

The Buyer's Playbook

Legal Insights Into M&A

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Where Value Moves: Price Adjustment Mechanisms

One of the fundamental considerations in private M&A transactions is the purchase price adjustment mechanism. Price is often presented as a single number, but that number is only the starting point. The choice of mechanism can have a significant impact on value, deal certainty, economic risk and post-completion involvement. It is not just a legal drafting point.

In this instalment of *The Buyer's Playbook*, we explore how price adjustment mechanisms operate and the implications of each.

What Are The Price Adjustment Mechanisms?

The two mechanisms most often used are known as “completion accounts” and “locked box”. While both aim to arrive at a fair equity value for the target, in practice the choice between them can affect value, timing, risk allocation and the balance of negotiating leverage.

At the heart of price adjustment mechanics is the distinction between enterprise value and equity value. While enterprise value is usually based on an EBITDA multiple, EBITDA ignores cash, debt and short-term working capital. Two businesses with identical EBITDA can therefore deliver very different outcomes for a buyer once those items are taken into account. This is why offers are usually made on a cash-free, debt-free and normalised working capital basis, and why adjustments are so important in converting enterprise value into the equity value actually payable.

The chosen pricing mechanism dictates not only how those adjustments are calculated, but also when in the transaction the relevant cash, debt and short-term working capital values are crystallised for pricing purposes.

What it Means in Practice?

Completion Accounts:

- The parties estimate the anticipated amount of cash, debt and working capital in the target group at completion and transact on the basis of those estimates.
- After completion, a set of completion accounts is produced reflecting the target group's actual financial position as at the completion date.
- A true-up payment is then made bridging the difference between the estimates and the actual value (the buyer pays where the final value exceeds the estimate, and the seller pays where the final value is lower than the estimate).

Locked Box:

- Price is fixed based on agreed (typically audited) accounts as of a “locked box date” (before completion).
- From that date until actual completion, the sellers will agree not to extract any value (leakage) and recompense the buyer on a “pound-for-pound” basis for any leakage. Certain permitted leakage can be agreed upfront.

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- It is also common for a mechanism to be included whereby the sellers are compensated for value generated between the locked box date and completion. This is typically structured as a fixed daily accrual from the locked box date, with the aggregate amount added to the consideration; this is commonly referred to as the “ticker”.

What Mechanism Is Typically Used?

Our own work, and recent published market studies, indicates the following:

- **UK/Europe:** Locked box is very common (often the default), especially in private equity-led deals. Completion accounts are still used but are less common, in particular where there is competitive buyer tension.
- **US:** Completion accounts remain the standard. Sellers and buyers often expect post-closing net debt and working capital adjustments. There is increased interest in locked box, but it remains less established.

That said, certain situations necessitate one mechanism over the other. Completion accounts work well where the target business is expected to change between signing and completion, or where reliable accounts are not available during due diligence. Key examples include transactions that contemplate a pre-completion reorganisation or carve-out, where there is a long period between signing and completion (for example, due to regulatory approvals), or volatile or seasonal businesses.

In addition to the standard pricing mechanisms, we are seeing many parties use a hybrid of the two: for example, locked box with adjustments for specific risks. We are also increasingly seeing earn-outs or deferred consideration being utilised alongside pricing mechanisms. This reflects a broader trend of tailoring the price adjustment mechanism to the deal and getting the best of both worlds.

Summary and Key Takeaways

Both completion accounts and locked box are established mechanisms to bridge enterprise value to equity value. The right choice depends on deal context, financial quality and negotiating leverage.

A list of the key trade-offs to keep in mind is set out at the back of this note. In summary:

- **Locked Box:** Provides upfront price certainty, avoids protracted post-completion adjustments and limits ongoing management involvement. It shifts focus to diligence and contractual protections (leakage, warranties, covenants) and works best where reliable, preferably audited, accounts are available. Sellers value the clean exit, while buyers benefit from clarity on price and reduced post-closing friction — though they must be comfortable bearing economic risk from the locked box date and relying more on contractual protections.
- **Completion Accounts:** Requires the price be trued-up after completion, ensuring the buyer pays for the business in its actual state at completion. This gives buyers protection in volatile or hard-to-forecast businesses by ensuring the price reflects the actual financial position at completion, but introduces post-closing price uncertainty, management time and dispute risk. Sellers may still prefer this route where accounts are not robust enough for locked box or where they believe interim performance will enhance the final price.

The value of a transaction often shifts not through the headline price but through the detail of the proposed mechanism, such as the definition of debt-like items, permitted leakage, accounting policies and the treatment of exceptional items.

Whichever mechanism is chosen, the value impact lies in the detail.

Conclusion

Price in M&A is rarely just a number. For buyers, the key is to understand how each price adjustment mechanism operates in practice and ensure that the chosen one aligns with the specific deal and business.

In the next instalment of The Buyer's Playbook, we will explore how buyers approach minority investments and joint ventures, when control is shared rather than absolute.

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Key Trade-Offs to Keep in Mind

Factor	Completion Accounts	Locked Box
Price Certainty	Final purchase price is determined only after completion, once completion accounts are prepared and agreed. This creates a period of uncertainty until the accounts are finalised.	Purchase price is fixed upfront by reference to historical accounts at the locked box date, providing price certainty at signing (subject only to any leakage).
Economic Risk/Benefit	The seller retains the economic benefit of the business until completion but also bears the risk of any deterioration. The buyer only pays for what it actually receives at completion.	Economic risk transfers to the buyer from the locked box date. This is particularly relevant where there is a sizeable gap between the locked box date and completion. Sellers may also receive the ticker to compensate them for value generated between the locked box date and completion.
Execution Effort/ Timing of Workload	Workload is weighted to the post-completion period: completion accounts must be prepared, reviewed and agreed after completion once the buyer controls the business. This delays final price determination and creates scope for disputes.	Workload is weighted to the pre-signing stage: buyer financial diligence on the locked box accounts and negotiation of leakage protections must be completed upfront. After completion, limited further work is required.
Control of Process	Seller provides the estimates upon which the initial payments are made. However, after completion, the buyer will typically control the target's financial information. Accordingly, the buyer will typically prepare the first draft of the completion accounts and the seller must then test the accuracy of those adjustments.	Prior to completion, the sellers control the information underlying the locked box reference accounts. Accordingly, the buyer's diligence team must extract and test as much of that information as possible prior to signing.
Dispute Risk	Completion accounts are often disputed and those disputes can last for months and even years after completion. Provisions governing the dispute process (e.g., referral to an expert accountant) should be built into the transaction documents.	Lower risk post-completion, as the price is fixed upfront. Residual risk instead relates to contractual claims (leakage covenant claims).
Management Time	Preparation of completion accounts can be resource intensive. Management may be tied up post-completion in preparing and negotiating completion accounts, and potentially in dispute resolution.	Less management time is typically consumed post-completion, with the only material action point being ascertaining if any undisclosed leakage has occurred and, if so, ensuring appropriate recompense.
Due Diligence Requirements	Other than customary financial due diligence, no additional, mechanism-specific diligence is required to fix the price at signing, because the accounts that "set" the price will be prepared and tested post-completion.	In addition to customary financial due diligence, detailed and targeted diligence of the locked box accounts is critical, as economic risk transfers to the buyer at the locked box accounts date and the locked box accounts set the price, with no post-completion price adjustment (save for leakage).
Market Practice/ Typical Use Cases	Common in bilateral or less competitive deals; particularly where the business is a strategic acquisition, or where the target's financials are not sufficiently robust for a locked box or are otherwise volatile, seasonal or complex (e.g., carve-outs).	Favoured in competitive auctions, private equity exits, and where price certainty, clean exits and reduced post-completion involvement are prioritised.