Hogan Lovells

Dr Kim Lars Mehrbrey is a partner, Dr Lisa Hofmeister is counsel and Jackie J. Bronsdon is an associate at Hogan Lovells International LLP. Mr Mehrbrey can be contacted on +49 211 13 68 473 or by email: kim.mehrbrey@hoganlovells.com. Ms Hofmeister can be contacted on +49 211 13 68 476 or by email: lisa.hofmeister@hoganlovells.com. Ms Bronsdon can be contacted on +49 211 13 68 476 or by email: jacqueline.bronsdon@hoganlovells.com.

Published by Financier Worldwide Ltd
©2021 Financier Worldwide Ltd. All rights reserved.
Permission to use this reprint has been granted by the publisher.

SPOTLIGHT ARTICLE February 2022

Profit maximisation through effective post-M&A claim management

BY KIM LARS MEHRBREY, LISA HOFMEISTER AND JACKIE J. BRONSDON

In M&A transactions, the buyer usually invests a considerable amount of time and money to get the deal done. The target company is thoroughly scrutinised in due diligence processes, detailed Q&A sessions take place and complex contractual clauses are negotiated. Once the deal has been closed, the meticulously negotiated contract often disappears into a drawer forever.

As a result, many claims arising out of such transactions are never identified and eventually become time-barred unless they are discovered by chance. The potential claimant (usually the buyer) thereby misses out on considerable profits.

Why post-M&A claim management is essential

The reason for this usually is that after the transaction is closed, the buyer's side does not analyse whether there are any contractual or statutory claims against the seller. Even companies with fully staffed legal teams are usually not aware of the potential profits a claim assessment can generate. They often also lack the time and the specialised expertise required to perform a diligent claim assessment. Sometimes claims also remain undiscovered because of a change of personnel familiar with the transaction.

Furthermore, a lot of companies are reluctant to pursue identified claims out of concern that this may make them seem like a difficult business partner. This view, however, is shortsighted at best, as it overlooks the fact that not identifying and pursuing claims entails significant risks of liability for the management and is not in the best interest of the shareholders.

In some jurisdictions, directors face liability if they do not identify and pursue well-founded claims. This is especially the case in Germany where courts have found board members as well as members of the supervisory board of a stock corporation liable for breach of duty in cases in which these parties had failed to assert enforceable and valid claims of the corporation against third parties.

Accordingly, not identifying and pursuing post-M&A claims in a timely manner could also be considered a breach of duty. Even though directors may refrain from asserting claims against third parties under certain circumstances, they are generally required to make a factual and legal assessment and to weigh the advantages and disadvantages of pursuing them. Those who simply ignore potential claims will usually not be considered as having satisfied their statutory duties.

Another aspect that sometimes alleviates a company's concerns of being perceived as the 'bad guy' is that more and more

M&A transactions involve warranty & indemnity insurance. In these cases, the insured claims will be fought out with the respective insurance companies rather than the business partners themselves.

Where to find examples in other industries and fields of law

In other fields of law, for example in construction law, making use of standardised claim management systems is a lot more common. Some companies have even dedicated entire departments to investigating as well as pursuing claims. This is especially the case in the area of antitrust damages, where annualised damages amounting to more than €100m are not unusual for big market players. These departments sometimes are the most profitable business units within the company. It is therefore all the more surprising that many company managers are unaware of the potential of strategic post-M&A claim management.

How to conduct proper post-M&A claim management

In most cases, the existence of post-M&A claims is not obvious and requires a thorough assessment. At the outset of any claim assessment, the relevant contractual and statutory time limits need to be taken into account and closely monitored. Otherwise, potential claims may run past the statute of limitation. For this purpose, the monitoring system should always include sufficient reminders and assigned staff to monitor for time compliance.

To what extent the claims are assessed can depend on various factors. Factors which proved to be useful in practice have been the value of the target company, the value of the potential claims as well as whether there is already some indication of violations of contractual and statutory provisions by the opposing party.

On the other hand, an in-depth review of potential claims does not make sense if pursuing claims against the opposing party is out of the question from the outset. This may be the case if the seller does not want to strain important business relations with the opposing party or if there are serious doubts regarding the opposing party's solvency.

The next step is to analyse the relevant contractual as well as statutory provisions and factual evidence for a potential violation. After acquiring the target company, the buyer usually has access to all information sources available to the target company. This will allow the buyer to determine the state of the company and to assess whether it is in line with what was contractually defined. In particular, the buyer is now able to conduct interviews with employees and to fully access the company's books.

Typically, the share purchase agreement contains a detailed list of representations and warranties. However, grounds for post-M&A claims are not limited to violations of these representations and warranties. According to German law, claims on the grounds of deceit by the opposing party cannot be contractually excluded.

For such claims to be successful, there does not necessarily have to be evidence of active deceit. Rather, a failure to disclose information relevant to the transaction can suffice. This way, the buyer may not only be entitled to claim damages, but rather even to demand rescission of the entire contract. The latter is particularly beneficial if the buyer is no longer interested in keeping the target company.

After sufficient evidence is gathered and potential claims are identified, there needs to be an analysis of the chances of success of the claims as well as a determination of whether pursuing these claims makes sense in financial and economic terms.

Maximising profits when implementing post-M&A claim management

Important factors for maximising profits when making use of claim management after an M&A transaction are conducting this process as efficiently as possible and employing a cost-efficient fee structure.

In terms of efficiency, making use of standardised assessment schemes specifically designed for identifying post-M&A claims has proven to be most successful. When dealing with cross-border transactions it is important to work in teams located in the relevant jurisdictions. This is usually achieved more easily by international law firms with teams set up around the globe.

In terms of fees, it is important to bear in mind that the party interested in professional claim management services does not always have to bear all legal fees. There are various possibilities to reduce expenses and clients can make use of flexible fee structures such as a flat fee for conducting a first assessment. In some jurisdictions, law firms can also work on a contingency fee basis.

To sum up

Against this background, post-closing claim management entails a lot more than merely examining legal aspects. It requires precise monitoring of deadlines, structured clarification of the facts, targeted legal analysis and initiating the appropriate legal steps. Making use of professional claim management services can yield considerable earnings potential for the company and at the same time avoid liability risks for the company's management. ■

This article first appeared in the February 2022 issue of Financier Worldwide magazine. Permission to use this reprint has been granted by the publisher. © 2022 Financier Worldwide Limited.

FINANCIER WORLDWIDE corporatefinanceintelligence