hillsbridge Invs Ltd v Moresfield Ltd* [2000] 2 BCLC 241, 2000 WL 664552 ('The Independent Accountants shall act as experts and not as arbitrators.').
65 Sachs (n 37) 366.

that the result is manifestly wrong.[66] Nevertheless, it might be helpful for the parties which seek to challenge an expert determination to keep in mind that a relatively high threshold might be set for the determination to be manifestly wrong, obviously varying among applicable laws.[67]

Finally, practitioners should also bear in mind that experts have not been recognized as benefiting from the doctrine of *Kompetenz-Kompetenz*.[68] Au contraire, as stressed by Lord Thomas in *Barclays Bank PLC v Nylon Capital LLP*,[69] 'where a dispute arises as to the jurisdiction of an expert, a court is the final decision maker as to whether the expert has jurisdiction, even if a clause purports to confer that jurisdiction on the expert in a manner that is final and binding'.[70] Therefore, a failure by the parties to accurately outline the jurisdiction of the expert could end in a long-lasting challenge before state courts at the outset of the procedures, the expert determination itself being stayed until the questions of jurisdiction are settled.[71]

4. AN INTERSECTION OF DIFFERENT DISPUTE RESOLUTION PROCEDURES

An overwhelming majority of disputes originating from M&A transactions are resolved without the involvement of state courts.[72] Arbitration appears to be a tailor-made dispute resolution mechanism to M&A transactions given the typically complex issues they raise, the frequent need for confidentiality, their generally sensitive nature in terms of both reputation as well as cost, and the potential difficulty of enforcing court judgments.[73] Arbitration works to the advantage of parties seeking expediency, a satisfactory understanding of business needs in M&A transactions on the part of the tribunal, and a spirit of cooperation that could lead to a settlement or at least to an outcome of an equitable award consistent with the applicable law.[74] Arbitration may also be attractive to a foreign party, which could reasonably worry that courts of a certain location might favour the domestic party in case of a dispute with a foreign one.[75]

In parallel with expert determination, 'foremost, and almost *de rigueur*', M&A contracts include a general arbitration clause referring any dispute between the parties arising out of or in connection with the contract to arbitration.[76] Especially for cross-

66 ibid; Klaus Sachs, 'The Interaction Between Expert Determination and Arbitration' in Gabrielle Kaufmann-Kohler and Alexandra Johnson (eds), *Arbitration of Merger and Acquisition Disputes* (Swiss Arbitration Association 2005) 235; Fabienne Borde, 'Expert Determination by Accounting Firms' in De Ly and Gélinas (eds) (n 31) 48, para 13; See eg *Evanston* (n 47).

67 Sachs (n 37) 366.

68 Valasek and Wilson (n 35) 69.

69 [2010] EWCA Civ 826, [2011] 1 All ER (Comm) 912.

70 ibid [23] (Lord Thomas).

71 Jones (n 35) 25.

72 Beata Gessel-Kalinowska vel Kalisz, 'Representations and Warranties in Cross-border Mergers and Acquisitions: The Challenges of Cultural Diversity' (2013) 24(1) ICC International Court of Arbitration Bulletin 32, 32.

73 ICC Commission on Arbitration and ADR Task Force on Financial Institutions and International Arbitration, *Financial Institutions and International Arbitration Report*, Publication 877-1 (ICC 2016) 135.

74 Beata (n 72) 32.

75 John C Coates IV, 'Managing Disputes Through Contract: Evidence from M&A' (2012) 23(2) Harvard Business Law Review 296, 309.

76 Sachs (n 37) 366.

border transactions, one can even claim that arbitration clauses have become the rule and state court jurisdiction clauses are the absolute exception.[77]

In practice, arbitration clauses are typically found at the end of the M&A contracts, whereas expert determination clauses are embedded in the price adjustment provisions.[78] Surprisingly, since in most cases, M&A contracts do not provide any particular provision as to the demarcation of these two procedures from each other these two dispute resolution mechanisms simply stand parallel.[79] Yet, the practice proves that neither the demarcation of the two mechanisms from each other nor the interaction between them is always bled.[80]

M&A contracts containing a general arbitration clause and a Purchase Price Adjustment Clause generate a number of issues as to the relation between these dispute resolution proceedings such as allocation of disputes: does a certain dispute fall within the jurisdiction of the accounting firm under the Purchase Price Adjustment Clause or does the authority to decide belong to the arbitral tribunal in compliance with the general arbitration clause?[81] The same issue also arises in contracts that do not contain an arbitration clause, where the question is one concerning the respective jurisdiction of the court and the accounting firm.[82]

Both in civil and common law jurisdictions, it is often mentioned that an arbitral tribunal or state court is destitute of jurisdiction to the extent that an issue has been contractually made subject to expert determination.[83] This exclusion of competence referred to as *Ausschlusswirkung* (literally exclusion effect) under German and Swiss law is reciprocal between the two mechanisms.[84] Therefore, if a party were to commence arbitral proceedings, introducing a claim the factual basis of which is referred to the expert determination under the contract, for instance, by claiming a reduction from the purchase price because of an alleged depletion in the target company's inventory, such request for arbitration would have to be dismissed as not admissible, or at least premature.[85]

Likewise, practice shows that in many M&A cases, courts have without too much difficulty found that the scope of the jurisdiction of the accounting firm does not include claims contending a breach of other provisions of the contract.[86] However, it is quite common that the parties experience difficulties demarcating the tasks of the expert from those of the arbitrators. One approach is to carefully circumscribe the tasks and powers delegated to the expert by means of a list in the expert determination clause and leaving the arbitral tribunal with jurisdiction over

77 ibid.
78 Ağaoğlu (n 5) 183.
79 ibid.
80 ibid 183–84; Sachs (n 66) 236.
81 The Committee on International Commercial Disputes of the Association of the Bar of the City of New York (n 7) 60.
82 ibid.
83 Sachs (n 37) 368; Ağaoğlu (n 5) 184.
84 ibid.
85 Sachs (n 37) 368; Ağaoğlu (n 5) 184.
86 The Committee on International Commercial Disputes of the Association of the Bar of the City of New York (n 7) 60.

all other issues.[87] Yet, doubts may still remain as to the determination of the proper jurisdiction to decide on preliminary legal issues, particularly those concerning the problems related to the interpretation of the ambiguous terms of an expert determination clause, such as the proper meaning an accounting term that the parties used when defining the expert determination procedure.[88]

For instance, in a high-value institutional arbitration narrated by Sachs,[89] the interpretation of the term 'recurring items' was subject to disagreement between the parties. While the buyer construed recurring items as were items that had occurred once and consequently had an effect in the subsequent period, the seller asserted that recurring items had to occur not only once but on a recurrent basis in each subsequent year of the relevant period.[90] There was an EUR 220,000,000 difference in the outcome depending on with which interpretation the parties went along.[91] Luckily, the parties managed to concur with a joint solution and prepared a special arbitration agreement according to which the arbitral tribunal's duty was to solely decide on the correct interpretation of the term, recurred items.[92] The arbitration agreement provided as follows in the relevant parts:

> 2.2. The Arbitral Tribunal shall first determine whether or not the eight claims asserted under the EBITDA Guarantee with the Notification relate to 'recurring items' within the meaning of Section 8.2(a)(iii) of the SPAs, predicated on the assumption that the accounting mistakes alleged by Party A in the Notification have actually occurred, and it being agreed that the Arbitral Tribunal shall determine in this context the interpretation of the term 'recurring items' as agreed by the parties in the SPAs. If and to the extent the Arbitral Tribunal determines that the accounting mistakes alleged by Party A in the Notification do not relate to recurring items, the Arbitral Tribunal shall reject the claims asserted by Party A in the Notification by final (partial) award. If and to the extent the Arbitral Tribunal determines that the accounting mistakes alleged by Party A in the Notification relate to recurring items, the Arbitral Tribunal shall rule, setting forth its reasons, preferably by binding interim (partial) award or otherwise by procedural order—and the parties will accept such determination as binding—as to which alleged accounting mistakes relate to recurring items. The arbitration proceedings shall then proceed to the next stage, as further outlined below.
>
> 2.3. If and to the extent the Arbitral Tribunal determines that the accounting mistakes alleged by Party A in the Notification relate to 'recurring items', the Arbitral Tribunal shall instruct the appointed auditors pursuant to Section 3 of this Agreement to assess, as experts, with the guidance of the Arbitral Tribunal which shall be based on its preceding decision (pursuant to Section 2.2 last

87 Carlevaris (n 3) 23; see Bernd Ehle, 'Arbitration as a Dispute Resolution Mechanism in Mergers and Acquisitions' in Dennis Campbell (ed), *The Comparative Law Yearbook of International Business* (Kluwer Law International 2005) 287, 299–301.

88 Sachs (n 37) 369.

89 ibid 369ff.

90 ibid 369.

91 ibid 369–70.

92 ibid 370.

> sentence) as to the determination of the exact questions, whether the accounting mistakes alleged by Party A in the Notification are due to 'evident mistakes' as otherwise set forth in Section 8.2(a)(iii) of the SPAs. If and to the extent that both auditors do not agree that the accounting mistakes alleged by Party A in the Notification constitute such 'evident mistakes', the Arbitral Tribunal shall reject the claims asserted by Party A in the Notification with respect to such alleged accounting mistakes by final (partial) award; if and to the extent that both auditors do agree that the accounting mistakes alleged by Party A in the Notification constitute such 'evident mistakes', the arbitration proceedings shall proceed to the next stage, as further outlined below.
>
> 2.4. With respect to the procedural stages described in Sections 2.2 and 2.3 above, the parties agree that within each such stage they may restrict their pleadings to those facts and evidence required to support the decision to be rendered at the end of the respective stage and that such restriction shall not preclude or restrict their pleadings under any subsequent procedural stage.[93]

In the event that the parties are not fortunate enough to agree on a joint solution as they did in the example above the answer to the question as to the proper authority for the interpretation of accounting terms may vary among different jurisdictions. Under the traditional view of French law, for instance, the interpretation of the accounting term at issue could not be left to an expert, but would have to be pondered by an arbitrator or a judge, as a result of the particular concept of the 'mandataire commun'.[94] Nonetheless, the Paris Court of Appeal, in its decision dated 2004, rejected a challenge based on the ground that the competence of the expert included the possibility to *apprécier* (assess) the meaning of those contract provisions that relate to his duty so that he can execute the same.[95] The interpretation was about a technical matter; hence, it was still within the authority of the expert.[96]

Under German and English Law, the expert may be authorized to decide preliminary questions of law and to interpret the contract where necessary, but it is held, at least under German law that, such authority must be granted expressly.[97] Though it rarely happens in the German practice, parties sometimes leave the decision on individual preliminary legal questions expressly to the hands of an arbitral tribunal, with the purpose of avoiding demarcation issues and unnecessary disagreement on the extent of the expert's power to make decisions.[98] On the other hand, in USA, the state

93 ibid 370.

94 Ağaoğlu (n 5) 188.

95 Cour d'Appel de Paris, 25ème Chambre, s B, arrêt du 17 Septembre 2004 quoted in Sachs (n 66) 244; Ağaoğlu (n 5) 188.

96 ibid.

97 ibid; Martin Borowsky, *Das Schiedsgutachten im Common Law, Ein rechtsvergleichender Beitrag zum Begriff der Schiedsgerichtsbarkeit* (Nomos 2001) 189; Hilmar Raeschke-Kessler, 'Die deutsche Rechtsprechung zur Schiedsgerichtsbarkeit von 1989 und die neuere Rechtsprechung zu Schiedsgutachten' in Ottoarndt Glossner (ed), *Jahrbuch für die Praxis der Schiedsgerichtsbarkeit*, (Fachmedien Recht und Wirtschaft in Deutscher Fachverlag GmbH 1989) vol 3, 211, 213 quoted in Sachs (n 66) 244.

98 Broichmann (n 18) 150; Sessler and Leimert (n 34) 159; Sachs (n 56) 812; Klaus Sachs, 'Praktische Durchfuhrung des Schiedsgutachtenverfahrens und Besonderheiten bei internationalen Verfahrenin' in

laws reserve the interpretation of the contract exclusively for the court or the arbitral tribunal.[99]

Furthermore, it may be useful to mention that if the expert has the competence to render decisions on preliminary questions of law under certain jurisdiction, the expert would also have the power to reopen the already decided legal preliminary issues or to make a re-interpretation in the event that additional evidence emerges during the determination process.

A further question relates to the relative hierarchy between arbitration and expert determination and the relationship of these two mechanisms to the courts: are these two dispute resolution proceedings independent of the other?[100] To exemplify, assuming that there is a dispute between the parties arising from the obligation under a Purchase Price Adjustment Clause to allow access to the financial information used to prepare the post-closing financial statements, should the resentful party apply to the state court or is there a requirement to file an arbitration demand initially?[101] The same question occurs also for the review process. Should a party attempting to enforce or set aside the expert determination made by the accounting firm apply to the state court or demand for arbitration?[102] While dealing with this question on their report on Purchase Price Adjustment Clauses and expert determinations dated 2013, The Committee on International Commercial Disputes of the New York City Bar Association avoided suggesting a right answer to this issue, yet noted that it is one of which the parties should be well-aware address.[103]

Some US courts that have approached this issue have held that the expert determination provision does not fall into the ambit of the general arbitration clause, thus, the jurisdiction of the arbitral tribunal. For instance, in *Cendant Corp v Forbes*,[104] the court held that 'it is logical to conclude that by entering into the appraisal agreement, they intended to remove the question from the range of arbitrable matters and to be bound by the appraiser's findings'. In *Wash Auto Co v 1828 L St Assocs*,[105] the court expressed that 'appraisal under lease cannot be subjected to challenge by invoking the general arbitration provision'. In *Dimson v Elghanayan*,[106] while finding that the inclusion of the valuation provision showed intent to remove valuation determinations from general arbitration clause, the court used the expression 'In our view, the presence of the provision for fixation of values by the appraiser removed that subject from consideration by the arbitrator.'[107]

Karl-Heinz Böckstiegel and others (eds), *Schiedsgutachten versus Schiedsgerichtsbarkeit* (Heymann 2007) 15, 20ff.

99 Ağaoğlu (n 5) 188; Borowski (n 97) 189.

100 The Committee on International Commercial Disputes of the Association of the Bar of the City of New York (n 7) 8.

101 ibid 61.

102 ibid.

103 ibid.

104 (1999) 70 F Supp 2d 339, 342–43 (SDNY).

105 (2006) 906 A 2d 869, 880 (DC).

106 *Re Dimson* (1967) 19 NY 2d 316, 325, 280 NYS 2d 97, 227 NE 2d 10 (NY Ct App).

107 ibid 325.

Katz v Feinberg[108] seems to be a particularly interesting case. There were two seemingly contradictory dispute resolution clauses in the purchase agreement. Purchase Agreement section 2(b) assigned determination of the 'Final Share Purchase Price', based on the company's 1995 financial statements, specifying that 'the determination by the Company Accountants of the final purchase price of the Shares shall be final and binding on Seller and Buyer and shall not be subject to any appeal, arbitration, proceeding, adjustment or review of any nature whatsoever' and Purchase Agreement section 14(g) referred all disputes under the agreement to arbitration in New York, under the rules of the American Arbitration Association.[109]

The Court first noted that:

> Under normal circumstances, when an agreement includes two dispute resolution provisions, one specific (a valuation provision) and one general (a broad arbitration clause), the specific provision will govern those claims that fall within it . . . We find the rule favoring specificity applicable in this case. The parties' Purchase Agreement includes both a specific provision, § 2(b), assigning determination of the Final Share Purchase Price to the Company Accountants, and a generally worded arbitration provision, § 14(g), assigning all claims arising from the agreement to an arbitrator. Under existing law, we find that the more specific assignment should govern.[110]

Furthermore, the Court stated that in the case:

> The inclusion in § 2(b) of language not only making the accountants' determination 'final and binding', but also excluding it from 'any appeal, arbitration, proceeding, adjustment or review of any nature whatsoever' further affirms the parties' intent to exclude determinations assigned to the accountants under § 2(b) from later challenge under the general arbitration provision of § 14(g).[111]

Consequently, in light of the case law and the strong language of the parties' agreement, the Court found that the arbitral tribunal did not possess the power to evaluate the determination of the expert and decide on a vacatur.[112]

While this approach positions two dispute resolution provisions independent from each other, it does not place general arbitration clause as having a superior position in comparison to the Purchase Price Adjustment Clause on the hierarchy.[113] Should this view is followed, since expert determinations have no *res judicata* effect and are not immediately enforceable a party must commence proceedings in a court of competent jurisdiction to enforce the decision of the accounting firm in order to

108 (2001) 167 F Supp 2d 556 (SDNY), aff'd, (2002) 290 F 3d 95 (2d Cir).
109 ibid.
110 ibid.
111 ibid.
112 ibid.
113 The Committee on International Commercial Disputes of the Association of the Bar of the City of New York (n 7) 61.

obtain the fruits of a successful expert determination.[114] Similarly, the unsuccessful party may then attempt to resist on the ground that the Court should, in its discretion, not enforce the expert determination agreement for various reasons or, alternatively, challenge the result of the expert determination.[115]

On the other hand, there is a second approach acknowledging the arbitration clause as having a superior position in comparison to the Purchase Price Adjustment Clause.[116] If this view is followed, one can claim that since the parties have referred any dispute arising out of or in connection with the contract to arbitration, those related to the expert determination are also to be decided by arbitration, rather than court litigation.[117] This argument can be particularly strong in the a cross-border perspective, where arbitration is chosen in part because neither party wants the national courts of the other to be involved in the dispute.[118]

Under this view, a party would initially need to file an arbitration request, instead of a lawsuit in the court, to enforce, challenge, or set aside an expert determination and the following arbitration award would then itself be subject to confirmation, challenge, or enforcement.[119] Though the fact that the purchase price adjustment reflected in an award would be enforceable under the New York Convention seems to be an advantage of this approach, the parties may want to face neither the delay nor the expense that would occur if the parties had to initiate arbitration in order to enforce payment of a purchase price adjustment.[120]

The New York Bar Association Report cites *Blue Tee Corp v Koehring Co*[121] as it helps to illustrate the issue.[122] The case included a purchase price adjustment dispute that was submitted to an independent accounting firm, namely Arthur Andersen, for the expert determination. In the course of the determination proceedings, evidence was submitted by the seller that the parties had agreed on a last-minute amendment to the inventory valuation method.[123] While the accounting firm 'expressly disclaimed competence to determine whether, as [the seller] argued, the parties had

114 Justin Thorens, 'L'expertise-arbitrage en droit Suisse et en droit allemand' [1968] Sem Jud 601, 604ff; Robert Hunt, 'The Law Relating to Expert Determination' [2008] 31 <http://www.roberthuntbarrister.com/ExpertDetLawApril2008.pdf> accessed 14 September 2018.

115 Various grounds have been argued for challenging agreements that refer disputes to expert determination, such as:

- any such agreement would be void as an attempted ouster of the jurisdiction of the courts;
- an issue in dispute is not susceptible to expert determination;
- an issue in dispute is not suitable for expert determination by the Expert appointed (or to be appointed);
- the terms of the agreement are too uncertain, by failing to specify with sufficient particularity the procedure to be followed by the expert (ibid 2ff).

116 The Committee on International Commercial Disputes of the Association of the Bar of the City of New York (n 7) 61.

117 ibid.

118 ibid.

119 ibid.

120 ibid 61–62.

121 (1993) 999 F 2d 633 (2d Cir).

122 The Committee on International Commercial Disputes of the Association of the Bar of the City of New York (n 7) 61.

123 *Blue Tee* (n 121) 635.

amended the Agreement at the last minute, thereby materially affecting the valuation of inventory' it determined that under a literal interpretation the buyer had overpaid by $878,000, assuming that there had not been an amendment in the agreement.[124] The seller then initiated arbitral proceeding in compliance with the general arbitration clause of the contract and demanded that the arbitral tribunal find in favour of its claim that it was entitled to a purchase price adjustment in its favour on the ground that parties had agreed on a change in the metric by which inventory was valued. [125] After the hearings which took eight days including multiple witness testimonies and oral and written presentations by the parties, the American Arbitration Association panel ruling in favour of the seller concluded that the inventory valuation mechanism had been changed by the parties.[126] Judge Sweet affirmed that the AAA panel had jurisdiction to resolve the dispute and the arbitral award was affirmed by the Second Circuit.[127]

Following the express disclaimer of the accounting firm to decide on the issue, in Blue Tee, the legal claim was held to be matter for the arbitral tribunal to decide. Since the tribunal also eventually changed the result of the expert determination by this way the question arises: why should the answer be any different if the issue was directly a challenge to the accounting firm's determination?[128]

However, the legal issue here was about the legal claim asserted by the seller contending that the agreement had been amended rather than a confirmation or a challenge to the accounting firm's determination. As mentioned earlier, if the interpretation of the contract is a question of law exclusively outside the scope of the expert and reserved for the court or the arbitral tribunal under the laws of most US states and if the expert does not have jurisdiction over preliminary questions concerning problems related to the expert determination clause, the Court's decision granting the authority to the arbitral tribunal to decide on the existence of an amendment to the valuation method would not necessarily indicate that the Court saw the arbitral tribunal at a higher place on the hierarchy than the accounting firm as suggested by the second view mentioned above. Therefore, though *Blue Tee Corp v Koehring Co* is a great example to illustrate the issue between the expert and the arbitral tribunal, in our humble opinion, it is not fully sufficient to be convinced that the arbitral tribunal is competent to decide where the issue is about a confirmation or a challenge to the determination of the accounting firm.

5. CONCLUSION

Purchase Price Adjustment Clauses pave the way for the parties to adapt the purchase price to the seller's financial condition as of the closing date and avoid the detrimental effects of the financial information asymmetry between signing and closing. Varying among transactions, metrics such as working capital, net assets, book value, net debt, and shareholders' equity are selected to calculate changes in specific aspects

124 ibid.
125 ibid 636.
126 ibid.
127 ibid.
128 The Committee on International Commercial Disputes of the Association of the Bar of the City of New York (n 7) 62.

of the target's financial condition. In order to overcome the problems arising from the complex and highly technical nature of these calculations, the parties generally agree to refer any dispute concerning the values reported in the financial schedules used to determine the amount of any price adjustment to an independent accounting firm for a final and binding expert determination.

In M&A contracts, the expert determination clauses typically embedded in the price adjustment provision quite often stands parallel to the general arbitration clause found most of the time at the end of the contract. In the absence of a particular provision sufficiently clarifying the relation between them, it is possible that this parallelism originates questions as to the demarcation and interaction of two dispute resolution proceedings, such as the proper jurisdiction to decide on the preliminary issues or the competence of the arbitral tribunal in the enforcement or vacatur of the determination.

Since even with the best drafting practical problems may still emerge, concurring on a common approach and expressly addressing these problematic issues when drafting their agreements may be of capital importance for the parties of M&A agreements in order to avoid the cost and ambiguity, which may occur in case of a disagreement. As Sachs noted, 'It is imperative that the contract be as precise as possible with regard to the scope and the rules governing each procedure.'[129] Depending on their selection, it would be in the best interest of parties to have the general arbitration clause include a carve-out specifically excluding from its scope a review of any determinations by the expert pursuant to the purchase price adjustment provision or, alternatively, explicitly empower the arbitral tribunal to review the determination.[130]

129 Sachs (n 37) 371.

130 The Committee on International Commercial Disputes of the Association of the Bar of the City of New York (n 7) 62, for model clauses see ibid, app C.