

Paying What Is Due: Legal Imperatives for Payment Mechanisms in Mergers and Acquisitions





Introduction

Purchase prices in mergers and acquisitions (M&A) are typically neither paid immediately nor paid in full at once, and from the commencement of a transaction to its completion, the value of the purchase price may either decline or appreciate; thereby giving one party an advantage over the other. Thus, given the dynamics and sophistications of M&As, the payment mechanism is as crucial as the price tag itself. Far from being a mere formality, the payment mechanism of an M&A transaction dictates risk allocation, aligns expectations, and safeguards value post-closing.

While the headline purchase price often commands attention, it is the underlying mechanism of how the price is determined, adjusted (where necessary), and paid that essentially governs risk mitigation and value realisation for parties. Dealmakers must go beyond negotiating the amount; they must meticulously structure how the price is confirmed, modified, or made contingent on future events.

This article examines key payment mechanisms employable for M&A deals and brings to the fore critical legal drafting and negotiation considerations.

Payment Mechanisms: Structures and Legal Considerations

1. **Locked Box Mechanism**

With the locked box mechanism, the purchase price is benchmarked against the target's last financial statements(audited) and determined by an independent expert at a set date ("locked box date"), which is prior to the date the transaction is completed, i.e., closing date or completion date. Notably, the locked box mechanism establishes a fixed purchase price based on the target's last financial statements(audited) before the transaction closes. A key characteristic is the absence of post-closing adjustments, i.e., the purchase price cannot be modified after it has been set. This mechanism offers certainty and speed, making it popular in private equity exits because of the clean break it provides. It is instructive to note that while the purchase price is set on the locked box date, payment is made only upon closing.

However, this mechanism involves significant risks for both parties. The buyer risks that the purchase price will not adjust for any positive or negative value changes in the target after the locked box date. Consequently, the buyer may face a decline in the target's value due to value extractions from the target known as *leakages*, e.g., dividend payouts, management fees, and operating costs incurred between the locked box date and closing. For the seller, the locked box mechanism will not allow them to derive benefits from any increase in the target's value during this period, since all the value is reserved for the buyer's interest.



Consequently, it is essential for legal advisers on both sides of the transaction to effectively reduce these risks while ensuring that the parties benefit from the purpose of the locked box mechanism. To mitigate the buyer's risks, definitive agreements such as the Share Purchase Agreement ("SPA") may include undertakings, representations, warranties, and indemnity provisions that permit and/or prohibit certain leakages agreed upon by the parties. While permissible leakages are often relevant for the target's operations such as staff remuneration, prohibited leakages are typically deductions which are not necessary for the target's operations, e.g., dividend payouts. These measures will preserve the holistic value of the target in favour of the buyer from the locked box date to the closing date. For the seller, their interest may be protected through the introduction of a clawback arrangement to capture value increases that unfairly benefit the buyer after the locked box date.

2. ***Completion Accounts***

A reflection of the traditional norms of payments for M&As, this payment mechanism enables parties to set a preliminary purchase price before the completion date and determine the final purchase price after the completion date. The definitive agreement, such as the SPA, outlines the set preliminary purchase price and states the determinants of the final purchase price upon completion. Essentially, the purchase price adjustments after the completion date are based on the actual financial position of the company at completion, considering the target's net debt, working capital, among others. Where the target's financial position is higher or lower than the preliminary purchase price set by the parties, the final purchase price will be adjusted to accommodate the differences.

Despite its potency in aligning the purchase price to the financial position of the target at closing, the completion account mechanism may demand more time and resources for parties to agree on the final purchase price. To maximise these resources, it is instructive that the SPA clearly details considerations, including the accounting policies to be employed in preparing the completion account, the party responsible for preparing the account, the counterparty to validate the account, the financial statements for consideration, means of resolving disputes (usually by expert determination), and the timelines.

Although additional time and resources may be expended to determine the final purchase price, if the completion account mechanism is structured properly, it helps both sides walk away with the confidence that the deal was fair.

3. ***Escrow Arrangements***

Escrow arrangements are used to give comfort for the availability of funds and payment of fees upon crystallisation. Notably, the purchase price could be held in an escrow account pending the fulfilment of the parties' closing obligations. This structure may be adopted in deals requiring regulatory approvals. For instance, where the Federal Competition and Consumer Protection Commission ("FCCPC") approval is required,¹ parties may elect to deposit the purchase price in an escrow account and pay to the seller only after the approval has been obtained to prevent any inference that the transaction was consummated before obtaining the FCCPC approval, as such consummation will expose the parties to strict penalties, which may be up to the parties' turnover in the most recent financial year.

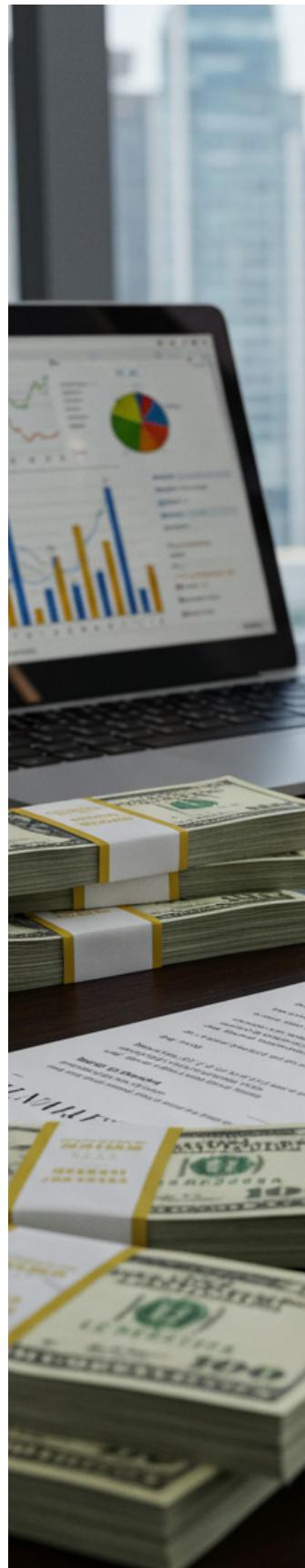
Additionally, escrow arrangements may involve holding a portion of the purchase price in trust to cover potential claims like breach of warranties, indemnities, variations in valuations, or unresolved liabilities. This provides a safety net and assurance for the party due to receive the monies when such claims arise after closing. For this reason, escrow arrangements may be leveraged in a payment mechanism involving completion accounts or earn-outs.

While the purpose of an escrow arrangement may vary, it is necessary to enter an escrow agreement with the escrow agent, i.e., the third party that holds the funds in trust for the parties and makes required payments to the relevant parties upon such payments becoming due and payable. The escrow agreement should, among others, meticulously provide clarity on the triggers for a release of funds, the term, and the limits on any claims. With an effective structure, an escrow arrangement is a practical way to protect both sides and reduce uncertainties in a deal.

4. ***Earn-Outs***

Depending on the transaction dynamics, differences in parties' views on valuations, and the seller's confidence in the target's performance post-closing, parties may agree that a portion of the purchase price becomes payable only upon the target reaching a set performance milestone after the transaction has been completed. This arrangement contemplates a deferred purchase price, and it is well-known as an *earn-out*.

Earn-outs are employable to bridge the differences in parties' value perceptions of the target. For example, in founder-led or high-growth companies, the seller may feel strongly about the company's upside, while the buyer remains cautious. Rather than lock horns over the price, parties structure payments around future performance; thus, the actual value



¹ For a detailed analysis of the requirement for the FCCPC approval relating to M&As, please see our [article](#).



plays out over time. Essentially, the buyer in a transaction with an earn-out mechanism elects to only *put his money* on realised financial positions of the target and commits to pay more in deferred purchase price when the disputed projections become realities. Such deferred payments are typically subject to set performance metrics for the target, including high revenue or customer growth.

The fact that the seller is no longer in control and management of the target after closing may threaten the success of earn-outs for the seller, as the chances of the target fulfilling the set performance metrics may be dependent on the buyer's management of the target and transparency. If the target's performance metrics are not met and the seller forfeits the earn-outs, the seller may allege that such forfeiture was due to the buyer's deliberate mismanagement of the target or lack of transparency. This makes it imperative that earn-out clauses in SPAs are carefully drafted to, among others, detail the determination of the target's performance metrics, basis for preparing the earn-out accounts, timelines, dispute resolution, and price adjustments where necessary.

5. **Equity Rollover**

Under this mechanism, sellers, who are often the founders or key executives, reinvest in the acquired company, i.e., instead of receiving the entire purchase price in cash, they agree to take up shares in the company post-acquisition, thereby becoming minority shareholders, with the new owners maintaining the majority.

The primary appeal for sellers is often christened as the *second bite at the apple*. Private equity buyers typically aim to grow the acquired company and sell it for a profit within three to seven years. By maintaining an equity stake, sellers can benefit from this future upside and potentially secure a larger payout at the next sale. This mechanism can also offer tax advantages by delaying capital gains tax on the reinvested amount until the final exit.² From an operational perspective, equity rollovers promote long-term collaboration, preserve business continuity, and utilise the founders' expertise for ongoing growth. For buyers, the benefits include reducing the immediate cash expenditure required to complete the acquisition, aligning the sellers' financial interests with theirs, and retaining key management talents.

However, equity rollovers present key risks for sellers, who may now face reduced control, restrictions on share transfers, limited liquidity, and diminished influence over strategic decisions. To mitigate these risks, the SPA and the shareholders agreement should clearly define the valuation methodology for the rolled-over equity, the rights attached to such shares, and appropriate exit or protection mechanisms.

² To further appreciate the tax regime for mergers, acquisitions, and private equity transactions based on the Nigeria Tax Act 2025, please see our article on the subject via [Mondaq](#) or [our website](#).

These may include tag-along rights, anti-dilution protections, information rights, and board representation, as well as provisions governing future capital raises, and transfer restrictions.

Additionally, where the acquired company is a Nigerian company, parties may face regulatory risk if the company's articles of association do not provide for payment for shares with consideration other than cash, as required by the Companies and Allied Matters Act No.3 of 2020 (as amended). Thus, an amendment of the acquired company's articles of association will be useful in this regard.

When properly structured, equity rollovers create a mutually beneficial arrangement that aligns incentives, fosters operational stability, and allows sellers to participate in the potential future growth of the business, while balancing the need for robust protections in their new minority shareholder role and ensuring regulatory compliance.



Conclusion

There is no prize for guessing that payment mechanisms in M&As abound and will continue to evolve.

While there is no one-size-fits-all mechanism, the appropriate mechanism is a function of factors, including parties' commercial intentions, transaction dynamics, projected timeline for completion, dynamics of varying valuations, risk appetites, exit objectives, and prospective post-completion outcomes.

In sum, achieving success with a payment mechanism requires engaging professional advisers from the outset. Legal and financial advisers play a critical role in structuring, negotiating, and documenting the payment mechanism in M&As to deliver the parties' intended outcomes, while protecting the parties from post-closing disputes and unintended consequences.

If you require any clarifications, please do not hesitate to contact us.

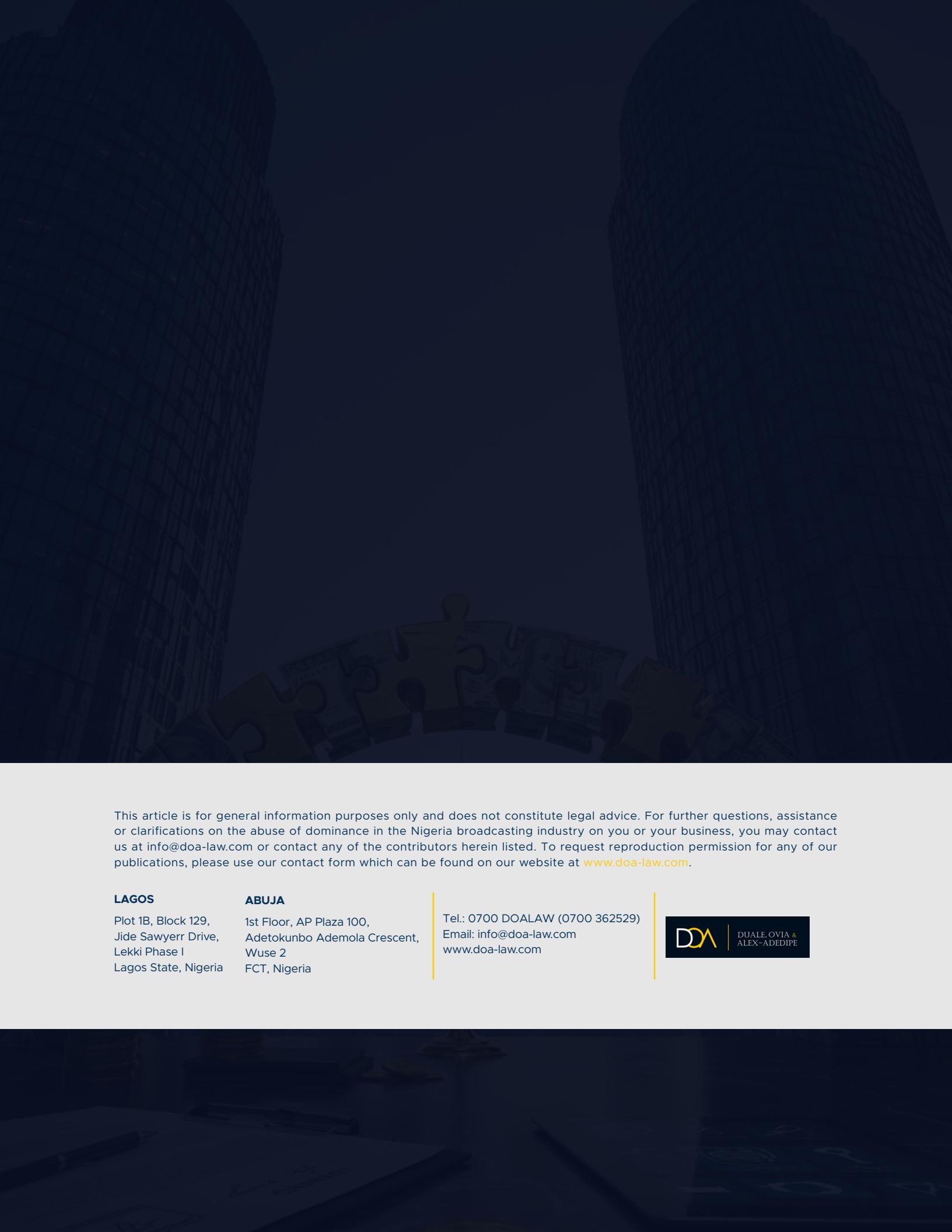
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