Glossary for M&A Study

Security for warranty claims

This security mechanism takes effect if warranty claims are made. Warranty claims are typically secured via an escrow account, retention of part of the purchase price or a bank guarantee.

Basket

A basket clause is a contract provision that prevents the other party from making minor claims. Warranty claims can only be asserted if the aggregate of all claims exceeds a certain limit. The parties may also agree that only the amount above the threshold (deductible, "excess-only") or the total amount of the claim ("first dollar") can be recovered.

Closing conditions

Closing conditions are contractually defined requirements for completion of the transaction. Examples include antitrust clearance and regulatory approval.

De minimis

In a sale and purchase agreement, de minimis stipulations refer to the amount below which the buyer cannot assert warranty claims. De minimis provisions are aimed at preventing the parties from making minor claims, and thus encourage a more constructive relationship. They are generally combined with a threshold or first dollar rule (see Basket). In general, a de minimis provision is seller-friendly.

Earn-out

An earn-out is a mechanism by which part of the purchase price is dependent on the future performance of the target company. Both the benefits and the risk of the target company post-acquisition are therefore shared by seller and buyer.

Liability cap

In practice, it is common to limit the seller's overall liability since it would seem unfair for the seller's potential liability to exceed the purchase price. The issue during negotiations, therefore, is not so much the principle, but more the exact level of the liability cap.

Purchase price adjustment

Purchase price adjustment is intended to allow for changes in the value of the target company's assets, typically between signing and closing. The inclusion of a purchase price adjustment mechanism is generally buyer-friendly.

Locked box

A locked box clause is a mechanism for establishing the purchase price, with the price usually being based on the most recent audited financial statements. The purchase price is fixed in these cases, with no subsequent adjustment taking place. No cash may be taken out of the company until the transaction has been completed, apart from defined exceptions, e.g. payments in the normal course of business to cover wages, taxes, etc. The locked box model is favoured by financial investors when selling and necessitates thorough financial due diligence.

MAC clause

Material Adverse Change clauses (MAC clauses) give the buyer the right to terminate the agreement if a specific event defined in the agreement that has a negative impact on the target business occurs prior to closing.

Arbitration

Arbitration clauses are used by sellers and buyers to exclude the jurisdiction of the state courts. They designate an arbitration court to resolve the dispute instead and subject themselves to its regulations.

Limitation period for warranty claims

Warranty claims can no longer be asserted by the buyer after the relevant limitation period has expired. Under normal statutory regulations, warranties become time-barred after three years (counted from the end of the calendar year). Contractual provisions often deviate from this statutory rule. Significantly shorter warranty periods are often agreed with regard to the operational business of the company being sold.

Warranty & Indemnity insurance

Insurance usually taken out by the buyer (which is then often called "buyer-side W&I insurance"). It covers the buyer against factors and risks of which it is unaware that may reduce the value of the investment. In some cases, W&I insurance may also cover the buyer against known risks resulting from acquisition of the company.

Non-compete clause

A non-compete clause prohibits the seller from participating in the market for a specified period. It is essential that (competition-related) legal restrictions are observed in such situations.