

M&A-Deals in Dispute

Settlement of M&A Disputes by Arbitration

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M&A-Deals embody a high potential for conflicts. Arbitration is an increasingly established instrument to solve such conflicts. The following compendium shows the issues concerned whilst using arbitration in M&A-Deals.

I. Typical Disputes with M&A-Deals

M&A-Disputes are as multilayered and complex as M&A-Deals themselves. Disputes on legal issues may arise from the selling process as well as from the purchase agreement itself. Concerning warranty and guarantee claims, sectoral questions frequently form the core of the dispute. There is comparatively little high court jurisdiction concerning these disputes. This is because if the parties – as is common in M&A-disputes – take the action to an arbitral court, arbitration proceedings and the arbitral award will not be made public.

The disputes can be approximately divided into those that arise before the closing of the transaction, and into those that arise afterwards:

1. Before the Deal: *Pre-Closing Disputes*

Typical disputes arising before the closing of the transaction may (so called *Pre-Closing Disputes*) result from:

- dissent within multiple sellers or buyers;
- a violation of the letter of intent;
- a violation of the confidentiality or exclusivity agreement;
- a withdrawal from negotiations in bad faith;
- dissent in the period between signing and closing, e.g. whether the conditions precedent are fulfilled or if the parties are sufficiently taking part in obtaining the necessary internal consent or official state approval.

2. After the Deal: *Post-Closing Disputes*

After the completion of the transaction disputes (so called *Post-Closing Disputes*) frequently arise

- in connection with price adjustment provisions;
- from representations and warranties;
- due to violation of pre-contractual obligations of the vendor to inform;
- in connection with post-contractual non-competition clauses.

II. Advantages of Arbitration

Arbitration generally leaves more freedom to the parties in defining the terms of procedure compared to court litigation. Especially concerning M&A disputes, arbitration enjoys the following advantages:

- **Professional Competence of Arbitrators.** Parties can influence the nomination of the arbitrators, thereby ensuring that the arbitrators have the particular expertise necessary for the dispute. Arbitrators do not have to be lawyers. In certain cases it may be advisable to nominate candidates with special knowledge in a particular branch of trade, e.g. businessmen or engineers.
- **Rapidity.** Arbitration is generally faster than litigation because there are no stages of appeal. The parties can also arrange for a “fast-track” arbitration and accelerate the procedure, if they only want to obtain a decision on a specific legal question.
- **Confidentiality.** In contrast to ordinary courts, arbitral proceedings take place with the public excluded. The arbitral award is not even publicised without the parties’ agreement.

- **Flexibility.** Parties can determine procedure themselves, whether it concerns the timescale, the number of petitions to the arbitral tribunal, or special rules for the taking of evidence.
- **Enforceability.** The arbitral award can be enforced more easily than ordinary court rulings, especially abroad, since there is an effective international network of treaties and conventions in place which governs the recognition and enforcement of foreign arbitral awards e.g. the New York Convention.

III. Choice of the Arbitrators

The choice of the arbitrators is paramount to the outcome of the proceedings. When parties sign the arbitration agreement, they need to decide whether they want to use an institutional arbitral court or ad hoc arbitration.

- **Institutional Arbitrations** are conducted under the rules of arbitration of a named institution (e.g. DIS¹, ICC², Swiss Chamber of Commerce³, LCIA⁴). The institution will administer the proceedings and provide the rules of arbitration as well as schedules of the costs of arbitration for an administrative fee, which makes the total cost of the arbitration more foreseeable. The rules of arbitration of the respective arbitral institutions provide different rules on the nomination of arbitrators. The degree of administering the proceedings differs from one institution to the other. As an example, DIS rules give parties the greatest possible amount of autonomy whilst ICC procedure is more controlled.
- **Ad hoc Arbitrations** are conducted pursuant to rules agreed on by the parties for a specific dispute. There is no arbitral institution in the background and no code of procedure made beforehand. The procedure thus is subject to the will of the parties. Whilst determining the code of procedure, parties are only lim-

ited by the applicable compulsory rules of civil procedure (in Germany the ZPO). Ad hoc procedure therefore appears cost effective, as the administrative fee for the institution does not have to be paid. On the other hand, the drafting of the arbitration agreement or the agreement with the arbitrator is more time-consuming for the parties and the parties' lawyers respectively.

With major transactions it is advisable to agree on institutional arbitration.



Experience indicates that DIS arbitration is well suited for M&A disputes.

The use of ICC or Swiss rules is especially advised for international transactions, if one party is reluctant to agree on DIS rules.

The actual arbitration panel, whether it be a sole arbitrator or a tribunal of three arbitrators, is constituted only as soon as the dispute arises. In case of a sole arbitrator, this happens by the parties agreeing on one candidate. In case of a tribunal of three arbitrators, each side nominates one arbitrator. These arbitrators will then nominate the presiding arbitrator.

IV. Costs

The costs of arbitration depend on the amount in dispute and on the choice of the arbitral institution and, in case of ad hoc arbitration on the arrangement as to the arbitrators' fees which has individually been made by the parties. In the case of institutional arbitration, an administrative fee is added to the costs of the arbitrators. *Table 1* illustrates the costs of arbitration, depending on the nature of the arbitral tribunal. The arbitral tribunal will frequently demand an advanced payment at the beginning of the proceedings for the arbitrators' fees and further expenses.

Advance payments are different from ordinary courts- they are to be paid by both the plaintiff and defendant.



It is the same case if the defendant counter sues.

¹ Deutsche Institution für Schiedsgerichtsbarkeit e.V., Köln.

² International Chamber of Commerce, Paris.

³ Swiss Chambers of Commerce, Zurich.

⁴ London Court of International Arbitration, London.

Amount in dispute in Euro	DIS-SchO	ICC Rules	Swiss Rules	LCIA Rules	Ad hoc Arbitration	State Court
100.000	16.200	25.900	max. 32.800	Fee 1.500 brit. Pounds (ca. 2.205 Euro) + Hours according to cost table	According to individual arrangement	2.600
500.000	46.600	67.000	max. 114.800			8.900
1.000.000	74.700	99.900	max. 166.800			13.400
5.000.000	171.700	197.600	max. 340.000			49.400
10.000.000	221.200	240.900	max. 448.700			94.400
50.000.000	353.200	399.500	max. 676.000			274.400
100.000.000	452.200	486.300	max. 825.500			274.400

Table 1: All amounts are converted into euros and rounded to € 100, each for a tribunal of three arbitrators with two parties involved and including administrative fees of the respective arbitral institutions, exclusive of turnover tax. Single committees are less expensive. Due to fluctuations of currencies the actual amounts may deviate from the indicated amounts.

For comparison, the costs for the first instance trial before a state court are shown in the right column. Due to a legal capping, costs for a first instance trial before a state court are maximised at € 274.400 when amounts in dispute are above € 30 Mio.

Situations where multiple parties are involved frequently occur in M&A transactions. These can increase arbitrators' fees even more. The expenses of the panel, daily fixed rates, witnesses' expenses and costs and eventual legal fees of the parties are regularly added.

Arbitration agreements may be advantageous in disputes concerning agreements made prior to the purchase agreement, because the vendor's intention to sell might be made public whilst litigating before a state court. !

As a result, arbitration is frequently more expensive than a first instance trial before a state court. !

One has to bear in mind though, that proceedings before a state court might last three instances and thus increase costs significantly.

- Other covenants/ Side Letters
- Management Warranty Deeds;

If partial agreements are linked by an internal correlation, the arbitration clause should be drafted with regard to the uniformity of the contract. !

- Management Participation Agreements;
- Shareholders' Agreements;
- Statutes.

V. Practical Application of Arbitration

Arbitral tribunals are only competent in case of dispute, if parties have agreed so beforehand. Arbitration agreements within M&A-transactions are practically applicable not only on the purchase agreement itself, but generally on all agreements connected to the transaction, as long as the claims resulting therefrom involve an economic interest. These are for instance:

- Confidentiality Agreements;
- Exclusivity Agreements;
- Letters of Intent;

Also by shareholders' agreements and statutes⁵, which are built or changed as to the target company, arbitration agreements can be recommended, because the confidentiality and the quickness are advantages, that are especially valued in disputes under company law.

Disputes under company law are in principle capable of arbitration. However with regard to the so called lack of quorum-disputes, contractual prevention has to be made to ensure the res judicata of the ruling for all partners/shareholders. !

VI. Form of the Arbitration Agreement

The arbitration agreement can be concluded separately or in the form of a contractual clause.

If the parties are legal persons or if the transaction, which belongs to the arbitration agreement, is imputable to the commercial or self-employed activity of both contracting parties, then it is sufficient to document the arbitration agreement in written form (Facsimile or Email is adequate). In the case of M&A agreements, the arbitration clause is included mostly in the notarial deed concerning the sale and transfer of the shares.

Only in the case of consumers' involvement must the arbitration agreement be contained in a deed separated from the main contract and signed by the parties themselves.

VII. Content of the Arbitration Agreement

Parties agree in the arbitration agreement that their conflict is not decided by the inherently responsible ordinary court, but by an arbitral tribunal. This is the minimum content of an arbitration agreement.

The respective arbitral institutions advise on using model clauses in the arbitration agreements⁶.

Despite the debarment of ordinary courts for the main action, expedited proceedings (temporary warrants) by the state-run court are still possible.

Additionally, it is highly recommended to amend the arbitration agreement with rules as to:

- **The Place of Arbitration.** The place of arbitration determines the compulsory applicable law. If the place is situated in Germany, procedure has to comply with German arbitration law. The actual

venue may be chosen different to this – for instance abroad.

- **The Number of Arbitrators.** Smaller cases are usually decided by a sole arbitrator, whilst major arbitration cases involve an arbitral tribunal of three arbitrators.

For larger M&A-Transactions three arbitrators are mostly advisable.

- **Qualification of Arbitrators.** The arbitrators do not necessarily have to be legally educated. It may even be advantageous to nominate people with specific expertise, e.g. engineers or businessmen, as arbitrators.

- **Language of the Case.** The language of the case can be freely chosen and may differ from the language of the contract. This does apply to the individual stages of proceedings as well. Thus, oral testimonies of witnesses may be more persuasive in their native language. Obtaining evidence can be considerably complicated if there are substantial amounts of relevant documents to be translated to the language of the proceedings beforehand. However, it is possible to exclude certain documents from translation.

- **Permissibility of a Discovery of Documents.** This concerns the discovery of facts attained from Anglo-American civil procedure, in which one party can compel the other to submit certain documents. It may thus seem advantageous for the vendor to demand an insight into the purchasers' calculations leading to the agreed purchase price adjustment, which are usually only in the purchaser's possession after *Closing*.

The respective rules of arbitration permit the discovery of documents- but to a varying degree. A clause on the permissibility of the discovery of documents is especially advisable in cases with connection to Anglo-American law.

⁶ Q.v. annex: "Model Clauses for Arbitration Agreements"

- **Extension of the Arbitration Agreement to Group Companies.** In international contracts, the so called group of companies' doctrine may lead to the extension of the arbitration agreement to parties which have not signed the arbitration agreement. Thus, a clarification is recommended.

VIII. Arbitration Involving Multiple Parties

If M&A-transactions involve multiple purchasers or vendors, problems may occur from the difficulties of the nomination of one arbitrator.

The respective arbitration rules solve the problem by either institutionally appointing all three arbitrators (as the Swiss rules, ICC and LCIA suggest) or by appointing the arbitrators which are usually chosen by the parties. They then must agree on a presiding arbitrator (following DIS rules).

In case of ad hoc arbitration agreements, it is advisable to determine an election mechanism for multiple party situations.

IX. Expert Determination

It is necessary to differentiate arbitration from expert determination. In M&A agreements, actual questions - for example with regard to the evaluation of the company or as to the questions on the balance sheet - these are increasingly assigned to experts. The experts are mostly official experts, who have the competency to solve the explicit problem. Typically, they make a binding decision which is not enforceable in law and which is only assailable in case of obvious incorrectness. The arbitration rules of practice can not be applied to the expert determination proceedings.

The duties and competences of an expert and those of the arbitral tribunal must be carefully distinguished.

This may be achieved by explicitly assigning the expert with narrowly defined tasks. All tasks outside his capacity fall within the competence of the arbitral tribunal.

It is also recommended to clarify by contract which questions made prior to process are fit for the expert decision.

X. Conclusion

Arbitration as a means of solving M&A disputes offers great freedom and opportunities to the parties, which they should use by correspondingly drafting the arbitration clause.



Model Clauses for Arbitration Agreements

The following model clauses are recommended by the respective arbitral institutions, whose codes of procedure can be found under the provided Internet addresses and may be used in case of ad hoc arbitration.

Deutsche Institution für Schiedsgerichtsbarkeit (DIS)

www.dis-arb.de

"Alle Streitigkeiten, die sich im Zusammenhang mit dem Vertrag [Bezeichnung des Vertrages] oder über seine Gültigkeit ergeben, werden nach der Schiedsgerichtsordnung der Deutschen Institution für Schiedsgerichtsbarkeit e. V. (DIS) unter Ausschluss des ordentlichen Rechtsweges endgültig entschieden."

"All disputes arising in connection with the contract [description of the contract] or its validity shall be finally settled in accordance with the Arbitration Rules of the German Institution of Arbitration e. V. (DIS) without recourse to the ordinary courts of law."

Folgende Ergänzungen sind empfehlenswert:

It is recommended that the following provisions be added to the arbitration clause:

- *"Der Ort des schiedsrichterlichen Verfahrens ist [•]."*
- *"Die Anzahl der Schiedsrichter beträgt [•]."*
- *"Das anwendbare materielle Recht ist [•]."*
- *"Die Sprache des schiedsrichterlichen Verfahrens ist [•]."*

- *"The place of arbitration is [•]."*
- *"The arbitral tribunal consists of [number of] arbitrators."*
- *"The substantive law of [•] is applicable to the dispute."*
- *"The language of the arbitral proceedings is [•]."*

Internationale Handelskammer Paris (ICC)

www.iccwbo.org

"Alle aus oder in Zusammenhang mit dem gegenwärtigen Vertrag sich ergebenden Streitigkeiten werden nach der Schiedsgerichtsordnung der Internationalen Handelskammer (ICC) von einem oder mehreren gemäß dieser Ordnung ernannten Schiedsrichtern endgültig entschieden."

"All disputes arising out of or in connection with the present contract shall be finally settled under the Rules of Arbitration of the International Chamber of Commerce by one or more arbitrators appointed in accordance with the said rules."

Internationale Schiedsordnung der Schweizerischen Handelskammern (Schweizerische Schiedsordnung)

www.swissarbitration.ch

"Streitigkeiten, Meinungsverschiedenheiten oder Ansprüche aus oder im Zusammenhang mit diesem Vertrag, einschließlich dessen Gültigkeit, Ungültigkeit, Verletzung oder Auflösung, sind durch ein Schiedsverfahren gemäß der Internationalen Schiedsordnung der Schweizerischen Handelskammern zu entscheiden. Es gilt die zur Zeit der Zustellung

"Any dispute, controversy or claim arising out of or in relation to this contract, including the validity, invalidity, breach or termination thereof, shall be resolved by arbitration in accordance with the Swiss Rules of International Arbitration of the Swiss Chambers of Commerce in force on the date when the Notice of Arbitration is submitted in accordance with

der Einleitungsanzeige in Kraft stehende Fassung der Schiedsordnung.

- Das Schiedsgericht soll aus [einem oder drei] Schiedsrichter[n] bestehen;
- Der Sitz des Schiedsverfahrens ist [Ort in der Schweiz, es sei denn, die Parteien einigen sich auf einen Sitz im Ausland];
- Die Sprache des Schiedsverfahrens ist [gewünschte Sprache einfügen]."

these Rules."

- The number of arbitrators shall be [one or three].
- The seat of arbitration shall be [name of city in Switzerland, unless the parties agree on a city abroad].
- The arbitral proceedings shall be conducted in [insert desired language]."

London Court of International Arbitration (LCIA)

www.lcia-arbitration.com

"Alle sich aus oder in Zusammenhang mit diesem Vertrag ergebenden Streitigkeiten einschließlich aller Fragen über sein Bestehen, seine Gültigkeit oder Beendigung, werden endgültig entschieden in einem Schiedsverfahren nach der LCIA Schiedsgerichtsordnung. Diese Schiedsgerichtsordnung gilt als durch Verweisung in diese Klausel.

- Die Anzahl der Schiedsrichter beträgt [ein/drei].
- Der Ort des Schiedsverfahrens ist [Stadt und/oder Land].
- Die Sprache des Schiedsverfahrens ist [•].
- Das auf den Vertrag anwendbare Recht ist das materielle Recht von [•]."

"Any dispute arising out of or in connection with this contract, including any question regarding its existence, validity or termination, shall be referred to and finally resolved by arbitration under the Rules of the LCIA, which Rules are deemed to be incorporated by reference into the clause.

- The number of arbitrators shall be [one/three].
- The seat, or legal place, of arbitration shall be [city and/or country].
- The language to be used in the arbitral proceedings shall be [•].
- The governing law of the contract shall be the substantive law of [•]."

Ad Hoc Schiedsverfahren

(Kurzklausele)

"Alle Streitigkeiten aus oder im Zusammenhang mit dem Vertrag der Parteien vom [•], einschließlich aller Streitigkeiten über seine Gültigkeit [und aus unerlaubter Handlung], entscheidet unter Ausschluss des ordentlichen Rechtswegs endgültig und bindend ein Schiedsgericht.

- Ort des Schiedsverfahrens ist [•].
- Die Anzahl der Schiedsrichter beträgt [•].
- Das anwendbare materielle Recht ist [•].
- Die Sprache des schiedsrichterlichen Verfahrens ist [•]."

"All disputes arising out of or in connection with the agreement between the parties of [•], including any disputes regarding the validity of that agreement [or any act or tort], shall be settled by an arbitral tribunal, whose decision shall be final and binding on both parties, without recourse of the ordinary courts of law.

- The place of arbitration shall be [•].
- The arbitral tribunal consists of [number of arbitrators].
- The substantive law of [•] is applicable to the dispute.
- The language of the arbitral proceedings is [•]."