

M&A Arbitration: Pre-Closing Disputes and Letter of Intent

Kluwer Arbitration Blog

November 21, 2017

[Nahila Cortes \(Allende & Brea\)](#)

Please refer to this post as: Nahila Cortes, 'M&A Arbitration: Pre-Closing Disputes and Letter of Intent', Kluwer Arbitration Blog, November 21 2017, <http://arbitrationblog.kluwerarbitration.com/2017/11/21/ma-arbitration-pre-closing-disputes-letter-intent/>

The complexity of M&A

In recent years there has been an increase in M&A disputes. These are often complex because the underlying dispute can involve complicated business transactions between big companies that merge, are acquired, or form a joint venture. And more importantly, they can have a significant impact on the market (for example, the recent deal of United Technologies to buy Rockwell Collins amounted to US\$30 billion).

In the context of the Argentine path to recovery from years of economic crisis and recession -which led to countless claims from foreign investors against the state- it is expected that there will be an increase in M&A, and foreign investors are likely to participate in these proceedings. Since the Argentine market seems to be gaining strength again, it is worth taking a close look at disputes that might arise in the context of international M&A disputes and how international arbitration can play a role to resolve them, especially when they arise at an earlier stage of the transaction.

Pre-closing disputes

The entire process of an M&A transaction can last several months, starting from the early negotiations until the end of the survival period or the expiration of statute of limitations. The parties involved in the transaction may initiate disputes based on different causes of action that are generally related to representations and warranties, earn out clauses, price adjustment provisions, indemnity clauses, and put and sales options, which arise at a post-closing phase.

However, disputes can also arise during the pre-closing phase. Such disputes are generally related to the breach of confidentiality or exclusivity provisions agreed in pre-contractual documents, or to other provisions and obligations arising out of the letter of intent (hereinafter "LOI").

Concerning the LOI, it could be the source of conflicts at the early stage of the M&A. The LOI is commonly understood to be non-binding document, used to express a tentative intention of the parties to enter into negotiations or to pursue negotiations for the conclusion of a contract. If signed, this document will govern throughout the negotiation stage until the final execution of the contract.

Yet, the binding effect of the LOI is controversial. Although the parties generally state therein that their sole intention is to outline their will by stating "*this LOI has no binding effects*" or "*they are subject to a contract,*" most LOIs might probably have legal implications that arise from (i) the

intention of the parties, (ii) the laws that governs the LOI, or (iii) a court decision that could impose binding obligations although they were not foreseen by the parties.

In this context, the first question that arises is whether the LOI is really a non-binding document and whether the parties must comply with minimum duties during the pre-contractual stage. Since there is not a uniform way to approach this matter, the parties negotiating a LOI in cross border transactions should acknowledge the degree of enforceability of the LOI according to the applicable law to it.

In Argentina, the Civil and Commercial Code (“C&CC”) expressly states that the LOI is an instrument by which a party, or all the parties, express their consent to negotiate over issues related to a future contract. Under the C&CC the LOI is subject to a restrictive interpretation, and it will have the binding effects of an offer if it fulfills the necessary requirements to be considered as such. Moreover, under Argentine law the parties have the duty to negotiate in good faith (sections 9, 961, and 991 C&CC) as well as the duty to inform, to protect confidential information, and to cooperate between the parties.

On the other hand, in common law jurisdictions the issue of the binding effect of the LOI is complex, and in the case of the U.S., there is no uniformity among States. In principle, the LOI is an agreement to *enter into negotiations* with no binding obligations arising out of it, however, depending on the jurisdiction, the courts may determine that the parties are bound by their terms by looking to the language of the LOI or to the conduct of the parties.

Regarding additional duties imposed to the parties that were not expressly agreed, the Uniform Commercial Code (“UCC”) and the Restatement (Second) of the Law of Contracts state that the duty to negotiate in good faith only applies in the contractual stage and the parties could waive it. However, U.S. case law shows that the different States have yet to reach a uniform ground regarding the enforceability of the duty to negotiate in good faith. Some states recognize this duty, such as Pennsylvania (see *Bennet and Chanel Home Centers Div.*), Delaware (see *SIGA Technologies*), and New York (See *Vacold LLC*); others do not.

Having said this, the binding effects of the LOI will be determined on a case-by-case basis and it is likely that litigious matters related to it may appear. In this context, **the second question that arises is whether an arbitration clause included in the LOI is enforceable.** *Fouchard, Gaillard, and Goldman* explain that an international arbitration agreement is an agreement in which two or more parties agree that a dispute which has arisen, or which may arise between them, and which has an international character, shall be resolved by one or more arbitrators. Shortly, the parties contractually agree to submit the dispute or the future disputes to an arbitral tribunal excluding the state courts jurisdiction.

The enforceability of the arbitration clause will depend on its validity as analyzed under the applicable rules. According to the 1958 New York Convention, the validity of the agreement will be analyzed under the law to which the parties have subjected it or, failing any indication thereon, under the law of the country where the award was made (Article V.1.a).

In the event that the arbitration agreement is governed by Argentine law, the C&CC will govern its formalities and substance. Section 1650 of the C&CC states that the arbitration agreement should be in writing and consented by all the parties. It could be included in a contract, in an independent agreement, in a bylaw, or in a rule of procedure.

Hence, under Argentine law, an arbitration clause included in an LOI will be enforceable, provided that all the parties consent to it. In the event there is a unilateral LOI, the other party will have to unconditionally accept the terms of the LOI including the arbitration clause. In the U.S., the situation

will be similar. Notwithstanding the non-binding nature, we must keep in mind that the arbitration clause inserted is severable from the underlying contract or document in which it is contained. Therefore, a dispute under the LOI containing an arbitration clause should be resolved by arbitration.

Drafting arbitration clauses in an LOI

It is important to bear in mind that if the parties decide to include an arbitration clause in their LOI, the drafting will play an important role. Poorly drafted clauses may be unenforceable or cause unnecessary delays. That is why parties may want to analyze the type of clause they will insert, and it will depend, among other things, on the type of binding provisions agreed to in the LOI, the amount of money involved, the structure of the transaction, and the stage of the pre-closing phase in which the clause will have effects.

There are many elements to consider when drafting the clause (see the IBA Guidelines for drafting arbitration clauses). For a clause to be inserted in an LOI, the following elements should at least be considered, since at this stage of the M&A the parties might not want to spend a lot of time and money in the dispute or might want to reconduct their relationship.

First, the expedited procedure provided in ICC rules, as well as in other institutions such as SIAC, HKIAC, SCC is a good option to expedite the resolution of the dispute and reduce costs. A fast resolution could help the parties to reconduct negotiations. Also, this procedure will be effective when the transaction involves a small amount of money, or if that is not case, when there are not many and fundamental binding provisions in the LOI.

Second, a multi-tiered clause is also another good element to include providing for mediation, negotiation or other form of alternative dispute resolution, before resorting to arbitration. This will give the parties an opportunity to settle their claims in a less “litigious” environment and reconduct their transaction.

Third, the scope of the arbitration clause should not be limited, unless there are very good reasons to do it. Since it is hard to foresee all the types of disputes that can arise at the negotiation phase of M&As, it is better to keep it simple and broad. As stated in the IBA Guidelines, less inclusive language invites arguments about whether a given dispute is subject to arbitration.

Conclusion

M&A transactions are complex. Although many disputes arise after the closing, they can also come up during the pre-closing phase. The LOI is commonly used by the parties to express their intention, and in principle is a non-binding document. Notwithstanding this, depending on the applicable law and the jurisdiction, it is likely that provisions will be considered as binding. In this sense, resorting to arbitration to solve the dispute is a possibility and a good option. However, the parties must be careful in the drafting in order to adequate the dispute provisions to the structure of the transaction and have an effective clause aligned with their intentions.

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