Floyd Advisory

Expert Tips for Avoiding Common M&A Pitfalls

Part 3: Resolving Issues at Arbitration or Trial

Introduction

Approximately one-third of M&A transactions end up in dispute.[1] While reasonable measures can be taken to mitigate disputes or navigate the negotiations preceding formal dispute resolution procedures (as discussed in in Part 1 and Part 2 of our "Expert Tips for Avoiding Common M&A Pitfalls" Series), post-acquisition disputes still emerge frequently. Arbitration is typically the forum specified within purchase agreements for resolving disputes if formal dispute resolution proceedings are required. Although arbitration holds mechanical similarities to litigation, including hearings, discovery, and written submissions, as well as leading to final and binding decisions, arbitration is often preferred to litigation because it "limits the scope of these elements and increases the involvement of the adjudicator."[2]

Still, trial in a litigation setting may be unavoidable (for example, in a case where the purchase agreement does not include an arbitration clause), or even preferable (if there are complex legal and regulatory issues). In any circumstance, there are certain best practices that can help achieve the best outcome through arbitration or at trial.

1. Know Your Audience and Venue, Including the Context of Precedent Judgements or Cases

When disputes are resolved through arbitration, understanding an arbitrator's background and experience, factors they may have considered in past decisions, and other relevant experience in past accounting arbitrations can inform your arbitration strategy and help position your issues in the most advantageous way.

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CASE STUDY 1

In one matter, a company discovered that a target it had acquired had numerous undisclosed contingent liabilities. While the acquirer was able to provide evidence with affidavits to prove the acquired company was aware of one-off liabilities being recorded, the arbitrator ultimately ruled in favor of the acquiree, as its methodology of recording contingent liabilities was consistently applied in accordance with its past practices (and was GAAP compliant based on the acquiree's application of the relevant guidance). In this case, the named arbitrator was known by the consulting experts, who had observed in previous engagements that the arbitrator tended to favor consistency with past practice acceptable under GAAP rather than strict compliance with a preferred GAAP methodology. Engaging experts prior to arbitrator selection would have given the acquiror a better chance at selecting a more favorable arbitrator for their claims.

Similarly, in litigation, parties can often rely on precedent judgments or cases to inform how to position cases at hearings, in briefings or reports, and eventually, at trial. Past judgements with similar facts and circumstances, however, do not provide enough support to win your case. Rather, it is more important to understand the full context of past case law and relevance to the dispute at hand. This is often a collaborative effort between counsel and experts to ensure any opinions or positions are consistent with those precedent matters that an adjudicator of fact may rely upon.

KEY INDUSTRY GUIDANCE

"Judges who preside over litigation also may follow legal case precedent in certain cases by using prior case decisions applicable to similar facts and issues to the case at hand. Therefore, it is important to know and understand any legal precedent that may potentially affect the practitioner's work and opinions. In most cases, this information can be obtained from the client or attorney."[3]

Parties to a dispute, whether in an arbitration or litigation forum, must be aware of relevant context. Making sure the team considers relevant history with arbitrators (or other adjudicators of fact), precedent determinations, rulings, and/or judgements can help achieve a successful outcome.

[1] Weil, Lentz, Evans. Litigation Services Handbook, Sixth Edition, at page 24.29.
[2] Weil, Lentz, Evans. Litigation Services Handbook, Sixth Edition, at page 1.20.
[3] AICPA Forensic & Valuation Services Practice Aid – Introduction to Civil Litigation, at page 16.

2. Ensure Positions are Well Supported by the Evidence in the Matter

In arbitration or litigation, it is imperative to consider which disputed items to focus on and, just as critically, consider which positions to abandon. Arbitration fees are not always "pay your own way" and are often decided based on the amounts won in proportion to the total disputed amount. Submitting claims that are less supported by evidence or the relevant purchase agreement mechanisms, for negotiation purposes, can undermine other claims, as can engaging in ad hominem attacks or pursuing straw-man arguments.

Engaging expert accountants can be valuable to the decision-making process when forming submissions. While accountants provide valuable support by reviewing accounting policies and practices, analyzing historical financials, reviewing due diligence materials, and performing other services that may be outside the arbitrator or judge's expertise, they may also "assist as the expert and write and submit their own expert report… [or] assist counsel in the analysis and development of a counsel- or company-prepared submission in arbitration or legal proceedings."[4]

CASE STUDY 2

In one matter, a client filed a submission to the arbitrator without thoroughly evaluating the strengths of its positions. During arbitration, it became evident that several of the client's positions lacked sufficient evidentiary support. If experts had been involved earlier in the arbitration process, they could have provided a critical review of the client's claims. This additional input may have identified gaps in the evidence and prompted adjustments to the legal strategy prior to submission. Instead, the focus remained on addressing each potential issue in dispute rather than prioritizing a holistic approach to strengthening the overall case.

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3. Maximize the Utility of Q&A in an Arbitration

It is important to take advantage of every opportunity to strengthen your position, including Arbitrator's Q&A that often follow initial submissions or reports. Arbitrators will often ask open-ended questions during such sessions, creating opportunities to tailor and strengthen your position, while contesting the opponent's. However, during the Q&A, parties should be mindful not to be adversarial but rather to identify misunderstandings or gaps in the presentation of facts. This helps parties narrow their arguments and put forth information relevant to the ultimate determination of the dispute. Additionally, the arbitrator can help the parties focus on the crux of the dispute, eliminating extraneous arguments and fostering cooperation between the parties.

CASE STUDY 3

In one case, a seller and its experts used the arbitrator's questions as a rebuttal report by answering each question on its own positions while underscoring discrepancies in arguments the buyer made in its initial report. The buyer and its experts, on the other hand, utilized the Q&A period to ask further questions of the seller, missing an opportunity to affirmatively answer the arbitrator's questions in relation to their own positions. This ultimately proved to hurt their case, as the arbitrator sided with the seller.

The questions asked during these sessions allow you to succinctly reinforce your positions and present all necessary information, while at the same time make strong arguments against the opposing side's points.

[4] Weil, Lentz, Evans. Litigation Services Handbook, Sixth Edition, at page 24.33.

4. Prioritize Presentation

Even a technically strong position may be weakened in arbitration or trial by poor presentation of information. The ability to present complex information in a succinct and engaging manner, whether orally, through written reports, or through the use of demonstratives and other aids, may be the difference between a negative outcome and a positive one.

Post-acquisition disputes may involve complex accounting or valuation issues that can be hard to comprehend, even for subject matter experts like arbitrators or experienced judges. Changes in the relevant guidance, cross-border considerations, and technical industry-specific guidance are just a few factors that may complicate the dispute at hand. Turning these complex issues into simple positions is imperative – timelines, graphics, functional models, and summaries are examples of tools that parties may use to bolster their positions and improve the presentation of their points.

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CASE STUDY 4

In one post-acquisition dispute involving leases that were initiated, amended, and renewed during periods where lease accounting guidance had significantly changed, seller's experts presented a clear timeline of the dates leases were executed and amended, compared to the relevant dates specified by then-applicable accounting guidance, to illustrate their point regarding what standards applied at each point in time. By visually illustrating these positions, seller and buyer were able to get on the same page and settle the issue before ever reaching arbitration.

CASE STUDY 5

In another case, plaintiff's expert created a flexible damages model that calculated different scenarios in real-time by changing certain inputs. The functionality to run various ranges of data for reasonableness and sensitivity allowed the judge to take a position on each input driving the valuation and to ultimately make a final determination.

Additionally, parties should take care not to overlook the importance of the presentation of oral arguments at arbitration or at trial. Both expert and fact witnesses that can remain calm and collected during cross examination will likely garner more favor than a witness that is flustered or rambling. A witness' demeanor and cadence can have a large effect on an arbitrator's, judge's, or jury's attention span and ultimate perception, and can affect the decisions rendered.

KEY INDUSTRY GUIDANCE

"The witness should make enough eye contact with the judge and/or jury to ensure that they are following the testimony and understanding the ideas... The key point is that the witness is trying to communicate to the trier of fact—either judge or jury—not to the client's counsel or opposing counsel. In general, the expert witness should avoid technical language and jargon… If a technical term is necessary for making a point, it should be defined or explained in terms intelligible to a lay person."[5]

Ultimately, parties must consider not only the information that must be conveyed to the trier of fact, but the best way to present it.

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Conclusion

The process of arbitration or trial may be your only option to resolve an M&A dispute, making it crucial to be well prepared heading into the process. Preparedness involves several factors, including developing an understanding of the arbitrator and relevant judgements or case law, consideration of which issues should be disputed and allocated time or money, making effective use of arbitrator Q&A, and distilling complex issues into digestible formats and concise presentations.

Floyd Advisory assists parties in managing complex issues that come with engaging in a transaction process, starting with pre-deal risk mitigation efforts – helping to review accounting practices, crafting language in purchase and sale agreements related to post-closing adjustments, and accounting records – and through to any post-transaction dispute processes, including the preparation of damage claims when breaches of representation and warranties arise in post-acquisition disputes.

Our professionals have served in many roles within transaction service advisory matters, including financial due diligence, ABAC due diligence, risk mitigation pre- and post-close consulting, and accounting experts or triers of facts during arbitration. Our team has worked on thousands of transactions where we have served as financial reporting and accounting experts. Our depth of experience helps our clients protect value during each phase of the M&A Transaction Timeline.

Floyd Advisory is a member of the AGN International association, as well as other international alliance networks.[6]

[5] Pratt. Shannon P. Valuing a Business: The Analysis and Appraisal of Closely Held Companies, Fifth Edition. Page 1045.
[6] AGN International Ltd is a company limited by guarantee registered in England & Wales, number 3132548, registered office 6 Hays Lane, London Bridge, London SE1 2HB, United Kingdom.

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ABOUT Floyd Advisory

Floyd Advisory is a consulting firm providing financial and accounting expertise in areas of SEC reporting, transaction advisory, investigations and compliance, litigation services, data analytics, as well as business strategy and valuation.

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