What's market for M&A?

Lawyers McCullough Robertson

McCullough Robertson's integrated corporate and tax team, led by 15 partners, has analysed its public and private deals over the last 18 months, focusing on the evolution of the commonly used "standard market clauses".

Prepared specifically for professional advisers, we are pleased to share with you a practical summary of the key considerations that will impact your client's next transaction.

Bridging the price gap

While traditionally parties have structured consideration by way of cash (or a combination of cash and scrip), parties are now creatively fine-tuning the structure and timing for consideration payments and calculations. For example, contingency consideration through appropriately capped and collared "earnouts" and royalties is a common feature in recent M&A documentation. The main purpose for this is to limit post-closing operating risk for buyers, while maximising the exit price for sellers.

Anti-embarrassment protection

Also becoming popular are "anti-embarrassment" or "face-saving" clauses designed to ensure a seller shares in unexpected post-closing profits and, in the process, is not embarrassed by being seen in the market as mistiming the sale or underestimating the genuine worth of the company or asset. These clauses address the possibility of the buyer on-selling a company or asset at a higher price within a short period post-closing. In recent times, these clauses have required the recalculation and upward adjustment of the original purchase price to ensure the seller shares in any unexpected uplift in value that the buyer achieves on its on-sale.

Pre-completion conduct - what is the "ordinary course"?

Buyers are endeavouring to control the conduct of a company or asset by imposing an extensive list of obligations and restrictions on the seller prior to closing. For example, there is generally an obligation for the seller to ensure the company or asset is conducted "in the ordinary course of business". However, what is "ordinary" has become somewhat of a grey area in recent times — in a period which cannot be described as "ordinary", parties will need to examine whether it is realistically possible for a seller to conduct a company or asset in its usual course of business, and whether this requires specific consideration by the parties on a case-by-case basis.

Transaction insurance

The level of warranty protection sought by buyers has increased in the last 18 months. In response, sellers are looking at ways in which they can exit from their business with minimal (if any) post-closing liability. Warranty and indemnity insurance (**W&I Insurance**) offer sellers the perfect solution for this. However, W&I Insurance is becoming more expensive. For a long time, the premiums for this type of insurance ranged from between 1% and 2% of the transaction value, but now premiums are more regularly being priced at between 3% and 5% of transaction value.

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Material adverse changes

Many buyers are now tightening the conditions which protect them against changes to a company or asset pre-closing by imposing "material adverse change" (MAC) clauses. The effect of a MAC clause allows a buyer to walk away from a transaction if the company or asset is adversely affected by certain defined events. Buyers are including MAC clauses either as a condition to closing or as an express termination right. Sellers are looking to counter this by expressly carving out the effects of economic or industry-wide events (such as pandemics or global conflicts).

Limitations of liability

Most sellers continue to look to limit their liability for warranty breaches and indemnity claims by imposing strict time and monetary thresholds on the buyer. Recent trends show that warranty claims are being capped at between 30% to 50% of the purchase price (except for claims relating to title, which can extend to 100%), with many buyers being limited to making a claim within 2 years of completion. It is also common for parties to continue to agree a minimum monetary liability threshold before a buyer can make a warranty claim.

Foreign investment and critical infrastructure

The mandatory approval requirements under Australia's foreign investment framework have tightened with recent amendments to the definition of what constitutes a "critical" Australian business under the *Security of Critical Infrastructure Act*. Foreign investors must now obtain approval from Australia's Foreign Investment Review Board for investments of 10% or more in any business operating in the following sectors: financial services and banking, telecommunications, energy, defence, health, data centres and cloud providers and higher education and research (amongst others).

Secured indemnities

Buyers are always looking for the best protection against the risk of a seller not being able to meet a claim for breach of warranty. This is particularly the case if the seller's financial capability is likely to diminish after closing. Common forms of protection sought by buyers in recent times range from cash retentions, negative covenants, parent company guarantees, and warranty and indemnity insurance.

Broader due diligence

Before completing a deal, buyers are now managing their risk by undertaking more extensive due diligence beyond traditional legal, accounting and tax investigations. Detailed due diligence is becoming more common in areas such as market sustainability, workplace health and safety, and to the extent to which there has been (and it will be possible to maintain) Environmental, Social and Corporate Governance (ESG) compliance.

Key contacts

McCullough Robertson Lawyers

McCullough Robertson is a leading adviser on M&A transactions in the mid-market. If you would like to discuss any of these considerations, please contact our partners:

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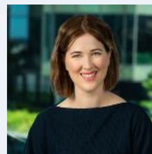

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