



# U.K. vs. U.S. M&A – An Overview of Key Issues

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# Presentation Overview

- Price Adjustment Structures
- Execution Risk
- Warranties and Representations
- Disclosure
- Limitation of a Seller's Liability
- Miscellaneous
- Conclusion

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# Price Adjustment Structures

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# Price Adjustment Structures

- **Completion (Closing) Accounts Mechanism / Net Working Capital Adjustment**
  - Very prevalent in the U.S.; use in the U.K. common but more limited, and dependent upon sector/geography.
  - Certain metrics – e.g. working capital – target numbers agreed by the parties prior to signing the SPA.
  - SPA provides for purchase price to be adjusted by reference to actual working capital of target as at completion.
  - Following completion, buyer (sometimes seller) and its accountants prepare draft completion accounts to calculate the actual working capital.
  - Final completion accounts will be subject to detailed provisions in the SPA (including a dispute resolution mechanism) so extent of price adjustment only known post-completion, i.e. post-completion “true-up”.
  - Economic risk passes to buyer at completion and buyer only pays for actual level of net working capital assets and liabilities of target that seller delivers on completion.

# Price Adjustment Structures cont.

## ▪ Locked-Box Mechanism

- Increasingly common in the U.K. in auction style deals and/or with PE seller wanting a clean break.
- Alternative pricing mechanism to completion accounts.
- Purchase price established by reference to set of agreed historic accounts/balance sheet comprising the locked-box accounts.
- Locked-box accounts fix equity price in respect of the cash, debt and working capital actually present at the date of the locked-box accounts.
- Equity price is hardwired into SPA and is not adjusted post-completion.
- From the date of the locked-box accounts, target is run for the benefit of buyer and no value (leakage) is allowed to leave the business i.e. box is locked (unless “permitted leakage”) backed up by an indemnity.
- Economic risk passes to buyer at locked-box date and seller would seek compensation for “value accrual” (e.g. for capital tied up in business) added onto the consideration.

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# Execution Risk

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# Conditions Precedent to Completion

U.K. Approach	U.S. Approach
<p><b>Regulatory and Antitrust</b></p> <p>Yes, depending on sectors (e.g. FCA consent) / sensitive areas (NSI Act) / thresholds (currently if UK turnover more than £70m or combined market share of 25% or more).</p>	<p><b>Regulatory and Antitrust</b></p> <p>Yes, CFIUS for foreign investment in US; HSR filing if certain threshold(s) are surpassed (Size of Transaction threshold currently \$101M USD).</p>
<p><b>Financing</b></p> <p>Rare. Buyer's financial ability to complete a transaction verified at MOU/HOTs/offer stage.</p>	<p><b>Financing</b></p> <p>Common for buyers to provide sellers with debt financing commitment letters, with conditions to drawdown dovetailing with the conditions to completion in SPA.</p>
<p><b>Material Adverse Change / Event</b></p> <p>Not as common and if they have been agreed to, tightly drafted and keenly negotiated to limit any get out for the buyer as much as possible.</p>	<p><b>Material Adverse Change / Event</b></p> <p>Very common. The occurrence of a MAC/MAE would give a walk-away right (note: rarely successful; per case law, only a serious downturn in the business with long-term ramifications will qualify as a MAC).</p>
<p><b>Repetition (Bring-Down) of Warranties</b></p> <p>Common to repeat only fundamental warranties (i.e. warranties as to title, capacity, authority and standing) at completion.</p>	<p><b>Repetition (Bring-Down) of Warranties and Covenants</b></p> <p>Buyers expect warranties and covenants to be repeated (or brought-down) in full at completion, and for the SPA to contain a condition for the continued accuracy of the warranties and covenants.</p>
<p><b>Others Not Customary</b></p>	<p><b>Others Not Uncommon But Heavily Negotiated</b></p> <p>Commercial consents/meetings; Environmental; Real Estate; Other Due Diligence; Etc.</p>

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# Warranties and Representations

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# Warranties and Representations

U.K. Approach	U.S. Approach
<p><b>Warranties vs. Representations</b></p> <p>“Represents” very often heavily and successfully resisted by sellers. Minimises risk of buyer being able to bring a tortious claim (i.e. non-contractual claim) for misrepresentation under Misrepresentation Act 1967 giving rise to rescission, but SPA will also contain an entire agreement clause and specifically exclude termination as a remedy save if CPs are not satisfied.</p>	<p><b>Warranties vs. Representations</b></p> <p>Customary that “seller represents and warrant”; does not affect available remedies – no statutory right of rescission arising from breach. Tortious / non-contractual claims minimized via “non-reliance” provision (i.e. buyer only relied on seller’s reps and warranties within the purchase agreement)</p>
<p><b>Basis of Recovery</b></p> <p>Buyer’s ability to recover will depend on how breach of warranty has affected overall value of target company’s shares subject to duty to mitigate.</p>	<p><b>Basis of Recovery</b></p> <p>Buyer is indemnified for breach of warranties on a dollar-for-dollar basis (subject to negotiated limitations such as baskets and caps).</p>
<p><b>Risk Allocation</b></p> <p>Favours seller(s). Each seller provides the same fundamental and business representations and warranties, unless seller is a PE or VC fund in which case only fundamental warranties given with business warranties given by the management.</p>	<p><b>Risk Allocation</b></p> <p>Favours buyer. Each seller typically provides the same fundamental and business representations and warranties.</p>
<p><b>Escrow/Retention</b></p> <p>Not uncommon but mostly used to address specific risks identified in due diligence.</p>	<p><b>Escrow/Retention</b></p> <p>Common for a portion of the consideration to be deposited into an escrow account – giving buyer a source of accessible funds for warranty breaches.</p>

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# Disclosure

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# Specific and General Disclosures

- On both sides of the Atlantic common for warranties in SPA to be qualified.

U.K. Approach	U.S. Approach
Statements and information disclosed in separate disclosure letter serve as exceptions to applicable warranties.	Disclosures set out in the disclosure schedules to SPA itself.
Disclosure letter customarily includes series of general disclosures (e.g. information that is available in public registers) qualifying all warranties in the SPA. Disclosure letter also provides for specific disclosures.	Disclosures are usually specific; unusual for a disclosure to be general and qualify all the warranties – cross-qualification generally allowed only where disclosure has clear relevance on its face to another warranty.
Common practice for general disclosure of information and documents provided to buyer during the due diligence exercise to be allowed – usually done by general disclosure of contents of the data room.	General disclosures of the contents of all or parts of the data room almost always resisted.
For disclosure to be effective, it needs to be fairly disclosed with sufficient detail to enable a buyer to understand the nature and scope of the matter being disclosed (standard derived from caselaw and drafted into SPA).	U.S. caselaw suggests disclosure should be reasonably apparent from the text of the disclosure schedules and it should not be so vague as to be meaningless. SPAs typically contain provisions expressly setting forth these interpretation standards.

# Disclosure

## ▪ Buyer's Knowledge; "Sandbagging"

- Common in U.S. deals to negotiate '*pro-sandbagging*' and '*anti-sandbagging*' provisions.
- A '*pro-sandbagging*' clause allows buyer to bring a claim for a breach of warranty in the SPA notwithstanding that the buyer had prior "knowledge" of that breach.
- An '*anti-sandbagging*' clause prevents buyer from bringing a claim if it knew about a matter before signing or completion.
- Where a U.S. style SPA is silent on this matter, issue will be governed by the relevant state law regarding breach of contract claims.
  - Most U.S. states (including Delaware and New York) permit some form of sandbagging when the SPA is silent;
  - But in some states, the absence of a '*pro-sandbagging*' clause would mean that a buyer would find it difficult to bring a successful claim for a breach of warranty of which it was aware before signing or completion (e.g. California).
- In the U.K., clauses relating to buyer's knowledge ('*anti-sandbagging*' clauses) are often negotiated alongside the issue of data room disclosure with a standard of fair disclosure as mentioned above.
- '*Pro-sandbagging*' clauses much less common in the U.K. and there is uncertainty regarding their validity.

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# Limitation of a Seller's Liability

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# Seller Limitations

U.K. Approach	U.S. Approach
<p><b>Financial Limitations</b></p> <p>100% of consideration for fundamental warranty claims.</p> <p>Caps on business warranty claims vary greatly depending on sector, deal size etc. but higher than in the U.S.</p> <p>Very often have de minimis (0.1%) and tipping baskets (1% to 2%).</p>	<p><b>Financial Limitations</b></p> <p>100% of consideration for fundamental warranty claims.</p> <p>Typically 10% to 20% of consideration for business warranty claims.</p> <p>Basket / Deductible: 0.5% - 1% of consideration.</p> <p>Less common to have fixed de minimis claim threshold (e.g. \$50k USD).</p>
<p><b>Time Limits</b></p> <p>Business warranty survival period usually between 12 to 24 months; 6 years for tax warranties.</p>	<p><b>Time Limits</b></p> <p>Warranty survival period usually between 12 to 24 months for non-fundamental warranties; statute of limitations for tax claims and other statute based warranties; indefinite for fundamental warranties (e.g. share ownership).</p>
<p><b>General Limitations</b></p> <p>Include disclosure, procedural limitations, recovery under insurance policies, changes to law, etc.</p>	<p><b>General Limitations</b></p> <p>Rare; disclosure limitations apply.</p>
<p><b>Warranty and Indemnity Insurance</b></p> <p>Increasingly common especially with PE and auction deals. Premiums dependent on sector and deal size but premiums typically 1% to 2% of insured amount and include exclusions.</p>	<p><b>Warranty and Indemnity Insurance (Representations and Warranties Insurance)</b></p> <p>Increasingly common in U.S.; premiums higher than UK (3% to 4%) because recovery is on an indemnity basis and fewer exclusions. Effect of making negotiated Financial Limitations</p>

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# Miscellaneous

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# Other Common Issues

U.K. Approach	U.S. Approach
<b>Restrictive Covenants</b>  Non-compete and non-solicitation covenants typically limited to under 3 years – anything longer unlikely to be enforceable.	<b>Restrictive Covenants</b>  Usually between 3 to 5 years in duration.
<b>Transfer Tax</b>  If share sale of U.K. target, stamp duty on 0.5% of consideration payable by buyer (accepted market practice).	<b>Transfer Tax</b>  Most share/stock transfer do not trigger transfer tax but if triggered, parties negotiate.
<b>Signature of Documents</b>  Certain documents e.g. powers of attorney must be signed as a deed following strict signing formalities e.g. witness. Statutory limitation period for deeds 12 years but for simple agreements is 6 years.	<b>Signature of Documents</b>  No distinction in terms of signing formalities or applicable limitation periods.



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# Conclusion

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# Conclusion

- Whilst a U.K. private M&A deal might look and feel like a U.S. private M&A deal on the surface, there are material differences between the two stemming from law, custom and market practice.
- It is important that the key issues covered in this overview are addressed early on in a transaction e.g. price adjustment structures should form part of discussions at the HOTs/LOI stage.
- The corporate and M&A team at Armstrong Teasdale has significant experience advising on cross-border private M&A transactions straddling the U.S., the U.K. and the E.U.

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# Questions?

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