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Arbitration of Cross-Border M&A Disputes

Joe Liu (Hong Kong International Arbitration Centre) · Tuesday, April 21st, 2015 · HK45

In recent years, the mergers and acquisitions (M&A) market has shown steady signs of recovery from the effects of the Global Financial Crisis. According to a survey of over 735 M&A professionals recently conducted by KPMG, 82% of survey participants said they were planning acquisitions in 2015. Respondents cited large cash reserves, opportunities in emerging markets and the availability of credit on favourable terms as some of the key drivers of deal activity. Research conducted by Deloitte in 2014 suggests that a surge in deal activity is set to continue into 2015. 84 per cent of 2,500 corporate and private equity respondents anticipated a sustained pace of M&A activity over the next 24 months. This optimism has been shared by leading law firms, which have predicted significant M&A activity across a wide range of sectors, including financial services, energy, healthcare, technology, media and communications.

Arbitration clauses are now a regular feature of M&A contracts, particularly those of an international nature, anda trend has emerged of subjecting M&A disputes to arbitration. For example, the €480 million dispute between Philips and Funai Electric over a failed sale of the former's consumer multimedia entertainment business is among a number of high-profile M&A cases in which companies have turned to arbitration over a soured acquisition.

In Hong Kong, the number of M&A disputes administered by the Hong Kong International Arbitration Centre (HKIAC) rose by more than half during 2012 and into 2013. The actual number of deals that have descended into arbitration disputes could be far higher, however, as many cases are resolved by *ad hoc* arbitration in Hong Kong.

Common disputes in M&A transactions

M&A disputes can arise across the entire spectrum of the phases of a deal, from pre-closing to post-closing disputes.

M&A disputes commonly arise at the post-closing stage. In this regard, contractual representations and warranties represent a major cause of dispute, as these statements have become increasingly far-reaching. M&A contracts often contain representations that (1) the financial statements of the target company are accurate, complete and prepared pursuant to the applicable accounting standards, (2) the target has not concluded any non-disclosed material contracts, or (3) there have been no material adverse changes in the operation of the target. Conflicts arise if these representations are breached, in which case claims for breach of contract, damages, indemnity and/or rescission are often raised against the seller. Fraudulent misrepresentation is sometimes alleged against the seller. The management of or exit from an investment vehicle (eg, a joint

venture (JV)), the competing exercise of put or call options and claims by shareholders against directors for failure to conduct a competitive sale are other common causes of post-closing disputes.

Purchase price adjustment disputes are also a recurring theme. M&A agreements usually provide for post-closing price adjustment mechanisms, as completion can take a significant amount of time after the relevant agreement has been signed. It is common to base purchase price adjustments on future profits or turnover of the target (earn-out provisions). Such provisions, however carefully drafted, are a notorious source of dispute, as difficulties often arise over the interpretation of these provisions (eg, as to the applicable accounting principles) and the quantum of the consideration. As substantial amounts of money are usually at stake, parties often try to influence the price adjustment mechanism in their favour.

Conflicts between the parties to an M&A transaction can also arise at any time before the acquisition actually takes place. For example, a dispute may result from one buyer's decision to acquire the target company alone or to withdraw from the transaction. Pre-closing disputes may also relate to breach of the letter of intent or the confidentiality or exclusivity agreement. The non-fulfilment of conditions precedent, such as failure to obtain necessary governmental permits or confirmation by the board of directors, often leads to disputes between the parties at the pre-closing phase.

Arbitration as a preferred means of resolving M&A disputes

Arbitration is one of the most commercially effective and pragmatic means by which parties can resolve M&A disputes. It offers a number of significant advantages, such as confidentiality, the ability to select a suitable and neutral seat of arbitration, the appointment of arbitrators who are familiar with M&A transactions, the choice of suitable and convenient languages and the enforcement of arbitral awards worldwide.

Parties can further enhance the effectiveness of arbitration by selecting suitable arbitration rules, such as the 2013 HKIAC Administered Arbitration Rules (the HKIAC Rules), as the applicable procedural rules and Hong Kong as the seat of arbitration. For the following reasons, HKIAC arbitration is among the most prevalent choices for resolving international M&A disputes concerning high-value and complex matters.

- **Neutral forum** – The HKIAC provides a neutral forum for M&A disputes between parties from different countries. According to the World Economic Forum's *Global Competitiveness Report* for 2014-2015, Hong Kong is ranked fifth worldwide and first in Asia for judicial independence. The Hong Kong courts have not refused to enforce any awards since 2011, including those against Chinese State-owned enterprises. While Hong Kong is the default seat of arbitration under the HKIAC Rules, parties are free to choose a different seat for their arbitral proceedings.
- **Confidentiality** – the HKIAC Rules contain robust confidentiality provisions in respect of arbitral proceedings and awards. The Hong Kong Arbitration Ordinance (Cap 609) extends the protection of confidentiality to cover arbitration-related court proceedings and judgments, and therefore offers the highest level of protection of confidentiality in the Asia-Pacific region. This is of vital importance to M&A disputes. Sellers would not want to disclose any price-sensitive information or any confidential information regarding the business and operation of the target company. Having spent a significant amount of time and money evaluating a transaction, a buyer would wish to preserve confidentiality of its investment from other potential acquirers.

- **Efficiency** – Speed can be critical in a pre-closing dispute, otherwise the closing of the transaction can be put at risk. Given the time pressure involved, a quick determination of price may be required prior to completion. Under the HKIAC Rules, a party can apply for the arbitral proceedings to be conducted on an expedited basis. This process will generally result in the appointment of a sole arbitrator, who will decide the dispute based on documents only, a limited number of briefs and within a short timeframe. The HKIAC can also appoint an emergency arbitrator within two days of an application for emergency relief being accepted. The emergency arbitrator is under a 15-day time limit to decide the application. In a recent case, the HKIAC appointed an emergency arbitrator within just five hours to hear an application for emergency injunctive relief in relation to a US$1.9 billion dispute regarding the acquisition of a large online game company. The emergency arbitrator issued an emergency award only a few days after the hearing.

- **Multi-party/multi-contract disputes** – International M&A deals are usually concluded under a suite of transaction documents involving multiple parties. The HKIAC Rules provide highly sophisticated and practical mechanisms to deal with this type of dispute through comprehensive provisions on joinder of additional parties, consolidation and commencement of a single proceeding under multiple contracts. Suppose, for example, that disputes arise between parties to a JV arrangement involving a shareholder agreement, a share purchase agreement, a credit agreement, a security agreement and a guarantee. If each of these documents contains a compatible HKIAC clause, the HKIAC will offer the rare possibility of consolidating these disputes into a single arbitral proceeding if there is a common question of law or fact and the claims arise out of the same transaction or series of transactions.

Parties can also choose other alternatives to resolve M&A disputes, such as mediation and expert determination, and these mechanisms can be combined with arbitration.

Conclusion

Sufficient attention should be paid to the drafting of arbitration clauses in M&A contracts, particularly in multi-party and multi-contract situations. Buyers and sellers should give serious consideration to the disputes that could conceivably arise, the choice of arbitration seat and rules, and the interplay between any arbitration clauses in all related agreements. Parties should ensure that their arbitration clauses are tailored to the needs of the underlying transaction(s) and that they will promote an efficient and cost-effective dispute resolution process.

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