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Role of Arbitration in Mergers and Acquisitions

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ABSTRACT

This article investigates the indispensable role of arbitration in navigating the aspect of mergers and acquisitions (M&A) disputes. M&A transactions, crucial for corporate growth, often encounter conflicts related to valuation, representations, and post-closing adjustments. Traditional litigation, with its drawbacks of time and cost, proves less than ideal for resolving these complexities. Arbitration emerges as a significant alternative, offering confidentiality, expertise, and efficiency. This article explores the advantages and challenges of arbitration in the M&A context, highlighting the escalating trend of incorporating arbitration clauses in M&A agreements. Examining jurisdictional considerations, the article sheds light on how the choice of venue influences the effectiveness of arbitration in this specialized domain. Through various case studies, this article contributes insights into the evolving landscape of M&A dispute resolution, highlighting the growing significance of arbitration in facilitating efficient and confidential solutions. This article also further discusses the challenges that might be faced with respect to arbitration in M&A disputes. Further, this article discusses the future developments and trends and that assistance that it provides to facilitate the process of arbitration.

Keywords*: Mergers and Acquisitions (M&A), Arbitration, Disputes, Arbitration Clause, Confidentiality, Resolution.*

I. INTRODUCTION

Mergers and acquisitions (M&A) are regarded as challenging transactions between companies, especially when they involve multiple corporate businesses, cross international borders, and extensive, comprehensive agreements.

M&A transactions are defined from a corporate standpoint as the combination of two businesses in a specific industry that leads to the growth of the market economy. Every M&A transaction involves a number of steps and procedures that could lead to disagreements between the parties, particularly when they happen internationally.[2]

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[2] Layan Al Fatayri, Arbitration In Cross-Border Merger & Acquisition Transactions: An Advantage?, The American Review of International Arbitration (24/11/2023, 8:48 pm), https://aria.law.columbia.edu/arbitration-in-cross-border-merger-acquisition-transactions-an-advantage/

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These large-scale international transactions may give rise to legal disputes between the parties, involving, among other things, questions about due diligence, contractual obligations, pre-closing and post-closing obligations, representations and warranties, and adjustments to the purchase price.

Owing to the impact these large-scale cross-border deals have on the global economy, international arbitration becomes the best option for regulating these transactions and providing a swift, effective, and private means of resolving any disputes that may occur. Arbitration is the most often used alternative dispute resolution mechanism used by the parties to resolve their issues arising from M&A transactions, as the number of M&A transactions globally continues to rise. In modern times, arbitration clauses are thought to be crucial in M&A contracts.

II. TYPES OF M&A DISPUTES

Mergers and acquisitions (M&A) deals go through several stages, and disputes usually arise after signing. A number of significant claims are connected to the pre-signing phase, and these disagreements frequently center on how the Shareholder Agreement ("SHA") and Share Purchase Agreement ("SPA") should be interpreted or applied.[3]

The types of M&A disputes can be classified as:

1. **Valuation Discrepancies:** Valuation is a central aspect of M&A transactions, determining the exchange ratio and overall deal consideration. Disputes may arise when the parties involved perceive the value of assets or the entire enterprise differently. Variances in valuation methodologies, assessment of intangible assets, or unforeseen financial challenges post-closure can be sources of contention.
2. **Earn-Out Disputes:** Earn-out provisions are commonly employed in M&A transactions, linking part of the purchase price to the future performance of the acquired business. Conflicts may arise when there are disagreements about the achievement of performance targets, calculation methodologies, or factors affecting the earn-out, such as external market conditions.
3. **Post-Signing Pre-Closing Disputes:** Arbitration disputes involving M&A may arise from shareholder and SPA-related claims. Disputes pertaining to SPAs are typically caused by violations of Material Adverse Change ("MAC") provisions and conditions

[3] Ercüment Erdem, Tilbe Birengel, Arbitration in Mergers & Acquisitions, Chambers and Partners (24/11/2023, 9:50 pm), https://chambers.com/articles/arbitration-in-mergers-acquisitions

precedent. Conditions precedent infringement accusations before an arbitral tribunal may arise from the non-fulfillment of legal or contractual obligations.

4. **Post-Closing Adjustments:** M&A agreements often include mechanisms for adjusting the purchase price post-closing based on changes in the target company's financial condition or other agreed-upon metrics. Disputes can arise when parties disagree on the interpretation of these adjustments, the accuracy of financial statements, or the impact of unforeseen events on the agreed-upon metrics.

III. ARBITRATION AS A PREFERRED DISPUTE RESOLUTION PROCESS IN MERGERS AND ACQUISITIONS

One of the most beneficial and cost-effective methods for parties to resolve M&A disputes is through arbitration. A growing number of M&A disputes have led to parties using arbitration as a procedure for resolving disputes and shielding themselves from losses brought on by omitted information. The practice has also demonstrated that, as an alternative to litigation and as a preferred method of resolving disputes, the majority of M&A parties agree to and prefer arbitration.

Arbitration provides parties with an unbiased and effective means of resolving disputes. As the parties to a cross-border M&A deal may come from different legal systems with differing rules and regulations, this is very helpful. In other words, arbitration offers an impartial platform for settling conflicts to parties from diverse legal systems who may be reluctant to take legal action in a foreign court system. This is particularly advantageous in cross-border mergers and acquisitions (M&A) transactions, as the parties can select the arbitration's venue and applicable law, potentially mitigating any potential bias.

Moreover, arbitration can offer more confidentiality and privacy than litigation procedures that are centered around the court. As a result, it is especially helpful in M&A transactions involving private data and trade secrets. This benefit can shield the businesses and parties engaged in the conflict from negative publicity and help them maintain their good names.

Compared to judicial decisions, arbitration can be more adaptable and customized to each party's unique needs, resulting in more effective and economical dispute resolution. Through arbitration, parties can customize the procedure to meet their unique requirements, such as choosing arbitrators with experience in M&A transactions or a particular sector. When handling a disagreement resulting from a substantial M&A transaction that involves complex business challenges, this can help guarantee that the method of dispute resolution is effective and pertinent to the issues at hand.

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Arbitration offers parties greater procedural flexibility and the opportunity to explore different approaches. The parties may agree on the details of the arbitration, such as the venues, length of time, and use of technology. Due to the fact that parties and witnesses will save time and money on travel, this could lead to a more efficient process. Parties to a lawsuit do not always have the entire power to change the rules and norms that the courts have established.

IV. TRENDS IN THE INCLUSION OF ARBITRATION CLAUSES

Arbitration clauses, which specify that any disputes arising from the M&A agreement will be resolved through arbitration rather than litigation, have become increasingly prevalent in M&A agreements in recent years. This trend reflects a growing recognition among parties involved in M&A transactions of the advantages offered by arbitration over traditional litigation in resolving disputes efficiently, confidentially, and cost-effectively.

Arbitration clauses have been proactively included to agreements by multinational firms involved in cross-border M&A deals. As these transactions are generally multinational in nature and include multiple jurisdictions and legal systems, arbitration is an ideal choice for settling disputes in an unbiased and legally binding manner. Furthermore, as arbitration reduces the chance of prolonged and unpredictable litigation across several jurisdictions, multinational companies like the predictability and certainty it provides.

However, not all claims pertaining to breach of contract are advisable for arbitration. It includes all claims that are based on or connected to the contract in any way, and therefore everything will be collected in one place. It is also a fact that there is nothing more cumbersome than having the claims divided across various forums.

There may be a breach of contract component to types of conflicts and they might make other kinds of assertions as well. Therefore, the arbitration clauses are very broad in nature in order to include all types of disputes that can arise in M&A transactions.[4]

(A) Advantages Driving the Trend:

This trend involving the inclusion of arbitration clauses in M&A contracts has various advantages to it that is helpful to the companies in the event of any dispute. These advantages include:

a. **Confidentiality**: Arbitration proceedings are typically confidential, protecting sensitive business information and trade secrets from public disclosure, which is

[4] Stacey Barnes, Mergers & Acquisitions Arbitration, 62 S. TEX. L. REV. 657 (2023).

particularly crucial in M&A transactions.

b. **Expertise**: Arbitration allows parties to select arbitrators with expertise in M&A law and industry-specific knowledge, ensuring that disputes are adjudicated by individuals familiar with the complexities of the transaction.

c. **Efficiency**: Arbitration proceedings are often faster and more streamlined than litigation, offering parties a much quicker resolution of disputes and minimizing disruptions to ongoing business operations.

d. **Flexibility**: Arbitration allows parties to tailor the dispute resolution process to their specific needs and preferences, including selecting the governing law, language, and procedural rules, enhancing the efficiency and effectiveness of the proceedings.

e. **Enforcement**: Arbitral awards are generally easier to enforce across international borders than court judgments, providing parties with greater assurance that the outcome of the arbitration will be upheld.

V. CASES

(A) Reliance, Future Group & Amazon dispute:

Details of the Dispute:

- Future Group, a prominent Indian conglomerate, announced plans to sell its retail, wholesale, and logistics business to Reliance Industries Limited (RIL) for $3.4 billion in August 2020.
- Amazon, a global e-commerce giant, had acquired a stake in one of Future Group's subsidiaries in 2019, which included a contract clause prohibiting the sale of assets to certain listed companies to avoid competition.
- Amazon contended that the deal between Future Group and RIL violated its shareholder rights and constituted a breach of contract, as it allegedly violated the non-compete clause agreed upon in the contract.
- The dispute arose from conflicting interpretations of contractual obligations and shareholder agreements, leading to legal proceedings between Amazon, Future Group, and RIL.

Arbitration Proceedings and Outcomes:

- Amazon initiated arbitration proceedings against Future Group in Singapore to resolve the dispute, citing the arbitration clause included in their contractual agreement.

- The arbitration process involved the selection of arbitrators, presentation of evidence, and legal arguments from both parties to determine the validity of Amazon's claims.
- The Singaporean arbitration tribunal ruled in favor of Amazon, issuing an injunction to block the Future Group-RIL deal, citing violations of contractual agreements.
- Despite appeals from RIL and Future Group to the Indian Supreme Court, the court upheld the Singaporean arbitral award, enforcing Amazon's position and preventing the completion of the deal between Future Group and RIL.

Implications:

The Future Group & Amazon Dispute serves as a landmark case highlighting the importance of thorough due diligence and compliance with contractual obligations in M&A transactions. The arbitration outcome underscores the enforceability of arbitration clauses in resolving disputes arising from M&A agreements, especially in cases involving conflicting interpretations of shareholder rights and contractual provisions.

Future M&A transactions may face increased scrutiny and risk assessment regarding non-compete clauses and contractual obligations to avoid similar legal disputes and potential injunctions.

(B) Elon Musk and X (formerly known as Twitter) Dispute:

Overview of the Dispute:

- In December 2021, Elon Musk, the CEO of Tesla and SpaceX, was involved in a legal dispute with X (formerly known as Twitter), a social media platform, over allegations of breaching contractual provisions.
- The dispute centered on Musk's alleged uploading of content on X without seeking legal advice, which X claimed violated contractual agreements and triggered a Material Adverse Effect (MAE) clause.
- The MAE clause allows parties to terminate a merger agreement if a material adverse event occurs that significantly impacts the business interests of either party, leading to the termination of the proposed merger between Musk and X.

Arbitration Process and Resolution:

- Elon Musk and X opted to resolve their dispute through arbitration, choosing JAMS, to oversee the proceedings.
- The arbitration process involved the selection of arbitrators, submission of evidence,

and legal arguments from both Musk and X to determine the validity of the claims and the interpretation of contractual provisions.

- Details of the arbitration proceedings, including any settlements reached or awards granted to either party, remain confidential as per the arbitration agreement between Musk and X.

Implications:

- The Elon Musk and X Dispute highlights the significance of contractual provisions, such as the Material Adverse Effect (MAE) clause, in M&A transactions and their potential implications for dispute resolution.
- The arbitration outcome may have broader legal implications for interpreting contractual agreements and enforcing arbitration clauses in resolving conflicts arising from M&A transactions.

VI. CHALLENGES AND LIMITATIONS OF ARBITRATION IN M&A

1. Enforcement of Arbitral Awards:

Despite the advantages of arbitration, one significant challenge is the enforcement of arbitral awards, particularly across international borders. While the New York Convention facilitates the recognition and enforcement of arbitral awards in over 160 countries, challenges may arise in jurisdictions with inconsistent or unpredictable enforcement practices.

Parties involved in M&A transactions must carefully consider the enforceability of arbitral awards in relevant jurisdictions when drafting arbitration clauses to ensure that the chosen dispute resolution mechanism provides effective recourse in the event of a dispute.

2. Cost Considerations:

Another challenge associated with arbitration in M&A transactions is the potential for high costs, including arbitrator fees, legal representation, and administrative expenses.

While arbitration is often perceived as a more cost-effective alternative to litigation, complex M&A disputes involving multiple parties and jurisdictions can still incur significant expenses.

Parties must weigh the anticipated costs of arbitration against the potential benefits, considering factors such as the complexity of the transaction, the likelihood of disputes, and the resources available to fund the arbitration process.

3. Lack of Precedent in M&A Arbitration:

Unlike litigation, which generates binding precedent that can guide future decisions, arbitration

awards are generally confidential and do not create legal precedent. The lack of precedent in M&A arbitration can make it challenging for parties to predict the likely outcome of disputes and may contribute to uncertainty in the arbitration process. Parties and arbitrators must rely on general principles of law, industry standards, and the specific facts of each case to reach decisions, emphasizing the importance of thorough preparation and advocacy in arbitration proceeding

VII. FUTURE TRENDS AND DEVELOPMENTS IN M&A ARBITRATION

The emergence of new technologies, such as artificial intelligence (AI), blockchain, and online dispute resolution (ODR), are various aspects that will revolutionize the arbitration process. AI-powered tools can streamline document review, case management, and legal research, reducing time and costs associated with arbitration proceedings. Blockchain technology offers secure and transparent mechanisms for evidentiary authentication and digital asset management, enhancing the integrity and efficiency of arbitration.

The ongoing legal reforms aimed at enhancing the efficiency and effectiveness of arbitration may have significant implications for M&A dispute resolution. Reforms addressing procedural rules, transparency, and the enforceability of arbitral awards can contribute to a more favorable environment for arbitration in M&A transactions.

Parties should stay up to date with relevant legal developments and consider the potential impact of reforms on their dispute resolution strategies when drafting M&A agreements.

International organizations, such as the International Chamber of Commerce (ICC) and the United Nations Commission on International Trade Law (UNCITRAL), play a crucial role in standardizing M&A arbitration practices. Through the development of model clauses, guidelines, etc., these organizations seek to promote consistency in M&A arbitration proceedings. Parties involved in M&A transactions can benefit from adhering to internationally recognized standards and practices endorsed by reputable organizations, enhancing the efficiency and credibility of arbitration as a dispute resolution mechanism.

VIII. CONCLUSION

All the aforementioned information leads us to the conclusion that arbitration is viewed as an effective dispute resolution tool in mergers and acquisitions (M&A) transactions, offering benefits which make it a more appealing and preferred method for M&A parties than going to court. More specifically, the breach of non-disclosure agreement and letter of intent provisions may set off pre-signing M&A conflicts. Share purchase agreement and shareholder conflicts

are frequent during the post-signing pre-closing phase. Lastly, claims for price adjustments and representations and guarantees are usually at the center of post-closing disputes. With benefits like efficiency, flexibility, and anonymity, the arbitration mechanism in M&A agreements may be a useful instrument for resolving disputes. As a result, parties should carefully consider the requirements and outcomes of arbitration when drafting M&A agreements and tailor the process to suit their particular circumstances.

However, despite its advantages, arbitration is not without its challenges and limitations. Enforcement of arbitral awards across international borders, cost considerations, and the lack of precedent in M&A arbitration pose significant hurdles that parties must navigate when opting for arbitration as a dispute resolution mechanism.

Looking ahead, future trends and developments in M&A arbitration, including the emergence of new technologies, ongoing legal reforms, and the role of international organizations in standardizing arbitration practices, are expected to shape the landscape of M&A dispute resolution. Parties involved in M&A transactions should stay informed about these developments and carefully consider the implications for their dispute resolution strategies.

In conclusion, while arbitration offers a valuable means of resolving M&A disputes efficiently and confidentially, parties must carefully weigh the advantages and challenges of arbitration and tailor their dispute resolution mechanisms to suit the circumstances of each transaction.

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