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CONFLICT RESOLUTION

A NEW YORK CASE HIGHLIGHTS THE COMPLEXITIES OF WORKING OUT POST-CLOSING PRICE ADJUSTMENTS

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Whether in connection with a stock purchase, an asset purchase or a merger, many purchase and sale agreements contain a post-closing purchase price adjustment provision. These provisions allow for purchase price adjustments arising from changes in asset value or new value caused by ongoing business operations from the time the acquisition is priced and the closing date of the transaction. Typically, at the transaction's close, the seller provides an updated net asset value, based on a set of closing date financial statements. The buyer is given a refund or must make an additional payment depending on whether the updated net asset value increased or decreased from the baseline date net asset value.

Many adjustment provisions provide for alternative dispute resolution, or ADR, as the remedial scheme for disputes concerning adjustments. ADR may have numerous advantages to litigation, including reduced costs and more expedient resolution. Unlike litigation, ADR can lead to a compromise result without the possibility of appeal or the protections of a court. How a dispute should be resolved depends on whether the dispute concerns the post-closing adjustment or the initially agreed-upon purchase price. Careful drafting of ADR clauses is essential to these determinations.

In 2003, the New York State Court of Appeals in Westmoreland Coal Co. v. Entech Inc. considered the appropriate forum for resolution of objections to closing-date financial statements. The specific issue before the court was whether the buyer's objections to the seller's accounting treatment and valuation of certain assets in its post-closing financial statements fell under an adjustment provision in a stock purchase agreement, which provided for ADR in the event of a dispute, or whether the buyer's objections amounted to alleged breaches of representation or warranty covered by the agreement's indemnification provision, which provided for litigation as the exclusive remedy.

Westmoreland Coal Co. purchased the stock of several subsidiaries of **Entech Inc.** through the agreement. Prior to signing the agreement, Westmoreland received the financial statements of Entech's subsidiaries. Entech represented and warranted in the agreement that the baseline financial statements were prepared in accordance with generally accepted accounting principles. Based on the statements, the companies' net asset value was calculated at $97,120,000, and Westmoreland agreed to a purchase price of $138 million, subject to adjustments specified in the adjustment provision.

The provision accounted for adjustments based on two contingencies. First, the purchase price would be adjusted to reflect a net asset value on the closing date higher or lower than the baseline of $97,120,000. Second, if the closing took place after Dec. 31, 2000, Entech agreed to pay Westmoreland the companies' net revenue from Jan. 1, 2001, up to and including the closing date.

When the transaction closed, Entech provided Westmoreland with a closing date certificate, which set forth Entech's calculation of the aggregate value of the companies' net assets as of the closing date. Westmoreland objected to Entech's calculation of the net assets on the basis that certain asset valuations did not comply with GAAP and claimed an adjustment in its favor of nearly $74 million.

Westmoreland argued that under the adjustment provision, the dispute should be submitted to ADR. Entech refused to submit to ADR, arguing that the calculation of the net asset value on the closing date was consistent with the calculation in the financial statements. Entech maintained that the objections amounted to alleged breaches of representation or warranty for which the exclusive remedy was litigation. Westmoreland commenced a proceeding to compel Entech to submit the parties' dispute to ADR. The New York State Supreme Court granted Westmoreland's petition determining erroneously that the adjustment provision applied because the indemnification provision applied only to circumstances involving third-party claims. The Appellate Division affirmed.

The New York Court of Appeals unanimously reversed, holding that Westmoreland's valuation objections amounted to claims for breach of representation or warranty for which litigation was the exclusive remedy. In reaching its decision, the court reviewed the agreement "as a harmonious and integrated whole" and noted that the adjustment provision required Entech to prepare the closing date certificate consistent with the preparation of the interim financial statements and Entech specifically represented and warranted that the baseline financial statements complied with GAAP. The court determined that the adjustment provision's "emphasis on consistent treatment can only reflect a purpose to flag changes in value occurring as a result of the companies' operations between July 31, 2000 (the date of acquisition pricing) and the closing date."

Westmoreland demonstrates the importance of clear and unambiguous language in adjustment provisions to avoid disputes over the proper forum for post-closing adjustment dispute resolution. In particular, to the extent ADR is to be used only for accounting disputes involving changes in asset value or new asset value acquired between the baseline date and closing date, parties should draft narrowly and specifically the ADR clauses in their purchase and sale agreements. ■

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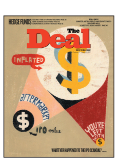

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