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Part II

Survey of Substantive Laws
United States

Frances E Bivens and E Alexandra Dosman

Frequency of M&A disputes
The vast majority of M&A transactions in the United States are negotiated, signed and closed without a hitch and do not lead to disputes. The parties to a transaction share a common interest in executing a successful deal and do not want the disruption to their business that would result from a dispute. That said, certain issues like purchase price adjustments, earn-outs and true-ups more frequently give rise disagreements, and as a result, parties often draft specific contract clauses that create mechanisms for handling those disputes in a quick and cost-effective manner, often by arbitration or determination by a person with expertise in the matter.

Pre-closing disputes, where one party decides that it does not want to go forward with the transaction, are not common, and when they occur are most commonly caused by the financial distress of a party or a change in market conditions. Both the financial crisis of 2007–2008 and the drop in oil prices in 2014 led to a rise in both pre- and post-closing litigation.

Post-closing disputes arise when the purchasing party decides that what it purchased is not what it expected. It has become increasingly common for one party (usually the buyer) to obtain insurance to cover any losses caused by misrepresentations and breach of warranties by a transaction counterparty. One of the largest providers of insurance for disputes regarding representations, warranties and indemnities in purchase agreements has reported

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1 Frances E Bivens is a partner at Davis Polk & Wardwell LLP. E Alexandra Dosman is a managing director at Vannin Capital LLC. The authors wish to thank Justin Sommers, an associate at Davis Polk & Wardwell LLP, and Jake Bissell-Linsk, a former associate at the firm, for their assistance in preparing this chapter.
that roughly one in five deals in which it provided insurance involve a claim, and that the frequency may be increasing.\(^2\)

However, there are several factors that can make M&A claims challenging to pursue. In particular, fraud-based claims are often frustrated by the prevalence of ‘non-reliance’ contractual language, which provides that the parties have relied only on the representations and warranties that are expressly included in the agreement.\(^3\) Another hurdle is that the purchaser may struggle to find a party against whom to pursue claims, especially when the acquired company is the counterparty and the party making all relevant representations and warranties.

**Form of dispute resolution**

As a general rule, international M&A transactions – in which at least one of the parties is based outside the United States – are more likely than domestic transactions to include a provision selecting arbitration. Parties choose arbitration in international transactions for a variety of reasons, including perceived bias of the court system in the home country of a counterparty, a concern about the quality of local courts and a lack of familiarity with the courts in a foreign jurisdiction. Arbitration also offers parties increased confidentiality, more control over the dispute resolution process (including limiting discovery), and ability to select decision-makers.\(^4\) M&A-related arbitrations comprise a significant percentage of cases filed under the auspices of the International Chamber of Commerce.\(^5\)

Whether the parties are financial sponsors or strategic buyers is also often a factor in determining whether the parties agree to arbitration. Transactions involving private equity funds or other financial sponsors may be more likely to include an arbitration agreement than transactions where one company purchases another to hold as part of its long-term business strategy. An agreement between two publicly traded companies will typically include the right to litigate disputes in court; the parties are less likely to be able to benefit from the private nature of arbitration, since they could be required to publicly disclose the dispute in US Securities and Exchange Commission filings in any event.

Transacting parties also typically prefer to arbitrate certain disputes that are collateral to M&A transactions, such as disputes regarding shareholder agreements and employment

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\(^5\) Andrea Carlevaris, ‘The Arbitration of Disputes Relating to Mergers and Acquisitions: A Study of ICC Cases’, *ICC International Court of Arbitration Bulletin* Vol. 24 No. 1 (2013) (M&A-related arbitrations ‘represent a significant portion of the caseload of the International Court of Arbitration of the International Chamber of Commerce (ICC Court). In 2012, they accounted for approximately 16 per cent of the total caseload (121 cases), in 2011 17.7 per cent (141 cases) and in 2010 13.6 per cent (108 cases)’) at *2.

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contracts. Disputes arising from these types of agreements may be commercially sensitive, and arbitration affords the parties greater assurances of the matter being resolved confidentially. As mentioned above, disputes over purchase price adjustments, earn-outs and true-ups are also commonly arbitrated pursuant to mechanisms that are designed for efficient and cost-effective resolutions.

Certain industries also tend to use arbitration more than others. For example, arbitration agreements have historically been more common in transactions involving oil and gas companies.

**Grounds for M&A arbitrations**

**Failure to complete the transaction (rare)**
Disputes arising from the failure to complete a transaction are rare, except in financial crises or rapid changes in market conditions. During a financial crisis, parties may struggle to obtain the necessary financing to close transactions or may themselves become financially distressed. Changed market conditions may impact the value of the asset being sold. Claims of failure to close that are brought in arbitrations are particularly rare; parties in US jurisdictions will typically prefer to bring failure-to-close claims in courts. For this reason, arbitration agreements in M&A transactions will often include a provision explicitly allowing for recourse to courts for injunctive relief. Further, because Delaware courts are more likely to quickly resolve claims seeking specific performance of the transaction than New York courts, parties often specify in their agreements that Delaware law and jurisdiction will apply to any such claims.

**Price adjustment (frequent)**
While disputes regarding price adjustments are common, many of these disputes are resolved through contractual clauses providing for expert determination without resorting to fully fledged trial-like arbitration. For example, it is common for disputes to be determined by a third-party accounting firm, whose resolution is contractually binding on the parties. As discussed below, under New York law a party can bring a special proceeding in state court to enforce such determinations.6

**Earn-out (frequent)**
Earn-out provisions, when they are used, frequently lead to disputes. As a result, many parties who begin a negotiation believing that they want to include an earn-out provision in the transaction terms realise during the course of negotiation that the provision will likely lead to disputes, and often find other mechanisms to achieve the desired financial result.

**Failure to disclose or fraud (rare)**
A major deterrent to bringing fraud claims and failure-to-disclose claims is the likelihood that the plaintiff or claimant will not be able to recover sufficient damages to justify the

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6 See New York Civil Practice Law and Rules, s. 7601 (‘A special proceeding may be commenced to specifically enforce an agreement that a question of valuation, or other issue or controversy be determined by a person named or to be selected. The court may enforce such an agreement as if it were an arbitration agreement[.]’).
costs of litigation. Contractual language disclaiming reliance on any representations that are not expressly set out in the contract may bar claims based on allegations of pre-contractual fraud, further reducing the likelihood of successful claims.

Misrepresentations and breach of warranties (rare, but becoming more common)

Many misrepresentations and breaches of warranties do not give rise to litigation because the amount in dispute does not justify the cost of litigation. Small claims of this kind may be more likely to be brought when an escrow is established to backstop breaches of representations and warranties – for example, when the seller presents a credit risk – because such claims often can be decided by the escrow agent upon an exchange of letters, which is less costly. Larger dollar-value claims are rare, but are becoming more common, as reflected by the data being reported by insurance companies.7

Such claims are also rare because there are often contractual provisions limiting their scope or value, including provisions setting a damages cap or a deductible that must be met before the seller becomes liable. In a recent decision, the Delaware Supreme Court broadly applied a post-closing bar on liability for breach, holding that where the agreement barred post-closing liability for misrepresentation and breach of warranty but allowed for a post-closing adjustment based on the target’s net working capital, the buyer could not seek a post-closing adjustment that could have been brought as a breach claim.8

Fraud and failure to disclose

A party may attempt to pursue fraud claims against an M&A counterparty in a variety of situations, including where a final agreement was not reached,9 where contractual remedies are unsatisfactory10 or where the alleged fraud does not correspond to contractually stipulated representations.11 Unless the contract contains an enforceable clause disclaiming reliance on any extra-contractual representation, a defrauded party may pursue a claim for fraud or fraudulent inducement.12 Moreover, in Delaware, while provisions barring extra-contractual fraud claims will be enforced, courts will not permit contracting parties

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7 See, e.g., note 2, supra.
9 RAA Mgmt., LLC v. Savage Sports Holdings, Inc., 45 A.3d 107, 109 (Del. 2012) (seeking to recover diligence costs where party ‘never would have proceeded to consider purchasing’ if it had not been defrauded).
10 FdG Logistics LLC v. A&G Logistics Holdings, Inc., 131 A.3d 842, 864 (Del. Ch. 2016) aff’d sub nom. A & R Logistics Holdings, Inc. v. FdG Logistics LLC, 148 A.3d 1171 (Del. 2016) (rejecting plaintiff’s claim to unwind allegedly fraudulent transaction as ‘unfeasible’ but noting that, if the fraud claims are successful, plaintiff’s recovery will not be limited by the merger agreement).
12 Kronenberg v. Katz, 872 A.2d 568, 593 (Del. Ch. 2004) (an effective ‘anti-reliance’ clause must amount to a ‘contractual promis[e]’ by the plaintiff that it did not ‘rely upon statements outside the contract’s four corners in deciding to sign the contract’); PetEdge, Inc. v. Cag, 234 F. Supp. 3d 477, 488 (S.D.N.Y. 2017) (similar).
to bar or limit fraud claims against parties who make deliberately false representations in the agreement itself. 13

Where a plaintiff’s fraud claims are not prohibited by an enforceable non-reliance provision, such claims will be judged according to the general standards for analysing common law fraud. Under both New York and Delaware law, a plaintiff seeking to establish fraud or fraudulent inducement 14 must plead: (1) a false representation; (2) the defendant’s knowledge or belief that the representation was false or a reckless indifference to its truthfulness; (3) an intent to induce the plaintiff to act or refrain from acting; (4) justifiable reliance on the representation by the plaintiff; and (5) damage caused by the reliance. 15 Actionable misrepresentations include both untrue factual statements and statements of opinion that are not honestly held. 16

Under both federal and New York state law, if a contract contains an arbitration clause, unless the arbitration clause in a contract was itself specifically induced by fraud, all fraud claims relating to the contract, including fraudulent inducement to contract, must be arbitrated and cannot be brought in court. 17

Burden of proof

Generally, in an arbitration governed by any US state’s law, the claimant must prove its claim, including claims for fraud or breach of contract, by a preponderance of the evidence. 18 Arbitrators may have the authority to adjust the burden to reflect their understandings of what outcome would be fundamentally fair under the circumstances, but in practice, arbitrators who are required by the contract to apply New York or Delaware law — or, for that matter, federal law or the law of any US state — will typically apply the same preponderance standard that would apply in federal civil court.

One difference between fraud and other causes of action is that fraud must be pleaded with particularity in civil courts, 19 whereas in asserting most other causes of action, the plaintiff must plead its claim under the less rigorous plausibility standard. 20 In the context

13 Abr y Partners V, L.P. v. F & W Acquisition LLC, 891 A.2d 1032, 1036 (Del. Ch. 2006) (‘[W]hen a seller intentionally misrepresents a fact embodied in a contract – that is, when a seller lies – public policy will not permit a contractual provision to limit the remedy of the buyer to a capped damage claim. Rather, the buyer is free to press a claim for rescission or for full compensatory damages’).
of an arbitration these pleading standards may not technically apply, but may inform the thinking of an arbitrator applying New York, Delaware or other US state law.

Knowledge sharing

A parent corporation is typically not imputed with the knowledge of its subsidiaries. For this reason, the parent of a target generally will not be liable for misstatements or omissions by the target. However, if the subsidiary is acting as an agent or alter ego of its parent, or under other special factual circumstances, such knowledge could be imputed to the parent.

A corporation’s officers generally will not be held individually liable for contractual claims brought against the corporation, unless the contract expressly calls for it. Therefore, the management of a seller cannot be held liable for the any misrepresentation or breach of warranty in its agreement with the buyer. If a claim of fraud in the inducement is brought, however, an officer could be held liable if he or she had actual knowledge of the fraud. Further, Delaware courts have held that this liability can potentially extend to a key institutional shareholder (e.g., a private equity sponsor) whose designated directors knew of the fraud, even if the shareholder itself did not.

Remedies

New York law recognises the broad authority of arbitrators with respect to remedies. For contractual claims, ‘the ordinary rule is that it is impractical to unwind a consummated merger,’ and compensatory money damages will be the typical remedy in an arbitration.

21 See In re Am. Bank Note Holographics, Inc. Sec. Litig., 93 F. Supp. 2d 424, 443–44 (S.D.N.Y. 2000) (‘While it is true that a subsidiary's fraud cannot be “automatically” . . . where factual allegations are sufficient to make a claim for participation of a subsidiary in the fraudulent scheme, a corporate parent may be liable’); see also Chill v. Gen. Elec. Co., 101 F.3d 263, 268 (2d Cir. 1996).


Subject to the arbitration agreement and any applicable institutional rules, parties may obtain injunctive relief, including forcing a party to close or to unwind a transaction.\textsuperscript{28} Given the urgency of injunctive relief (particularly pre-closing), parties usually prefer to bring such claims in court.

In addition, the type of award available to a claimant in arbitration is often expressly limited by the arbitration agreement. For example, an arbitration agreement can foreclose the possibility of punitive damages, even where such damages may otherwise be available. Where fraud or other tort claims are subject to arbitration, those claims may also be governed by the contract’s provision addressing damages, if the provision is sufficiently broad to include those claims.\textsuperscript{29}

**Measure of damages**

The ordinary remedy for a breach of contract under New York law is an award of damages based on the plaintiff’s expectations if the contract had not been breached.\textsuperscript{30} In the M&A context, that could be measured by, for example, the difference between the seller’s representation of the value of the company and its actual value or, in the case of a failed transaction, the buyer’s damages from lost synergies.\textsuperscript{31}

Under New York law, punitive damages are not ordinarily recoverable for breach of contract.\textsuperscript{32} M&A agreements often provide for capped or liquidated damages. Parties can typically design their liquidated damages provisions however they wish, so long as the provision is intended to be compensatory rather than punitive. The general rule, under New York law, is that plaintiffs bringing fraud claims may recover for the pecuniary loss sustained as a result of the fraud. These damages can be measured by (1) the difference between the value of the thing bought, sold or exchanged and its purchase price, or the value of the thing exchanged for it; and (2) pecuniary loss suffered otherwise as a consequence of the recipient’s reliance on the truth of the representation.\textsuperscript{33} In the context of fraudulent inducement, the law puts the parties back into the position they were in before the contract.

**Special substantive issues**

In the United States, a broad spectrum of disputes may be resolved by private arbitration. This includes statutory claims such as those arising under antitrust laws, those based on


\textsuperscript{30} Glen Banks, 28A N.Y. Prac., Contract Law § 22:1 (2018) (‘Even though a breach may be willful and without justification, punitive damages cannot be awarded’).


most types of employment contracts, and a wide array of consumer disputes. To the extent that these matters arise as ancillary to an M&A arbitration, they are likely to be resolved as part of the arbitration process rather than in court.

Other US legal regimes may come into play depending on the nature of the transaction, such as the review process under the Committee on Foreign Investment in the United States (CFIUS). In addition, if any of the parties are nearing insolvency, bankruptcy proceedings (voluntary or involuntary) may have an impact on pending arbitral proceedings.

**Special procedural issues**

New York law contains a special provision for court enforcement of expert determinations. In the M&A context, specific factual or technical issues such as purchase price adjustments are often determined by expert independent accountants rather than by arbitration. Under CPLR Article 76, a party may bring a proceeding to ‘specifically enforce an agreement that a question of valuation, appraisal or controversy be determined by a person named or to be selected.’ The standard of review of such determinations is more searching than that applied to arbitral awards: a party must show ‘palpable error’ or a failure to follow accepted procedures. Parties using expert determinations in conjunction with arbitration clauses for wider disagreements should be careful to clarify the scope of the issues to be determined in that more limited process.

Another recent development with respect to M&A arbitration is the now-common availability of emergency arbitration. In the past decade, almost all arbitral institutions have incorporated such provisions into their rules. While the practice in M&A-related disputes still favours a court forum for interim relief, the willingness of US courts to enforce interim awards by arbitrators may encourage the use of emergency arbitration in M&A transactions.

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37 Alexandra Dosman and Grant Hanessian, ‘Songs of Innocence and Experience: Ten Years of Emergency Arbitration’, 27(2) American Review of International Arbitration (Fall 2016).

Appendix 1

The Contributing Authors

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Frances E Bivens is a partner in Davis Polk & Wardwell LLP’s litigation department and regularly acts as lead counsel in a broad range of high stakes commercial litigation matters in federal and state courts around the country and arbitrations around the globe. Ms Bivens has an electrical engineering degree and specialises in complex litigation involving technical issues. She also regularly handles complex financial matters, including arbitrations arising from M&A transactions. Her practice is international and has included matters arising in India, China, Korea, Hungary, France, Switzerland, Brazil, Mexico, Argentina and the United Kingdom.

Ms Bivens is a member of the executive committee of the New York International Arbitration Center; a member of the international commercial disputes committee, New York City Bar Association; and a member of the international advisory committee of the ICDR.

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E Alexandra Dosman advises clients on funding options for international arbitration cases (both commercial and investor-state) and for litigation relating to the enforcement of arbitral awards in US courts. She is based in New York as a managing director of Vannin Capital’s global international arbitration team.

From May 2013 to October 2017, Ms Dosman was the first executive director of the New York International Arbitration Center, a non-profit organisation that works alongside practitioners, academics and the judiciary to promote and enhance the conduct of international arbitration in New York. Prior to taking up her role at NYIAC, Ms Dosman practised arbitration and litigation in the New York office of Shearman & Sterling LLP for
seven years, where she played a leading role in international commercial and investment treaty arbitration cases.

Ms Dosman writes and speaks widely on international arbitration topics. She also sits as an independent arbitrator and has adjudicated cases under the Arbitration Rules of the International Court of Arbitration of the International Chamber of Commerce (ICC) and the UNCITRAL Arbitration Rules.

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M&A disputes can be unique in their hostility and complexity. *The Guide to M&A Arbitration* – published by Global Arbitration Review – is a new, practical guide intended to provide guidance on what merger parties should think about, when. It pools the wisdom of specialists who describe how to prevent these disputes arising and how best to resolve them when they do. The guide is structured in two sections. Part I consists of 10 chapters on planning and procedural issues, covering everything from drafting clauses to how to structure contracts to minimise the potential for disputes. Part II offers a geographical survey of important differences in national laws that may affect the outcome of a dispute. It is written by 39 specialists from a variety of backgrounds and takes a practical approach throughout.