***PE Pathways* — Expert or Arbitrator?**
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Nick Stawasz:

Welcome to *PE Pathways*, our podcast series where experienced dealmakers share their thoughts on current private equity and M&A trends and developments. Today, we are going to discuss some of the commonly used dispute resolution options for post-closing disputes regarding purchase price adjustments and/or announced. Specifically, whether the third party engaged to resolve the dispute has the role of an expert or an arbitrator.

My name is Nick Stawasz, and I'm a partner in the private equity practice of Troutman Pepper Locke. I'm happy to be joined today by my fellow partner, Dan Boland, who is a member of the firm's business litigation practice, and who was a CPA, and in his prior life, was an auditor with E&Y. Welcome, Dan.

Dan Boland:

Thanks, Nick. Happy to be here.

Nick Stawasz:

Dan, I'd like to start off. What are the differences between a dispute resolution process being deemed an arbitration or an expert determination?

Dan Boland:

There's a couple of significant differences, Nick. For one, standard of review. Although there's a limited review for both expert determinations and arbitrations, the review standard does differ somewhat between the two. Both are subject to appeal for fraud, or if the decision maker exceeds its authority. With respect to expert determinations, a court will not second-guess an expert decision on factual issues that are within the expert's subject matter expertise. Although courts will review any legal determinations by an expert de novo, which means the court will essentially decide the issue independently without any real deference at all to the expert's decision.

Conversely, to overturn an arbitrator's decision, a party must show that the arbitrator manifestly disregarded the law. In other words, the arbitrator completely ignored the law in reaching its decision. Another, and I think primary difference, between an expert determination and arbitration is the scope of authority that's granted to the decision maker. Arbitrators have the plenary power to interpret the party's agreement from a legal perspective, and really to resolve all disputes that the parties may have about that particular issue. Whereas experts, they have

the authority to resolve only the specific factual disputes that the parties have identified for the dispute resolution process.

Nick Stawasz:

Thanks, Dan. As a follow-up to that, what if there is a legal issue that needs to be resolved related to the expert's resolution of the particular factual issue?

Dan Boland:

That's a good question. So, recent case law in Delaware has confirmed that experts do have some authority to interpret contractual terms if those provisions are necessary for the expert to decide the factual issue in dispute. So, the key question is, where is that line? I think it really depends on the specific agreement at issue. But as a general matter, the more closely related the contract term is to the expert's area of expertise, the more likely that the expert will have the authority to interpret that term without the court first weighing in.

For example, imagine the parties have assigned to an accounting expert the authority to determine a specific financial metric that governs a purchase price adjustment or an earn-out. But the agreement lacks specificity as to exactly how that metric should be calculated or what it should include from a financial or accounting perspective. A court may likely say that determining how to calculate that metric falls within the expert scope of authority to interpret the contract because it's so closely related to the expert subject matter expertise, whether that be accounting or financial.

Nick Stawasz:

Now that we have an understanding of the differences between the two, what are some reasons why a party might want an arbitration determination, and what are some reasons why they may want an expert determination?

Dan Boland:

It's another good question. I think it depends on the situation and what are the parties' goals. I think many times a party may think, "I want a court deciding legal issues. I do not necessarily want an accountant or a financial expert to address those things that are really legal in nature." Therefore, parties prefer an expert determination over arbitration because that will preserve those purely legal issues for a court to decide.

Nick Stawasz:

Why then would the parties want an arbitration?

Dan Boland:

I think there's two very important considerations. One is, what's the amount in dispute? Also, what's the desired speed and finality that you're looking for in the process? If the amount in

dispute is anticipated to be relatively small, then an arbitration could be the preferable path because it will result in a complete resolution of the dispute, generally on a quicker basis, and potentially avoiding legal fees and costs that might swallow the amount that the parties are arguing over in the first place. For example, let's assume you have a purchase price dispute for $1 or $2 million and one party asserts a legal defense.

For example, let's say one party says the other missed a deadline. Therefore, they waived the ability to obtain any purchase price adjustment. An arbitrator generally will have the authority to consider and rule on that dispute, along with all the other issues, to provide a complete resolution. An expert does not. Again, an expert can only consider issues that are within its area of expertise. So, why is this important?

If the parties have agreed on an expert determination, you may find yourself in a situation where you're fighting a post-closing dispute in two different venues. You may have to go to a court to resolve the legal issue of whether or not the deadline was breached, and therefore, there's no possibility for a purchase price adjustment. That could involve motion to dismiss briefing, discovery, depositions, summary judgment, trial. All before the parties even have an opportunity to submit to the expert what is the right metric or how do you determine whether or not there should be a purchase price adjustment under the metric in the parties' agreement.

That court litigation alone may come with a significant price tag that could really make it impractical for resolving the dispute. So, an expert determination can sometimes result in a more costly and much longer process, sometimes years. When I think, most parties generally envision the dispute resolution process being more streamlined and contained. I think a party needs to consider what is most important given the situation, speed, finality, containing costs, or is there enough in dispute that it really makes sense to make sure legal experts interpret the contract and resolve any type of legal disputes. It's a trade-off, which may often turn on the amount of dollars that are at stake.

Nick Stawasz:

Thank you, Dan. Now that we have a sense of the considerations and the differences between the two, what can parties do to help ensure that their chosen determination will ultimately be the determination that it's adhered to after the closing of a transaction?

Dan Boland:

Here, I think you really need to understand how a court will read the agreement and what it will look to, to determine whether or not if it's an expert determination or an arbitration. In Delaware, the courts have clarified that labels alone are just not enough. Simply referring to the decision maker as an arbitrator or the actual decision as an arbitral award is not sufficient in and of itself to determine the process to be an arbitration. Same thing goes for expert determination. Just calling the decision maker an expert is not going to be enough to ensure that the process is an expert determination.

Delaware courts will look at the dispute resolution process as a whole and determine whether or not, does this look more like an arbitration or does it look more like an expert determination. For example, does the agreement grant the decision maker authority to decide only a specific

factual issue that is within the decision maker's area of expertise? Or conversely, does the agreement grant broad authority to decide other issues, including certain legal issues, which is more like an arbitration?

Another factor, does the process provide an opportunity for the parties to present evidence to the decision maker, which is consistent with an arbitration? Is the process, on the other hand, more limited, with very limited opportunity to make submissions to the decision maker, more like an expert determination? There's other factors as well, but the court will look at the agreement and the dispute resolution process as a whole and say, "What does it look like more, an expert determination or an arbitration?" Again, the parties need to understand the way the court will look at it, and interpret the agreement language, and be sure to craft the process consistent with what their intent is.

Nick Stawasz:

Dan, if there's a lack of clarity as to the type of resolution procedure in the document, what can then happen?

Dan Boland:

Then, I'll have to get more involved. It means, potentially, more litigation and also more delay, which no one wants. If an agreement's unclear and the parties disagree post-closing about whether they agreed to an expert determination or an arbitration, oftentimes, there's litigation to decide that issue as a threshold matter before the substantive dispute is given to the expert or arbitrator. Again, adding delay and increased cost to the process.

Nick Stawasz:

Now, whether it's an expert or an arbitrator, what are your thoughts on whether this entity, this firm, should be a nationally recognized accounting firm?

Dan Boland:

I see that designation most often. I think that's the most common designation in purchase agreements, and it's easy to understand why, Nick. Accounting firm often makes sense given the accounting financial nature of most post-closing disputes, particularly if the key determination is whether the financials comply with gap or there's some failure to comply with gap. So, that makes sense. But parties should be aware that it can sometimes create unforeseen delays. Parties typically want folks with experience serving as an arbitrator or the decision maker previously. And if you have two large companies in a transaction, they may have a hard time finding an arbitrator with the desired experience at a nationally recognized accounting firm that is not conflicted out based on performing some type of other work for one of the parties.

I've seen situations where, between the two parties, conflicts have knocked out more than 10 potential accounting firms as the potential decision makers. Again, this can sometimes create frustration and also cause delay on the front end. Now, a potential alternative that I sometimes

see is defining the arbitrator as someone with the requisite accounting or financial expertise at a nationally recognized accounting firm or a consulting firm with a dispute resolution group. This can increase the potential options because it brings in additional firms that are not purely accounting firms necessarily, but have CPAs who deal with similar accounting issues, valuation

questions, post-closing disputes, and serve as a neutral, often and have that experience.

Nick Stawasz:

An alternative that we often both see is actually naming that decision maker specifically in the agreement. What're your thoughts about going that route?

Dan Boland:

I think that can be effective and certainly streamline the selection process. But I think there's a couple other things you want to take into consideration if you decide to do so. When I think you want to make sure that the firm that's plugged into the agreement doesn't already have an existing conflict and also consider language that would prevent either one of the parties from retaining that firm after the agreement closes, that would create a conflict and frustrate the purpose of that provision in the first place.

I think it's also a good practice to include language for selecting an alternative in the event that the firm written into the agreement, for whatever reason, is no longer a valid option by the time any dispute arises.

Nick Stawasz:

This has been a great discussion, Dan, and thank you for spending some time with me today to talk through this topic. Thank you to our audience for listening today. Please keep your eyes open for future episodes of *PE Pathways*, where we bring experienced dealmakers on to share their thoughts on current private equity and M&A trends and developments. You can find the latest episodes wherever you get your podcasts.