

# M&A Arbitration Clauses: "Watch-Outs" From A Litigator's Perspective

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Merger and acquisition agreements contain many "boilerplate" clauses that rarely receive the same attention as the more heavily negotiated deal terms. To the extent they are considered at all, it would be as a post-closing afterthought and only when a deal has taken a turn for the worse. At that point, the parties are almost always surprised to find that their dispute resolution clauses are ambiguous.

This *Legal Update* will help reconsider the boilerplate language associated with an alternative dispute resolution provision, and its importance, in order to do better deals.

## Part I: Alternative Dispute Resolution

Oftentimes parties desire to avoid costly litigation and resolve their dispute through arbitration. A boilerplate arbitration provision is inserted into the agreement and the issue is settled, or is it? The following is boilerplate language calling for dispute resolution through an arbitration proceeding:

In the event that the parties are unable to resolve a dispute relating to this agreement, the parties hereby agree to binding arbitration in New York City, New York pursuant to the Rules of the American Arbitration Association at New York City, New York. There will be one arbitrator, who will be knowledgeable in [substantive area] and the [applicable industry]. Any such arbitration shall last no longer than four business days with the entire proceeding to be completed, including the decision by the arbitrator, within four months of the initial demand for arbitration.

The award of the arbitrator shall be final and binding upon the parties. The arbitration award may include all damages otherwise recoverable by the prevailing party under this Agreement in a court of law, including termination of this Agreement. Judgment based upon the award of the arbitrator may be entered in any Court having jurisdiction thereof.

This provision, which was the Seller's standard boilerplate, has several problems. First, it specified that the arbitrator had to be knowledgeable in both a substantive area and the applicable industry. The parties presumed that such double expertise was needed when all such knowledge was irrelevant to a dispute over the nature of the contract.

Second, the parties presumed that arbitration would save both time and money and wanted an adjudicator with particular expertise and experience to produce that efficiency. But that expertise was not only irrelevant and counterproductive in the dispute, the presumption that arbitration is always faster and less expensive than litigation in court was erroneous.

## Part II: Recommendations

Following are some key considerations in evaluating an alternative dispute resolution provision:

- Before deciding on what kind of dispute resolution process you want, think carefully about the full range of disputes the parties may have under the agreement. Do not get fixated on one particular paradigm for what the dispute may be.
- Before including an arbitration clause, ask yourself these questions:
  1. What specific types of disputes do the parties want to decide with an arbitrator rather than a judge? Is specific technical expertise really required?
  2. Are you likely to need discovery to get all the facts needed to resolve a dispute? Typical arbitration rules only permit discovery upon the agreement of the parties or the discretion of the arbitrator.
  3. What rules of evidence do you want used? Generally, arbitrators do not apply state or federal rules of evidence unless the parties agree. Usually, that means one party sees an advantage to having or not having formal rules of evidence and agreement will not likely be possible. It is better to make these decisions when the deal is put together, not after a dispute has arisen.
  4. Do you need a well-defined process for the dispute resolution? Courts have well-defined processes; arbitration has less well-defined processes.
  5. What rules do you want to apply? Major arbitration service providers, such as the American Arbitration Association, have extensive written rules for both domestic and international arbitrations. Other arbitration service providers have less extensive or less burdensome requirements.
  6. Do you need clear and correct application of the law? Arbitrators are not generally chosen based on their knowledge of the law. This can lead to significant problems because there is generally no appellate review of the Award to correct for legal errors. An arbitration award can be confirmed even if it was based on errors of law and fact.
- Before combining court-based dispute resolution with other resolution mechanisms, be sure you consider all the provisions of the agreement together and confirm it is clear which dispute resolution mechanism will apply to each type of dispute.

Asking these questions before choosing a dispute resolution mechanism will lead to better decisions about whether to use alternative dispute resolution mechanisms, fewer costly disputes and, hopefully, better deals.

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