

Corporate Finance/M&A - USA

Dispute over accounting methodology is subject to arbitration procedures

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Introduction

Post-closing purchase price and working capital adjustments are common in mergers and acquisitions, as are disputes between the transaction parties regarding such adjustments. Given the technical nature of these provisions, transaction agreements often provide that these disputes are to be resolved by a neutral arbitrator, such as an independent accounting firm, instead of courts through traditional litigation. In *Alliant Techsystems, Inc v MidOcean Bushnell Holdings, LP*⁽¹⁾ the Delaware Chancery Court decided a case in which the parties contested the question of whether their dispute over accounting methodology, arising in connection with working capital adjustment procedures, was to be heard by an independent accounting firm or a court. This opinion, together with other recent Delaware cases considering arbitration provisions,⁽²⁾ highlights the need for drafters to carefully consider the scope of review that arbitrators may undertake in resolving disputes over purchase price adjustments.

Facts

The dispute arose as the parties were working through the post-closing purchase price adjustment mechanics set out in the purchase agreement. Alliant Techsystems, Inc (ATK) challenged MidOcean Bushnell Holdings LP's estimate of net working capital, contending that it did not comply with US Generally Accepted Accounting Principles (GAAP). When the parties could not reach an agreement on the net working capital amount, ATK sought to have an independent accounting firm arbitrate the dispute, as provided for by the purchase agreement's provisions governing the purchase price adjustment process. MidOcean countered that disputes over accounting methodology had to be resolved by a court under the agreement's indemnification provisions. According to MidOcean, ATK needed to allege that MidOcean had breached its contractual representations that the financial statements were prepared in accordance with GAAP and could not bring such a dispute under the agreement's purchase price adjustment provisions.

ATK asked the Delaware Chancery Court to order specific performance, compelling MidOcean to submit the accounting dispute to arbitration, while MidOcean sought a declaration that the dispute be resolved under the agreement's indemnification provisions.

Decision

The court found in favour of ATK, finding that the agreement required the parties to submit their dispute to arbitration. It observed that the agreement required MidOcean's pre-closing estimate of net working capital to conform to the definition of 'net working capital' in the agreement, and that this definition provided that net working capital was to be "calculated in accordance with GAAP and otherwise in a manner consistent with the practices and methodologies used in the preparation of the Financial Statements". Therefore, in preparing its post-closing calculation of net working capital - also in accordance with the definition of "net working capital" in the agreement - ATK was not bound to follow the methodology used in the three financial statements to the extent that such methodology was not consistent with GAAP, and the resulting discrepancy in the parties' net working capital calculations properly fell within the purchase price adjustment procedures of the agreement. Given this conclusion, the provision in the agreement stating that purchase price disputes were to be arbitrated by an accounting firm applied and the court entered an order for specific performance, compelling the parties to submit their dispute to arbitration.

In reaching this decision, the court rejected claims from MidOcean that:

- the parties intended for the accounting firm to resolve only issues of "pure mathematics";
- an exclusive remedy provision in the agreement's indemnification provisions should have

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governed the dispute; and

- prior precedents required disputes over accounting methodologies to be decided under indemnification provisions in acquisition agreements.

Comment

This decision highlights the care that practitioners must use in crafting purchase price adjustment provisions in order to prevent unwanted outcomes with respect to post-closing disputes. Parties may wish to specify in the purchase price adjustment provisions whether questions of accounting methodology will be resolved using the arbitration mechanism or by the courts.

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Endnotes

(1) CA No 9813-CB (Del Ch Apr 24 2015, rev Apr 27 2015).

(2) For example, *Weiner v Milliken Design, Inc* and *Garda USA v SPX*.

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