This article is from Dispute Resolution Journal. © 2016, Juris Net, LLC.
www.arbitrationlaw.com

ARBITRATION IN M&A TRANSACTIONS: LAWS OF NEW YORK AND DELAWARE

Frederick R. Fucci ∗

Part I

Pre-Contractual Considerations
(Preliminary Agreements) and
Purchase Price and Working Capital Adjustments[1]

I. INTRODUCTION

The purpose of this article is to outline the aspects of M&A transactions that tend to give rise to disputes and, against that background, examine how arbitrators hearing those disputes have decided them so as to help practitioners better guard against the risks and also highlight the unique aspects of arbitration as a method of resolving disputes in M&A. Frequently, the general disputes clause of a merger or acquisition agreement calls for some form of arbitration. There also usually are particular aspects of the transaction, such as post-closing price or working capital adjustments that have their own dispute resolution process, typically revolving around referral to an accountant or an expert, which may or may not be considered some form of arbitration. "M&A" will be defined in a broad sense, encompassing acquisitions of both stock and assets of targets and joint ventures. The focus of this article will be agreements

∗ **Frederick R. Fucci**, a Partner at Troutman Sanders LLP, is a transactional and project finance lawyer who focuses on the acquisition, development and financing of power generation and other energy assets, as well as M&A and joint ventures in other industries. He also regularly acts as an arbitrator in domestic and international commercial and construction disputes under AAA, ICDR, ICC, and LCIA rules and is a member of the AAA's commercial and construction rosters, the ICDR's International Panel, the CPR Panel of Distinguished Neutrals, the Hong Kong International Arbitration Centre and Vienna International Arbitration Centre, among others. He is qualified as a lawyer in New York and New Jersey and as a solicitor in England & Wales. Fred was named to the NY Metro *Super Lawyers List* in Energy and Natural Resources for the years 2013- 2016.

[1] Part II of this Article (to be published in upcoming issues of Dispute Resolution Journal) will consider Claims for Breach of Representation and Warranty, Earnouts, Tax Claims, and Material Adverse Changes Conditions and Part III will cover Closing Conditions, Fraud and Extra-Contractual Rights, Remedies for Breach and the use of Emergency Arbitration Proceedings.

governed by New York law – and in some cases, Delaware law, given the prevalence of Delaware law agreements in the U.S. for many types of corporate transactions.

Fortunately, we have access to very important direct sources to guide the inquiry – opinions of courts and in many cases the actual awards of arbitrators. Published court opinions result when one party is seeking to enforce an arbitral award and the other is resisting. Often courts discuss the substance of the dispute and the award. In many cases, it is also possible to have access to the awards themselves, as they are attached to the petitions to confirm. For domestic awards sought to be enforced by the New York State courts, this is accomplished under the New York State civil procedure law, the *Civil Practice Law and Rules* (CPLR). Sections 7510 and 7514 of the CPLR require a court to confirm an award presented by a party (unless there are certain grounds to disregard the award – quite rare and discussed in more detail below) and to enter judgment upon confirmation of the award. In other words, under New York law, arbitral awards essentially become New York court judgments that can be enforced in the usual way.

For international awards, the terms of the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards, known as the New York Convention, apply.[2] They require that the courts of any state party to the convention enforce an arbitral award rendered in any other contracting state. The New York Convention is implemented in the United States though the Federal Arbitration Act.[3] Under the Federal Arbitration Act, if the agreements giving rise to the award are commercial and not entirely between citizens of the United States, then any party to the arbitration may apply to any court with jurisdiction for an order confirming the award[4], usually to the federal district courts based on the diversity of citizenship principle of jurisdiction.

Whether the application for an order to enforce is made to the New York State courts or a federal district court in New York, the arbitral award must be attached to the application to confirm for the court to consider. In most cases those awards can be obtained by retrieving

---

[2] Convention on the Recognition and Enforcement of Arbitral Awards, June 10, 1958, 21 U.S.T. 2517, 330 U.N.T.S. 38.

[3] Pub.L. 68–401, 43 Stat. 883, enacted February 12, 1925, codified at 9 U.S.C. § 1 et seq.

[4] 9 U.S.C. §207.

the docket from the case. In effect, unless confidential treatment is sought and granted, which is relatively unusual, the award attached to the application becomes a public document. As a result, a researcher or any person curious to know can have access to a trove of actual arbitral awards on any number of subjects. The arbitral awards referred to in this article have been obtained though the relevant court cases. These awards and court opinions will form the basis of the discussion of this article, as well as the relevant substantive law, which will be presented as background.[5]

II. PRE-CONTRACTUAL CONSIDERATIONS – LOIS / MOUS

Most M&A transactions begin with some sort of initial expression of the parties' understanding – a letter of intent or a memorandum of understanding or a similar form of preliminary agreement. It is generally understood that the transaction will only be consummated on the basis of fully negotiated and signed contracts, but it is important to the business people driving the deal that their initial understanding be set down. The intent is that the terms of the initial agreement be picked up in the final documents, thus giving guidance to the lawyers drafting and negotiating the contracts.

Naturally when a letter of intent is signed and then the deal is not finalized, bad feelings arise. Someone's expectations are frustrated and lawsuits or demands for arbitration often result. In most respects, the New York law relating to letters of intent is pretty straightforward, especially in light of the practice that has developed in drafting M&A-related letters of intent. Typically, one part of the letter of intent sets out the parties' initial agreement but states that it is not intended to be binding and that no obligations will arise except upon the signing of definitive documentation. Another part contains binding agreements, however. The typical binding aspects of a letter of intent are with relation to exclusivity (if it is granted and for how long), confidentiality, governing law and how disputes will be resolved. Sometimes M&A related letters of intent contain binding break-up fee provisions. Often the disputes clause is overlooked since the letter of intent is meant to be a feel-good document and the business people driving the deal don't want to dampen the mood by talking about what will happen if things go wrong. As in all contracts, not specifying a dispute resolution mechanism is a

[5] The awards retrieved and discussed are from the ten years prior to publication.

dangerous path to go down because if a dispute arises the party seeking relief could spend a considerable amount of time and costs establishing the right forum to hear the dispute, especially if the parties are from different places, instead of getting right down to asserting its rights. This is where transactional lawyers have the opportunity to introduce agreements to arbitrate to take advantages of the benefits of arbitration.

A. New York State Law on Preliminary Agreements

It has been the law in New York for some time that where the parties "have clearly expressed an intention not to be bound until their preliminary negotiations have culminated in the execution of a formal contract, they cannot be held until that event has occurred."[6] Where a letter of intent "leaves for future negotiation [material] provisions , … courts will decline to supply them by implication," unless there is an indication in the letter of intent of an objective method, independent of a party's mere wish or desire, upon which to make these provisions definite.[7] This is based on a long standing principle of New York law where "an agreement to agree," which leaves material terms of a proposed contract for future negotiations, is unenforceable.[8] Conversely, where "[t]he plain language of the LOI manifests the parties' intent to be bound by its terms [and] it does not contain an express reservation by either party of the right not to be bound until a more formal agreement is signed," the LOI will be enforced.[9]

Is sum, according to the case law developed by New York courts over time, in determining whether a letter of intent is enforceable, courts are required "to determine "whether the agreement contemplated the negotiation of later agreements and if the consummation of those agreements was a precondition to a party's performance."[10] Nothing

---

[6] *Brause v. Goldman*, 10 A.D.2d 328, 332, 199 N.Y.S.2d 606, 611 (1st Dept 1960), *aff'd* 9 N.Y.2d 620, 210 N.Y.S. 225 (1961).

[7] *Bernstein v. Felske*, 143 A.2d 863, 865, 533 N.Y.S.2d 538, 540 (2nd Dept. 1988), as excerpted in Soloway & Bernstein, *The Enforceability of Letters of Intent*, N.Y. LAW JOURNAL (Jan. 29, 2014), www.nylj.com.

[8] *2004 McDonald Ave. Realty v 2004 McDonald Ave. Corp*., 50 A.2d3d 413, 414, 80 N.Y.S.2d 203, 204 (2nd Dep't 2008)(citations omitted).

[9] *Bed Bath & Beyond v Ibex Constr*., 52 A.3d 413, 414, 860 N.Y.S.2d 107, 108 (1st Dept. 2008(citations omitted).

[10] *IDT Corp v Tyco Group, S.A.R.L.*, 13 N.Y.3d 209, 213, 890 N.Y.S.2d 401, 403 (2009). See also Soloway & Bernstein, *op. cit.*

in this summary of the way New York State courts look at letters of intent is in the least bit surprising or would give pause of any out-of-state or foreign parties choosing New York law to govern their preliminary documents.

B. New York Federal Court Practice on Preliminary Agreements

Federal courts sitting in New York, however, have developed a parallel scheme of looking at letters of intent and other pre-contractual agreements that is more nuanced and based on a characterization of the documents into one of two types, as first articulated by a federal district court judge in 1987 in a case called *Teachers Insurance & Annuity Association of America v Tribune Company*.[11] The *Tribune* case, as it has come to be called, continues to be cited in federal court opinions on letters of intent.

1. Type 1 – Binding Agreement

The first category, Type I agreements, are "fully binding agreements, which are created when the parties agree on all the points that require negotiation (including whether to be bound) but agree to memorialize their agreement in a more formal document."[12] Type I agreements fully bind the parties that enter them "to carry out the terms of the agreement even if the formal instrument is never executed." [13] In practice, one rarely encounters these Type I letters of intent. Parties generally are fairly attuned to the preliminary/definitive agreement scheme, but there are occasionally times when they invest so much time in negotiating a letter of intent or a term sheet that they are happy to essentially let that be their agreement whether or not they get around to making the agreement more formal. Other times one party is eager to nail down the other and succeeds in obtaining this binding type language without the other being fully aware of the consequences of it, especially if that other party has not involved legal counsel at the letter of intent stage.

---

[11] Judge Laval in *Teachers Insurance & Annuity Association of America v Tribune Company*, 670 F.Supp. 491 (S.D.N.Y. 1987).

[12] *Vacold LLC v. Cerami, 545 F.3d 114, 124 (2d Cir. 2008)* (alterations omitted)(*Vacold).*

[13] *Id.*

If there is an issue about whether a document is a Type I letter of intent, the following factors are to be considered.[14]

- Whether there is an expressed reservation of the right not to be bound in the absence of a writing;
- Whether there has been partial performance of the contract;
- Whether all of the terms of the alleged contract have been agreed upon; and
- Whether the agreement at issue is the type of contract that is usually committed to writing.

If, after assessing these factors, the Court finds that the parties have indeed entered into a Type I agreement, they are bound to carry out the terms of the agreement even though they never proceed to signing the final contract.

2. Type II – Good Faith Negotiation Obligation

Alternatively, Type II agreements, are preliminary contracts that are binding on the parties "only to a certain degree because the parties agree on certain major terms, but leave other terms open for further negotiation."[15] These agreements "do not commit the parties to their ultimate contractual objective," but rather "bind the parties to the obligation to negotiate the open issues in good faith in an attempt to reach the objective within the agreed framework."[16] If the parties fail to reach such a final agreement after making a good faith effort to do so, there is no further obligation. If one of the parties does not act in good faith, liability to the other party may arise. So, in sum, parties to a Type II preliminary agreement have agreed to proceed toward a contractual goal, but have left necessary terms for later negotiation. Parties to a Type II agreement are obligated to negotiate in good faith toward a final contract incorporating the agreed terms.

---

[14] Per *Winston v. Mediafare Entertainment Corp.*, 777 F.2d 78 (2nd Cir. 1985).

[15] *Vacold* at 124 (alterations omitted).

[16] *Id*. (internal citations and alterations omitted).

Incidentally, the New York Court of Appeals, the highest New York State court,[17] had occasion to consider the scheme developed by the federal courts sitting in New York and was not impressed. It noted in one case that federal courts had divided preliminary agreements into two types and stated that "[w]hile we do not disagree with the reasoning in federal cases, we do not find the rigid classifications into 'Types' useful."[18] The lack of enthusiasm by the Court of Appeals has not deterred the federal courts, however. The Second Circuit and the district courts continue to use the Type I/Type II framework.[19] In one case from 2014, the Southern District has stated that "[a]bsent guidance from the Second Circuit or the New York Court of Appeals to the contrary, this Court will continue to rely on the framework."[20]

C. Preliminary Agreement Disputes in Practice

So how do you tell if a letter of intent or an MOU is a Type I or Type II preliminary agreement? Not surprisingly, the starting point is the actual language of the document entered into by the parties.[21] And there is a wealth of case law as parties continue to litigate the contours of what the distinctions mean.

While it is not M&A related, one recent case, *Worldwide Services, Ltd and Rider Limited v. Bombardier Aerospace Corporation*, where the plaintiff brought a case asserting that some preliminary agreements to purchase jet airplanes were enforceable, is a treasure

---

[17] See the Afterword on New York and Delaware Court Terminology for a description of the different levels of courts and judges in the state and federal systems and how they are referred to.

[18] *IDT Corp. v. Tyco Grp.,* 918 N.E.2d 913, 915 n.2, 13 N.Y.3d 209, 215 n.2, 890 N.Y.S.2d 401 (2009)).

[19] *See SSP Capital Partners, LLP v. Mandala, LLC,* 402 Fed. App'x 572, 573 (2d Cir. 2010) (summary order); *Sawabeh Info. Servs. Co. v. Brody,* No. 11 Civ. 4164 (SAS), 2014 U.S. Dist. LEXIS 1050, 2014 WL 46479, at *10 (S.D.N.Y. Jan. 6, 2014), *rev'd on other grounds*, *598 Fed. App'x 794 (2d Cir. 2015)* (affirming the district court's judgment except as to breach of fiduciary duty); *Nat'l Gear & Piston, Inc. v. Cummins Power Sys., LLC,* 861 F. Supp. 2d 344, 356 (S.D.N.Y. 2012).

[20] *Gas Natural, Inc. v. Iberdrola, S.A.,* 33 F. Supp. 3d 373 (S.D.N.Y.) at 378 n.1. ("*Gas Natural*").

[21] "In the analysis of both these types of binding agreements, the Court has found the language of the agreements to be the most important factor in discerning the parties' manifested intent." *Spencer Trask Software and Info. Servs. LLC v. Rpost Intl Lmt.,* 383 F. Supp. 2d 428, 441 (S.D.N.Y. 2003).

trove of law and analysis on the subject, as Judge Ramos of the Southern District considered whether the disputed agreements were either Type I or Type II preliminary agreements.[22] This analysis is entirely relevant to LOIs and other M&A-related preliminary agreements.

The plaintiff in *Worldwide Services* was an entrepreneur who required private jet planes to carry out his business internationally. In the opinion there is an elaborate recitation of the facts leading to the dispute, which involved a series of agreements and negotiations the purpose of which was to allow the entrepreneur to purchase three jet airplanes from Bombardier, the Canadian aerospace company. Bombardier was developing a new series of long-range jet and the plaintiff wished to secure two of the first ones of the series built. The projected delivery dates were too far out in the future, so he also contracted for an older model to be delivered sooner, considering the purchase of the older model and the two newer ones to be a package deal. In 2009, the parties entered into a purchase agreement for the older model and a letter of intent for each newer one. The entrepreneur made deposits under the LOIs to secure the production slots and to allow the purchase of the planes at a special introductory price. The parties contemplated that they would enter into the actual purchase agreements later for the two newer planes.

The manufacture of all three planes ran into delays, such that the parties amended the existing purchase agreement and decided to enter into a purchase agreement for one of the newer models and keep the LOI in place for the second one. Thus in 2011, they had in place two signed purchase agreements and an LOI for the third plane. Further delays ensured near the end of 2011 for the older model making it unlikely Bombardier could meet the delivery schedule. The parties renegotiated the contracts with Bombardier making significant concessions. *Worldwide Services* maintained its position that the LOI should not be converted into a contract for the third until the problems with the first were resolved. It contended that the intent always was for there to be a package deal for all three planes.

Further delays and negotiations ensued. Worldwide Services remained unwilling to sign the contract for the third plane until the delivery issues for the first plane (which mostly had to do with U.S. Federal Aviation Administration certification) were resolved. As a

[22] 2015 U.S. Dist. LEXIS 130974.

result, the parties entered a memorandum of understanding regarding the third plane in March 2012. The MOU started out as follows:

> Immediately after the FAA certification is obtained for [the older model], Buyer and Seller shall *negotiate in good faith and with the intent and design to conclude and sign* the Aircraft Purchase Agreement of the second [newer model].[23]

The MOU went on to refer to and incorporate specific e-mail correspondence between the parties, which, according to *Worldwide Services*, contained the agreed upon material terms, including price, and delivery date. The first plane was delivered in March 2012 and the parties continued to discuss entering into the contract for the third. There were delays due to personal issues affecting the principals on both sides. Negotiations resumed. Principals of the parties met in May, July and December 2013 following which the plaintiff felt assured that a deal was reached and all issues were resolved, including a penalty Bombardier should pay if the third plane was not delivered on time. In July, a representative of Bombardier e-mailed to confirm that they had board approval to proceed with the discussions as had in the July meeting. The plaintiff had his lawyers revise the purchase agreement to reflect what was agreed. Bombardier's lawyer made further changes to the purchase agreement in February 2014 "to incorporate the latest matters discussed." Per the terms of the MOU, the plaintiff believed that all that was left was to conclude and sign the purchase agreement, consistent with the terms of the MOU.

In the meantime, a new president took over at Bombardier on January 1, 2014. Bombardier told the plaintiff that the new president's approval was required. After further back and forth, the new president informed the plaintiff on May 9, 2014 that Bombardier would not sign the purchase agreement for the third plane and that it had sold its reservation slot to a third party. The plaintiff claimed that the motivation was that the price he had extracted due to all the delays was too low and that Bombardier had found another party who was willing to pay more. In response to the recriminations that followed, the new president wrote to the plaintiff, claiming, among other things, that the original LOI for the third plane had expired because the parties were unable to finalize the purchase agreement within 30 days following the launch of the new model program, as the original LOI

[23] *Worldwide Services* at *12 (emphasis in original).

had required. He didn't mention the March 2012 MOU with the good-faith negotiation language.

The plaintiff sued for specific performance, claiming that a Type I preliminary agreement existed (it was unclear from the complaint whether the supposed July 2013 agreements or the draft contract was being relied on). It also sought specific performance under the MOU to finalize the "ministerial" components of the purchase agreement. In the alternative, plaintiff asked for money damages, which should be the difference between the price the plaintiff agreed for the third plane and the market price or, in the alternative, promissory estoppel damages.

In his opinion, Judge Ramos went through the four-point analysis cited above to determine if a Type I preliminary agreement existed. In short, the Court was not persuaded. The court looked to the terms of the draft purchase agreement (including its integration clause) to determine that the parties' intent was only to be bound once a purchase agreement was signed. The Court gave short shrift to the partial performance analysis, but did consider both sides' arguments about whether all material terms were agreed to (plaintiff: yes; Bombardier: absolutely not) and did not come down one way or the other. As to the last part of the test, whether the agreement is usually one committed to writing, the Court found that the parties did not intend to be bound by an unexecuted agreement. In sum, he found that the plaintiff had not "plausibly argued the existence of a Type I preliminary agreement."[24]

He then went on to consider whether the MOU was a Type II preliminary agreement that imposed an obligation to negotiate in good faith. There are five factors to consider, per Second Circuit guidance.[25]

- Whether the intent to be bound is revealed by the language of the agreement;
- The context of the negotiations;
- The existence of open terms;
- Partial performance; and

---

[24] *Id*. at *53.

[25] *Id* at *47, citing through to *Arcadian Phosphates, Inc. v Arcadian Corp.*, 884 F.2d 69, 72 (2nd Cir. 1989).

- The necessity of putting the agreement in final form, as indicated by the customary form of such transactions.

Clearly there is considerable overlap in these factors with the Type I factors, but the courts apply them differently. There is more of an emphasis on the context of the negotiations and less on the existence of unresolved terms.

As to the first factor, the actual language of the MOU, it could not be clearer in terms of requiring the parties to negotiate in good faith. As to the partial performance prong, the Court focused on the plaintiff's "package deal" argument but also on amount of time the parties' negotiations went on, citing previous cases finding the existence of a Type II preliminary agreement when the negotiations went on for a long time.[26] The court also seemed to be impressed with the fact that at least three drafts of the agreement for the third plane were exchanged. The court found that the length of the negotiations and the number of drafts exchanged supported the Type II finding. The court did not find it fatal that the MOU left some open terms to be resolved. As to the fifth "final form" factor, Type II agreements necessarily contemplate future negotiations and contracts. In sum, the Court found that all factors pointed in favor of a Type II finding.

Judge Ramos then considered the actions of Bombardier, namely that it added a condition late in the game that the new President sign off on the deal that had been negotiated and that it admitted selling the slot for the third plane to a third party. Judge Ramos found on these facts that this was bad faith.

1. Damages for Breach of Good Faith Obligations

Judge Ramos' decision in the *Bombardier* case also contains a good discussion of what the damages should be if there is a breach of an obligation to negotiate in good faith when a Type II preliminary agreement is found to exist. In that case, the plaintiff asserted that it

[26] See e.g. *EQT Infrastructure Ltd. v. Smith*, 861 F. Supp. 2d 220, 230 (S.D.N.Y. 2012) – "Here, the LOI contemplated that Plaintiff would 'expend significant time, effort, and expense in connection with the Possible Transaction,' . . . and Plaintiff did so after the LOI was executed, hiring lawyers, accountants, and consultants, at a total cost of $1.5 million so far, to conduct due diligence and draft documents necessary to complete the Possible Transaction. This effort weighs in favor of finding that Plaintiff and Defendants were bound to continue to negotiate in good faith."

was entitled to either specific performance or damages as a result of the breach.

So, having established an obligation (the duty to negotiate in good faith under the MOU) and a breach (Bombardier acting in bad faith), Judge Ramos went on to consider the plaintiff's damage theories. Some interesting points are raised here.

a. Specific Performance

Could the plaintiff obtain specific performance of the MOU, so to speak? That is to say, could the court order Bombardier to finalize and sign the full agreement to sell the third plane? The court considers that question but doesn't rule on it because the question before it was on Bombardier's motion to dismiss. Interestingly, the court did not dismiss the specific performance request and sets the question for determination after discovery. Therefore, there remains the tantalizing possibility that a U.S. federal judge would order a party to enter into an agreement based on an obligation in an MOU to negotiate it in good faith, something that would be highly unusual.

b. Money Damages (Benefit of the Bargain)

Could the plaintiff get money damages for the breach of the MOU obligation to negotiate in good faith? The plaintiff was seeking the difference between the price it had negotiated for the new model and the market price. The court cited a New York State case from some years ago where a trial court held on a summary judgment motion that lost profits were not available for a breach of duty to negotiate in good faith, which decision was upheld by the Court of Appeals.[27] It also "recognized" that the Second Circuit has explained that although out-of-pocket costs incurred in the course of good faith partial performance are appropriate, lost profits are not available when no agreement is reached.[28] However, the court also noted that whether lost profits may *never* be recovered for a party's failure to negotiate in good faith is unclear. It cited an 8th Circuit case applying New York law to the effect that the New York State cases should not necessarily

[27] *Goodstein Constr. Corp. v. New York,* 604 N.E.2d 1356, 1360-61, 80 N.Y.2d 366, 373-74, 590 N.Y.S.2d 425 (N.Y. 1992).

[28] *L-7 Designs, Inc. v. Old Navy, LLC,* 647 F.3d 419, 431 (2d Cir. 2011) (citing *Goodstein,* 604 N.E.2d at 1360-61, 80 N.Y.2d at 373-74; *Arcadian Phosphates,* 884 F.2d at 74 n.2).

be read as categorically precluding benefit-of-the-bargain damages for all breaches of binding preliminary agreements to negotiate a final agreement in good faith.[29] That court said that the issue of benefit-of-the-bargain damages was a "difficult, largely unsettled question of remedies."[30] While getting damages for a breach of good faith negotiation obligation certainly seems like a stretch, the recent New York case law from the federal courts holds out that also tantalizing possibility.

In fact, the Southern District has on at least one occasion found for benefit-of-the-bargain damages when an obligation to negotiate in good faith was breached. In that case, the parties had entered into a complete contract regarding a cable television network's broadcasting of ten episodes of a television program produced by the producers and also an option for an additional ten episodes in the following season, but with certain open terms for the following season.[31] The Southern District found a breach of an obligation to negotiate in good faith on the part of the producers for the second season, thus depriving the network of the broadcast fees it would have earned. In assessing damages, the court noted that "[s]ince the obligation to negotiate a contract in good faith does not guarantee that a final contract would be concluded if both parties complied with that obligation, the calculation of damages caused by a breach may in some circumstances be problematical".[32] However, in that case, the court found that it was simple enough to do so in that there were enough indications in the terms and conditions for the first season to understand the economics of the transaction. As a result, the court awarded damages to the network for the value of the ten episodes that it could not air due to the producers' breach of their obligation to negotiate in good faith.

c. Reliance Damages

If specific performance is practically unheard of and benefit-of-the-bargain damages are iffy for breach of the obligation to negotiate in good faith, what is then the more accepted damage theory for breach

---

[29] *Fairbrook Leasing, Inc. v. Mesaba Aviation, Inc.,* 519 F.3d 421, 429 (8th Cir. 2008).

[30] *Id*.

[31] *Network Enterprises v. APBA Offshore Productions, Inc. and Michael D. Allweiss*, 427 F. Supp.2d 463 (S.D.N.Y. 2006).

[32] 427 F.Supp. 2d at 487.

of that obligation? It is what you could call in broad terms "reliance" damages, essentially a type of promissory estoppel argument. The classic hornbook elements for proving a promissory estoppel claim are (1) a clear and unambiguous promise; (2) reasonable and foreseeable reliance on that promise; and 3) injury to the relying party as a result of the reliance.[33] In the *Worldwide Services v Bombardier* case, the court had no trouble at all finding that Worldwide Services had relied on Bombardier's promises to its detriment, especially in so far as the "package deal" was concerned where Worldwide Services would never have bought the first two planes if it could not have bought the third. Again, the court did not reach the question of damages, since the motion before it was from Bombardier to dismiss. Accordingly, it did not dismiss the counts and set the matter for discovery. Therefore, the possibility that Bombardier will be liable for reliance damages remains open.

As noted above, New York courts have no trouble finding that a party wronged by the bad faith of the other is entitled to at least its out-of-pocket expenses.[34] "Reliance" damages go somewhat beyond that and there are instances in which they are recoverable as well. Reliance damages typically are described as the plaintiff's expenses of preparation and of part performance, as well as those foreseeable expenses incurred in reliance upon the contract.[35] In practice, a plaintiff's ability to demonstrate actual reliance upon an agreement requires satisfying a number of criteria. These criteria are foreseeability, proximate cause, proving the amount of damages to a reasonable degree of certainty and the exercise of reasonable efforts to mitigate the damages.

2. Accepting Competing Offers

Another interesting recent letter of intent case involving a potential acquisition is *Gas Natural, Inc. v Iberdrola, S.A. and Iberdrola U.S.A., Inc.*, a 2014 opinion of Judge Abrams of the Southern District.[36] In that case the plaintiff, Gas Natural, contacted Iberdrola

[33] *Kaye v. Grossman,* 202 F.3d 611, 615 (2d Cir. 2000).

[34] "It is undisputed that reliance damages are recoverable under New York law. The goal of reliance damages is to allow 'recover[y] for those efforts that were to [a party's] detriment and thereby placed him in a worse position.'" *Fairbrook Leasing, Inc. et al., v. Mesaba Aviation, Inc.*, 519 F.3d 421 (8th Cir. 2008).

[35] *Bausch & Lomb Inc. v. Bressler*, 977 F.2d 720, 729 (2nd Cir. 1992)(*"Bausch & Lomb*").

[36] 33 F.Supp. 3d 373; 2014 U.S. Dist. LEXIS 97989.

through a broker to express interest in purchasing a natural gas distribution company called New Hampshire Gas from Iberdrola. The parties exchanged several draft letters of intent and then signed a final one on May 16, 2013.

As summarized in the court's opinion, the letter of intent began by "setting out the terms on which Iberdrola would grant information relating to Gas Natural's interest in purchasing New Hampshire Gas and describes the arrangements applying to [the parties'] discussions. In "consideration of [Gas Natural's] interest shown in relation to the Transaction," Iberdrola will undertake to devote the necessary time and resources to negotiate the Transaction in good faith with Gas Natural during the period of forty-five (45) days from the date" the LOI was executed. Iberdrola agreed, within the 45-day period, to grant Gas Natural access to confidential information and to provide a mutually acceptable resolution to certain litigation affecting New Hampshire Gas. During the same 45-day period, Gas Natural was to complete a due diligence process and begin trying to obtain all necessary internal approval and permits that could be required as a precondition to the transaction.

The final paragraph of substance stated that:

> Notwithstanding the foregoing, this letter constitutes a non-binding letter of intent and that no contract or agreement related to the Transaction or any legal obligation resulting therefrom shall be deemed to exist unless and until a Definitive Agreement has been executed and delivered by the necessary parties.

During the negotiation period, Gas Natural asked repeatedly for an exclusivity clause but none appeared in the final signed LOI. Once the 45 days referred to in the LOI expired, the parties agreed to extend the good faith negotiation period through September 1, 2013. On August 1, 2013, however, Iberdrola informed Gas Natural that they had received a competing offer for New Hampshire Gas and were no longer going to negotiate with Gas Natural.

Gas Natural sued claiming a breach of the duty to negotiate in good faith an asking for reliance damages, that is to be covered for the expenses it had incurred. It did not ask to enforce the transaction itself. Iberdrola moved to dismiss the complaint. Judge Abrams noted in her opinion that the question of whether the LOI in fact

imposed an obligation to negotiate in good faith would have made a good first year law exam question.[37] She then went through a detailed analysis of the Type I / Type II law and elements. Iberdrola relied heavily in its defense on the language of the LOI, arguing that "the parties said three different ways that the LOI is *entirely* non-binding."[38] She considered that argument but found that the language of the LOI to the effect that Iberdrola undertook to negotiate in good faith over a specific period of time was more important and that the party's description of the LOI as non-binding, while relevant, is not determinative. The language of the LOI that it was not intended to create legal obligations in relation to the 'Transaction" was meant to refer to the actual sale of the business and not the LOI itself. The court also found that the second and fourth Type II factors – context of the negotiations and partial performance – also weighed in favor of Gas Natural. The court found it significant that the parties exchanged several drafts of the LOI, which, as noted above in the discussion of *Worldwide Services*, has been found to support the existence of a Type II agreement, and that the parties agreed to extend the 45-day period speaks strongly against Iberdrola's argument that the LOI was meant simply to memorialize the state of the negotiations as of a certain date. While the court found that the two other Type II factors weighed against Gas Natural – the existence of open terms and whether it is customary to put such agreements in final form – the other three weighed in favor of Gas Natural, especially the good faith negotiation language, and found that a Type II agreement existed.

3. *Meaning of Good Faith and Bad Faith in Case Law*

Having established that the LOI was a Type II agreement obligating Iberdrola to negotiate in good faith, Judge Abrams considered whether the good faith obligation was breached – and found that it was not. In her analysis she surveyed the New York cases to try and determine what constitutes good faith and bad faith in the context of negotiations, beginning with an observation made by another Southern District judge in a case from 2013 that the parameters of what constitutes good faith or bad faith are not clearly delineated.[39] However there are some guideposts in the cases.

---

[37] 33 F. Supp 3d at 378.

[38] Citation from Iberdrola's reply brief, 33 F.Supp. 3d at 379 (emphasis added).

[39] *L-7 Designs, Inc. v Old Navy, LLC*, 964 F.Supp. 2d 299, 307 (S.D.N.Y. 2013).

First, "at the very least, good faith requires honesty in fact."[40] Each party must provide an "honest articulation of interests, positions, or understandings."[41]

Second, "self-interest is not bad faith."[42] In a case which considered whether a publisher made good faith attempts to promote a book—the Second Circuit explained that, to show bad faith, plaintiff would need to demonstrate that defendants' acts were "undertaken for reasons other than a good faith business judgment."[43] Acting in one's financial self-interest, "for example, in response to market changes, does not constitute bad faith."[44]

Third, "bad faith requires some 'deliberate misconduct'—arbitrary or capricious action taken out of spite or ill will or to back out of an otherwise binding contractual commitment."[45] A party acts in bad faith if it "renounce[es] the deal, abandon[s] the negotiations, or insist [s] on conditions that do not conform to the preliminary agreement.".[46] "Thus, 'trying to scuttle the deal' or to take advantage of expenditures made by the other side to advance the project may constitute bad faith, depending on the circumstances."[47] Courts in the Southern District find bad faith when a party attempts to alter the terms on which the parties have already reached agreement. There are examples of this for instance when one party imposes a new condition or insists upon a lowered interest rate.[48]

---

[40] *L-7 Designs, Inc. v. Old Navy, LLC,* 964 F.Supp.2d 299, 307 (S.D.N.Y.2013)("L-7 Designs I").

[41] Citing *Penguin Grp. (USA) Inc. v. Steinbeck,* 06CV2438(GBD), 2009 WL 857466, at *2 (S.D.N.Y. Mar. 31, 2009).

[42] Citing *L–7 Designs I,* 964 F.Supp.2d at 307.

[43] Citing *Zilg v. Prentice–Hall, Inc.,* 717 F.2d 671, 681 (2d Cir.1983).

[44] *L–7 Designs I,* 964 F.Supp.2d at 307 citing Judge Posner's decision in *Venture Associates Corp. v. Zenith Data Systems Corp.,* 96 F.3d 275, 279 (7th Cir.1996).

[45] *Id.* at 308.

[46] *L–7 Designs II,* 647 F.3d at 430.

[47] *L–7 Designs I,* 964 F.Supp.2d at 308; *see, e.g., Network Enterprises, Inc. v. APBA Offshore Prods., Inc.,* 427 F.Supp.2d 463, 486 (S.D.N.Y.2006) *aff'd,* 264 Fed.Appx. 36 (2d Cir.2008) (concluding that a party acted in bad faith by refusing to provide information in one discussion so as to gain leverage in a different, but related, negotiation).

[48] *See, e.g., EQT Infrastructure Ltd. v. Smith,* 861 F.Supp.2d 220, 231 (S.D.N.Y.2012) ("As I have found it plausible that the LOI was a Type II agreement, the obligation to negotiate in good faith did not expire on September 8, 2010, and thus the imposition of a new condition in October could violate that obligation."); *Teachers Ins. & Annuity Ass'n*

And in a blindingly obvious conclusion to the analysis, Judge Abrams finished her survey of what good faith means under New York law with quotes to cases reaffirming the principle that determinations are questions of fact that depend on the particular circumstances of the case.[49]

Turning to the particular facts of *Gas Natural*, Judge Abrams examined whether Iberdrola's discussions with another party and ultimate decision to sell New Hampshire gas to that party was a breach of its duty of good faith to Gas Natural. She found that it was not. She was not willing to read an exclusivity clause into the LOI when one was not included, despite Gas Natural's repeated requests. She surveyed some cases to the effect that it is perhaps plausible, in some instances, that the duty of good faith might preclude a seller from soliciting offers from, or otherwise negotiating with, third parties,[50] but she could not get past the fact that the parties specifically contemplated and rejected an exclusivity clause. She found that construing the duty of good faith so as to require exclusivity would be a "back door" means of re-inserting a clause that the parties rejected.

She did consider whether the duty of good faith obligated Iberdrola to disclose that they had received competing offers—or at least correct Gas Natural's alleged misunderstanding that it was the only interested party—presented a closer question. Good faith, to be sure, "requires honesty in fact.[51]" At the same time, however, in order to

---

of Am. v. Ormesa Geothermal, 791 F.Supp. 401, 415 (S.D.N.Y.1991) ("By, among other things, insisting upon a lowered interest rate, [defendant] attempted to change and undercut terms that had been agreed to in the Commitment letter.").

[49] Finally, "whether particular conduct violates or is consistent with the duty of good faith and fair dealing necessarily depends upon the facts of the particular case, and is ordinarily a question of fact to be determined by the jury or other finder of fact." *Tractebel Energy Mktg., Inc. v. AEP Power Mktg., Inc.,* 487 F.3d 89, 98 (2d Cir.2007). What "good faith" requires varies on a case-by-case basis: "the boundaries set by the duty of good faith are generally defined by the parties' intent and reasonable expectations in entering the contract." *Cross & Cross Properties. Ltd. v. Everett Allied Co.,* 886 F.2d 497, 502 (2d Cir.1989); *accord L–7 II,* 964 F.Supp.2d at 307.

[50] Citing *Venture Associates,* 96 F.3d at 277 (noting that "the concept of good faith" might "entail" an "obligation not to entertain other offers"); *Bear Stearns Inv. Products, Inc. v. Hitachi Auto. Products (USA), Inc.,* 401 B.R. 598, 628 (S.D.N.Y.2009) ("The question for trial is therefore, whether Hitachi breached its obligation of good faith by secretly re-marketing the Delphi Claims and selling them to Deutsche Bank while it was still engaged in talks with Bear Stearns.").

[51] Citing *L–7 Designs I,* 964 F.Supp.2d at 307.

show a breach of the duty of good faith, Plaintiff must plausibly allege "some 'deliberate misconduct'—arbitrary or capricious action taken out of spite or ill will or to back out of an otherwise binding contractual commitment."[52] If Gas Natural had alleged that Iberdrola affirmatively misrepresented their intent to seek other bids or the presence of interested third parties, then the outcome of the case might be different. In the case, though, Gas Natural alleged only that (1) Iberdrola "did not object" to the statement in a May 13, 2013 email from Gas Natural's representative that "I know we all understand most likely there isn't someone else out there ..."; (2) that despite repeated statements by Gas Natural that it understood itself to be the "only potential buyer interested in New Hampshire Gas," Iberdrola never "suggest[ed] that Iberdrola was seeking other potential buyers, let alone that they had received an alternative offer for the acquisition of New Hampshire Gas"; and (3) that Iberdrola "deceitfully led Gas Natural to believe there had been no third-party interest in the purchase of New Hampshire Gas".

She found that by attempting to construe the duty of good faith so broadly—to require affirmative disclosure of the existence of interested third parties—Gas Natural sought to impose an obligation that Iberdrola never accepted. If Gas Natural—a sophisticated entity involved in a multimillion dollar acquisition—was so concerned about losing out to a third party, it could have (1) required Iberdrola to state in writing that they had not received other offers; (2) insisted on a right of first refusal; or (3) refused to sign the LOI absent an exclusivity clause.

While Judge Abrams found on the particular facts of the *Gas Natural v Iberdrola* case that it was not bad faith to accept a competing offer from a third party, Judge Ramos reached a different conclusion in the *Worldwide Services v Bombardier* case discussed above. In that case the plaintiff claimed that adding a new condition in early 2014 that the new President of Bombardier sign off on the deal was bad faith, as well as negotiating with and selling to a third party. Judge Ramos recited that ordinarily it is up to the finder of fact to determine whether the duty of good faith is breached and cited other cases where federal courts in New York had found bad faith when a party attempted to alter the terms on which the parties had already reached agreement or stated that the duty of good faith might

[52] *Id.* at 308.

preclude a seller of a business from soliciting offers from or negotiating with third parties.[53] On the facts of the *Bombardier* case, Judge Ramos did find that the plaintiff had adequately alleged that Bombardier breached its duty of good faith by its actions.

4. Post-Exclusivity Period Good Faith Obligations?

An interesting question arises as to whether an obligation to negotiate in good faith could continue after the exclusivity period in a letter of intent expires. It could easily be argued that once a binding exclusivity period expires, the seller of the business could deal with whomever he or she pleased. Until fairly recently no New York Court had squarely addressed the question, however. Judge Seibel of the Southern District did finally consider the issue directly in 2012 in *EQT Infrastructure Ltd. v. Smith*[54] and found that the obligation to negotiate in good faith could in fact extend beyond the exclusivity period. That case involved an offer in November 2009 by an infrastructure fund (EQT), which was incorporated in Guernsey, Channel Islands, to buy certain stevedoring and storage businesses owned by the defendant at the port of New Haven, Connecticut. The same owner also operated a marine services businesses but it was always clear that EQT could not buy the marine services business due to the operation of the Jones Act, a restrictive federal statute that prohibits foreign owners from engaging in "coastwide trade" within in the U.S.[55]

Negotiations followed over a period of months on the price until a letter of intent was signed in early August 2010 which described the "possible transaction" as EQT's purchase of the "Stevedoring and Bulk Storage" businesses, "but excluding the Marine Services operations," for $110 million. The letter of intent included the standard language that the possible transaction was "subject to the satisfaction of conditions customary of a buyer in transactions of this type including ... execution of a definitive purchase agreement (the 'Definitive Agreement') and related agreements ... reflecting the

---

[53] *Gas Natural*, 33 F.Supp. 3d at 383.

[54] 861 F. Supp. 2d 220 (S.D.N.Y. 2012).

[55] The Merchant Marine Act of 1920, 46 U.S.C. § 55102. As cited by the Court, this law provides that "a vessel may not provide any part of the transportation of merchandise by water, or by land and water, between points in the United States to which the coastwise laws apply, either directly or via a foreign port, unless the vessel is wholly owned by citizens of the United States for purposes of engaging in the coastwise trade."

terms of the Possible Transaction reasonably satisfactory in form and substance to the parties." It also had a paragraph to the effect that the letter did not create any binding obligation, "to enter into the Definitive Agreement or to effect the Possible Transaction," nor "any other binding obligation", except as set forth in certain paragraphs, one of which was a binding exclusivity period of slightly over a month (until early September 2010) during which the seller undertook to "work with [EQT] in good faith and on an exclusive basis with respect to a Possible Transaction," and would not "solicit, initiate, encourage or facilitate the submission of inquiries, proposals or offers" from any other entity. The parties also acknowledged that EQT would "expend considerable time, effort, and expense in connection with the Possible Transaction." The LOI does not state that the Possible Transaction was conditioned on the sale of the Marine Business to a buyer other than EQT, a point which came to be disputed between the parties.

As is typical, after the parties executed the letter of intent, EQT conducted due diligence, began drafting the purchase and sale agreement and worked with the Seller to prepare requests for government approvals. It also hired lawyers, accountants, and other consultants in connection with its due diligence, spending, according to EQT, over $1.5 million.

On October 19, 2010, about six weeks after the exclusivity period expired, the Seller's legal counsel sent a letter to EQT to the effect that the Sellers would not sell the Businesses for $110 million because they had sought alternative buyers for the marine fleet "but to no avail," which meant that the owner of the Marine Business had to continue to run it for an extended period of time. In order to make the deal with EQT for the Businesses economically viable for the owner, the Sellers requested an increase of the purchase price from $110 to $125 million. In addition, EQT claimed, prior to the October 19th Letter, the Sellers had never said that the purchase price of $110 million was contingent on the owners ability to sell the Marine Business, but, Sellers knew all along during their negotiations with EQT "that they would not sell the stevedoring and bulk storage operations for $110 million unless [the Owner] could sell the marine services business," (*Id.* ¶ 37).

On January 21, 2011, EQT sued the Sellers alleging fraud and breach of contract based on the obligation to negotiate in good faith. The Sellers moved to dismiss the action.

Since it was a federal court, Judge Seibel went through the Type I/Type II analysis. Both parties agreed it was not a Type I letter of intent. After analyzing the various factors, she found that it was a Type II letter of intent creating a binding obligation to negotiate in good faith. Judge Seibel then addressed the Sellers' argument that by the time the Sellers sent the October 19th Letter, the Exclusivity Period had expired, and thus the Sellers were free to decline to sell the Businesses to Plaintiff for $110 million. She found that the October 19th letter plausibly suggested that at least as of that date, the Sellers had conditioned the sale of the Businesses to EQT for $110 million on the sale of the Marine Business to another buyer. She then held:

> As I have found it plausible that the LOI was a Type II agreement, the obligation to negotiate in good faith did not expire on September 8, 2010, and thus the imposition of a new condition in October could violate that obligation.

She also found that even if Sellers' good faith obligation had expired on September 8, 2010 that EQT plausibly alleged that they breached their obligation before then since they seem to have known all along, but did not tell EQT, that they would not sell the stevedoring and storage businesses with being able to sell the Marine Services Business to someone else. In sum, the Judge dismissed the Sellers' motion to dismiss, making them potentially liable for EQT's reliance damages.

D. Policy Behind Law of Preliminary Agreements

What sense are we to make of the law in New York on preliminary agreements. Is there a method to the madness?

It bears repeating that all of the cases cited in the above discussion of Type I and Type II preliminary agreements are federal cases. It is still the case that if a dispute is heard in a New York State court, those courts will not apply the federal Type I and Type II scheme.[56] The practice in New York State courts is not to assess whether an obligation to negotiate in good faith was created by the context of the negotiations, as the federal courts do, but to ask the question whether the agreement contemplated the negotiation of later agreements and if the consummation of those agreements was a precondition to a party's

---

[56] See e.g. *Northern Stamping, Inc. v. Monomoy Capital Partners, L.P.*, 129 A.D.3d 448; 2015 N.Y. App. Div. LEXIS 4662; 2015 NY Slip Op 04742; 11 N.Y.S.3d 20 (1st Dept. 2015).

performance.[57] Under the New York State court precedents, it clearly is much more difficult to prove that a party is damaged by not complying with a letter of intent or an MOU, especially if the document has a statement that the terms set out are subject to the execution and delivery of definitive agreements.

When determining whether either type of binding preliminary agreement exists, courts and arbitrators have to be mindful of the need to balance two competing policy concerns: "avoid trapping parties in surprise contractual obligations that they never intended" while also enforcing and preserving agreements that were intended to be binding, even despite a need for further documentation or further negotiation. Otherwise, as Judge Leval explained in the original Type I/Type II case, "parties would be obliged to expend enormous sums negotiating every detail of final contract documentation before knowing whether they have an agreement, and if so, on what terms."[58]

E. Example of Arbitral Award Dealing with a Dispute Regarding a Letter of Intent for a Joint Venture

This case involved a dispute over a letter of intent dated January 25, 2008 to create a joint venture between two American entrepreneurs who had had previous success in the high-end leather baggage market and an Italian manufacturer of similar products who wished to penetrate the U.S. market.[59] The letter of intent, which was quite elaborate, followed the format of having both non-binding expressions of intent and binding agreements.[60] It began by expressing the intent of the parties to form a joint venture company for the promotion of the products bearing a brand of the Italian company. The Parties also expressed their "intention to negotiate in good faith definitive agreements", including a Joint Venture Agreement, a License Agreement and a Management Agreement

---

[57] Citing again the Court of Appeals in *IDT Corp. v. Tyco Grp.*, 918 N.E.2d 913, 13 N.Y.3d 209, 890 N.Y.S.2d 401 (2009).

[58] *Tribune,* 670 F. Supp. at 499.

[59] Arbitration between Charles Clifford, Lawrence Lein and Compass Partners International LLC v Finduck S.r.l. and Mandarina Duck S.p.A., ICDR Case No. 50 181 T 00094 09 (Award Jan. 28 2010), as filed in *Charles Clifford, Lawrence Lein and Compass Partners International LLC v Finduck S.r.l. and Mandarina Duck S.p.A.*, Petition to Confirm Arbitral Award, Supreme Court, N.Y. County, Index No. 652299/2010 (Dec. 17, 2010).

[60] Summary of facts derived from award as filed in petition to confirm.

(defined to be "Definitive Agreements") which were to "provide the terms and conditions expressed" in the rest of the LOI. There then ensued eleven paragraphs setting out "matters in principle" relating to topics such as ownership and management of the venture, trademark and distribution rights, definition of the territory, licensing of the brand, sourcing and other aspects relating to the contemplated operation of the venture. The LOI states that each paragraph under the "Matters in Principle" heading "is not intended to be binding on the Parties."

The LOI also had a section containing binding agreements, which were intended to "legally binding and enforceable against each of the Parties, whether or not the Parties sign the Definitive Agreements with respect to the Transaction." The three paragraphs relate to exclusivity, confidentiality and certain miscellaneous items including legal fees, governing law (New York) and resolution of disputes (arbitration under AAA rules in New York). The period in which the parties were to deal exclusively with one another with relation to the proposed venture was slightly more than one month.

Prior to the signing of the LOI, the American venturers had been making preparations for promoting the Italian brand in the U.S. These included extending offers to hire marketing personnel and other expenses consistent with a business plan the parties had signed off on in December 2007. Both parties expended considerable efforts to finalize the Definitive Agreements during the exclusivity period but were unable to. Nonetheless, certain steps to implement the venture continued to be taken. One was the transfer of certain inventory belonging to the Italian company to an entity controlled by the American venturers. Another was a lease entered into by that entity in March 2008 for showroom space in New York. The American parties' lawyers created a joint venture company. The parties continued to push to finalize the Definitive Agreements as the American venturers were in San Diego for an important trade show and hoping to announce the creation of the joint venture there. Some sort of announcement was made but it fell short of announcing that a full joint venture existed.

Activity continued where the American venturers placed an order for the Italian company's goods (meant to be sold by the joint venture) and took possession of and built out the leased space in New York. The American parties made a number of detailed suggestions about altering the Italian products so that they would in their view be more competitive in the U.S. market. These were not well-received

by the Italian venturers. The lead negotiator for the Italians wrote that he was personally enthusiastic about this new project but:

> [p]lease note that, even if we decided to start anyway for S. Diego Show, we (both your team and our) were not (and are still not) ready to work as we should and as we will. And we both knew it. So, even if we are working on all issues, please consider that it will take some time to be really on the right and common track.

Negotiations continued over the joint venture operating agreement with the American venturers believing that the changes were merely ministerial, which to them indicated that an agreement had been reached, and the Italian party considering that the changes were of greater substance. The Definitive Agreements were still unsigned when the main Italian negotiator informed the American venturers on May 7 that the Italian company had been sold to different investors and that it would take some time for the sale of the company to be approved by the Italian antitrust authorities. A period of uncertainty ensured with the Italian company invoicing the American venturers for the inventory that was purchased in their minds for the joint venture. A meeting with the new managing director of the Italian company was arranged in Bologna in early June 2008. At that meeting the American venturers presented a list of the expenses they had incurred so far on behalf of the venture, which included legal fees, the costs of two tradeshows, the NY showroom start-up costs, salaries for the new personnel and travel. Accounts of what was agreed at the meeting differed. The new owners of the Italian brand indicated that they were not comfortable with joint ventures with foreign companies but that would consider a licensing arrangement with the American venturers. The American venturers sent a detailed e-mail on June 11th outlining what they thought was agreed at the meeting to which a response was never received.

The sale of the Italian company closed at the end of June. The American venturers were anxious to proceed with the venture and sought feedback from the new Italian owners. On July 8th, one of the American venturers wrote to "confirm that we are continuing to sell in the USA and the balance of the Territory the [brand] merchandise that has already been delivered to us." He noted further that "we are also very actively marketing and intend to sell the merchandise that we have already ordered from China through you for Fall delivery." After noting that "we are delighted to be cooperating with your new

organization", he finishes by saying that "in all other respects, we assume that we both will continue to operate in accordance with the June 11th e-mail, including the start-up expense reimbursement". A representative of the Italian company responded on July 10th that it was "a pleasure to hear that you are going on with the pushing of the brand in USA." He noted that he had met with a senior executive the prior day and that they were going to finalize a draft proposal about how the parties could cooperate as soon as possible. No proposal was forthcoming. The Italians seemed to be thinking in terms of revisiting the issue in September.

At the end of July 2008, the American venturers approached the Italian company regarding a potential project where the Italian company would supply computer bags for Dell laptops. The Italian company agreed to assist the American venturers in making samples and sourcing the product in China. The parties negotiated and entered into a licensing agreement under which the American venturers would pay the Italian company a royalty. The American venturers continued to press for reimbursement of expenses, which they thought had been agreed at the Bologna meeting in June, but there was little communication in August. At the end of August, a private equity fund made a significant capital infusion in the parent of the Italian company, giving it a 49% interest.

No meeting took place in September but a representative of the Italian company did send an e-mail to the American venturers on September 19th suggesting that they were again thinking of a joint venture concept, saying he was meeting with their lawyer "to make a proper proposal to you towards JV in accordance with our new shareholder's policy," but that it would still require the shareholder's consideration. A new CEO took over at the Italian entity on October 6th and he first learned of the dealings with the American venturers on October 10th. He testified at the arbitration hearings that he had some issues with the LOI that had been signed and with the interaction to date with the American venturers, so he concluded that the Italian company should take a step back. While no joint venture proposal was forthcoming, the Italian company did send a detailed letter to the American venturers outlining how a distribution and licensing arrangement would work for the Dell products. As expressed in the letter, the Italian company's thinking appears to have shifted away again from a joint venture concept to wishing to deal with the terms of each project on a case-by-case basis.

> We have very much appreciated your intention to continue to distribute our products in the US. We hope our relationship with you will evolve to something different than it is now. Of course it needs time for this. It is however clear to you that today the framework is different: [Italian entity] has changed ownership and is now part of a group of companies with a market approach and a policy which is different from those [Italian entity] had … Nevertheless, we believe that it is in the interest of both parties that our business relationship continues. For these reasons, we intend to agree with you the specific terms and conditions of each single activity.

The letter then proposed some specific terms relating to the Dell arrangement, to which the American venturers agreed the next day. A few days later the new CEO of the Italian company sent a letter (by registered mail) outlining the corporate changes that had occurred at the Italian company and saying that its commercial goals had changed. It then turned to the proposed joint venture:

> While I appreciate your intention to continue to distribute our products in the US and have agreed with the terms and conditions relating to the Dell Project …, I regret to inform you that our holding company …has elected not to pursue, for the moment, the negotiation of a joint venture agreement aimed at strengthening [the brand's] presence in the US market with specific reference to our travel and business line… The management of the group is well aware that, in the past (up until the first of May 2008), there have been a series of negotiations between the former shareholders of the Company and yourself and that during this time, a set of agreements have been drafted, nevertheless, the decision adopted by the holding company is not to continue this negotiation process.

The American venturers were of course upset and tried to engage their Italian counterparts in a dialogue to preserve the venture. A phone call was arranged. Accounts differed as to the reasons offered, but both sides agreed during testimony that the Italian company made it clear it did not wish to continue negotiations. The tone of communications sharpened with the American venturers eventually threatening legal action. The Italian CEO responded:

> We are very sorry of your letter but we can neither understand your claims. At this regard we want to be very clear: first, the 'letter of intent' you refer to had been signed by the old ownership of [brand], and anyway it would be binding only until February 29, 2008 (i.e. it has been not valid for a long time); secondly, we never authorized any expense nor on our behalf, nor on yours, nor on anybody's.

The American venturers invoked the arbitration clause and made a claim. The case was administered by the ICDR and heard by a sole arbitrator. During the proceedings, counsel to the parties disagreed about whether the letter of intent was a "Type I" or "Type II" letter of intent. The arbitrator did not reach that issue since during closing arguments at the hearing the Italian entity's attorney conceded that it was a Type II preliminary agreement under New York law creating an obligation to negotiate in good faith. The question then became whether that duty was breached and what the damages should be.

The Italian entity argued that if the duty to negotiate in good faith did not end when the month-long exclusivity period expired, it certainly ended during the June 11th meeting in Bologna when a different framework (licensing) was proposed (and agreed to). The arbitrator found that it would be easier to accept that theory if the Italian entity had conducted itself in a more consistent way after the June 11 meeting. However, it communicated on several occasions after the meeting that a joint venture proposal was going to be made. Clearly an obligation to negotiate in good faith cannot continue *ad infinitum*, but it was not unreasonable to find that it still was in effect in October of that year.[61]

Were the terms of the Italian CEO's letter a breach of that duty to negotiate in good faith? The arbitrator found that it was a close question on the facts as understood within the confines of the New York case law on the subject under which there are legitimate reasons for ceasing the negotiations, such as failing to agree in good faith on terms, and others that cross the line, such as simply abandoning the deal. The arbitrator considered the decision in *Tribune*, which contained the guidance that the obligation to negotiate in good faith

---

[61] The arbitrator noted that there was no case law in New York on the specific point of whether a duty to negotiate in good faith could continue beyond the expiration of the exclusivity period. This was before the decision in *EQT Infrastructure Ltd. v Smith*, 861 F. Supp. 2d 220 (S.D.N.Y. 2012), citied above, where a Southern District court judge found it could.

"bar[s] a party from renouncing the deal [or] abandoning the negotiations …"[62] and found that the Italian entity's actions amounted to a renunciation or abandonment of the negotiations within the meaning of *Tribune*. He found it of importance that no reasons of any substance were given in the letter. Had there been reasons stated, it might have made a difference in the analysis, as the reason for ceasing a negotiation has some importance in the analysis under New York law, as artificial a construct as that might seem. The new management was not acting maliciously or with deliberate bad faith - they were new to the company had their own priorities and were understandably unaware of the subtleties of the New York case law on pre-contractual obligations, which Judge Laval in the *Tribune* case noted was complex. Nonetheless, the arbitrator found that:

> Case law does plainly provide that when there is an obligation to negotiate a "Type II" pre-contractual commitment in good faith, a party's simply ceasing a negotiation because it no longer finds the opportunity appealing constitutes an abandonment, and thus a breach of the obligation to negotiate in good faith.

As to damages, the arbitrator cited the New York case law discussed above – *Goldstein Construction*[63] where the New York Court of Appeals did not allow lost profits as a remedy for breach of a duty to negotiate in good faith but foresaw the possibility of reliance damages if sufficiently pleaded and *Fairbrook Leasing*[64] when the Eighth Circuit stated that "[i]t is undisputed that reliance damages are recoverable under New York law" – to the effect that reliance damages could be obtained by the American venturers. Those reliance damages are generally understood as a claimant's expenses of preparation and of part performance, as well as those foreseeable expenses incurred in reliance upon the contract.[65] In short, the arbitrator awarded damages to the American venturers to cover certain of their reliance expenses (start-up costs, marketing and trade show expenses, operating losses, storage fees and some element for the American venturers' time) but not all of their expenses since he found that at times the American venturers were "out in front" of the

---

[62] 670 F.Supp. at 498.

[63] *Goodstein Construction Corp. v City of New York*, 80 N.Y. 2d 366 (1992) (known as *Goodstein II*).

[64] *Fairbrook Leasing, Inc. et al., v. Mesaba Aviation, Inc.*, 519 F.3d 421 (8th Cir. 2008).

[65] *Bausch & Lomb Inc. v. Bressler*, 977 F.2d 720, 729 (2nd Cir. 1992).

Italian entity in their expectations and that certain specific costs were not really foreseeable in reliance on the LOI.

III. PURCHASE PRICE AND WORKING CAPITAL ADJUSTMENTS

Typically, parties to acquisition agreements agree on a price for the acquired entity or assets based on assumptions as to certain financial metrics of the acquired company (cash, EBITDA, net worth, or value of assets, for instance) or the amount working capital in the business at closing (probably the most common metric). However, it is usually not possible to determine any of these items with precision on the day of closing. The amounts have to be determined later and there is a purchase price adjustment following closing based on the amounts determined. Sometimes it is dollar-for-dollar for amounts above or below a defined threshold or sometimes the purchase price adjusts by defined sums if certain thresholds are reached.

Purchase price and working capital adjustments are areas that are ripe for dispute and it is the practice to provide for some mechanism to resolve any disagreement that may arise. The normal process is that the buyer first proposes a purchase price adjustment and submits it to the seller. The seller has some period of time to review the proposal and make comments. Then there is a period of time where the parties seek to agree. If the parties don't agree during this period of time, there are basically three choices to settle the dispute: (1) appoint an expert or accountant to make the determination; (2) have the dispute settled under the agreement's general dispute resolution choice, be it arbitration or court jurisdiction; or (3) have a special arbitration procedure for purposes of the adjustments. Different consequences attach to the choice of mechanism. This is of quite some interest to arbitration practitioners since the choice may or may not be considered an agreement to arbitrate and there are many cases decided under New York law that deal with the distinctions between different types of dispute resolution mechanisms.

A. Expert Determination vs. Arbitral Award

One commentary has suggested that New York courts tend to evaluate the scope of the authority given to the decision maker. In an expert determination proceeding, the authority granted to the expert is limited to deciding a specific factual dispute, normally concerning a

matter within the specific expertise of the decision maker. In contrast, arbitrators determine liability and act quasi judicially.[66]

An opinion from 2014 from Judge Koeltl of the Southern District is illustrative of this analysis. In *Seed Holdings, Inc. v Jiffy International AS et al.*,[67]the buyers entered into an asset purchase agreement in April 2012 to acquire from Jiffy International and some affiliates all of the assets of a Canadian company and a U.S. company supplying flower and vegetable seed packets to those respective markets. The agreement was governed by New York law. The asset purchase agreement had a provision where the purchase price was determined according to a target working capital. Three days prior to closing it was up to the sellers to provide an estimate of working capital. If that was under $43 million, then the purchase price would be reduced by the amount under. After closing, it was up to the buyer to determine the actual working capital on closing and provide the number to the sellers within 30 days. The sellers then had a comment period. If they parties could not agree the dispute was to be submitted to the "binding determination of a third party accounting firm mutually selected by Buyers and Sellers." The independent accountant, as it was called, was to submit a written resolution of disputes within 15 days after being retained. The agreement stated that:

> The determination of such Independent Accountants to the Actual Closing Working Capital will be conclusive and binding upon all parties to this Agreement and their Affiliates.[68]

The sellers' determination of the estimated working capital prior to closing was $38.671 million. The buyer's determination of actual working capital at closing in June 2012 was $33.548, almost $5 million less. The parties could not agree and the matter was submitted to an accounting firm (Plante & Moran) in November 2012. Each of the parties made submissions to the accountant from the firm who handled the matter. The accountant then had a telephone conference to ask questions of the parties. Attorneys were present but not allowed to participate. The independent accountants issued a draft report in March 2013 where they determined that the sellers owed the buyers $4.2 million due to the lower actual working capital. The

---

[66] Practical Law, *Purchase Price Adjustment Determinations in the U.S.*

[67] 5 F. Supp.3d, 2014 U.S. Dist. LEXIS 38565.

[68] 5 F.Supp.3d at 570.

independent accountants then held another conference to hear the objections of the parties. After that they issued their final report with the amount unchanged. Shortly afterwards, the sellers commenced an action in New York State Supreme Court to have the independent accountants' determination vacated under an article of the CPLR relating to the enforcement of expert determinations, which authorizes a special proceeding to be commenced in New York State courts to "specifically enforce an agreement that a question of valuation, appraisal or controversy be determined by a person named or to be selected."[69] On the same day, the buyers commenced an action in the Southern District to have the accountants' determination enforced as an arbitral award under the Federal Arbitration Act. Thus the question of whether the accountants' decision was an expert determination or an arbitral award had to be explicitly decided if the Southern District were to retain jurisdiction on the basis of a federal question being presented.

Judge Koeltl went through the analysis. The key factor is not what the parties call the process or the decision that is rendered, or whether they use the word "arbitration" or not, but whether they have agreed to submit a dispute that has arisen between them for a final and binding determination.[70] He cited with approval decisions of the Eastern District and the Second Circuit to the effect that no "magic words" such as "arbitrate" are needed to obtain the benefit of the Federal Arbitration Act[71] and that it is irrelevant that the contract language in questions does not use the word "arbitration" as such.[72] Using these standards, the expert determination procedure in the dispute between Seed Holdings and Jiffy International, which called for the determination of the independent accountants to be conclusive and binding on the parties, amounted to arbitration for purposes of the Federal Arbitration Act.

The upshot of this distinction between expert determination is that some jurisdictions (including New York) allow an expert determination to be reviewed by courts and be subject to revision while arbitral awards are given greater deference and generally not

---

[69] N.Y. C.P.L.R. §7601.

[70] 5 F.Supp.3d at 577.

[71] *AMF Inc. v. Brunswick Corp.*, 621 F.Supp. 456, 460 (E.D.N.Y. 1985).

[72] *McDonnell Douglas Fin. Corp. v. Pa. Power & Light Co.*, 858 F.2d 825, 830 (2d Cir. 1988).

upset. Thus, the choice for counsel to parties negotiating an acquisition agreement is whether to make it clear that the purchase price or working capital adjustment mechanism is merely an expert determination if they want to leave open the possibility of challenging the expert determination, or an agreement to arbitrate, where the award ultimately issued is given considerable deference and rarely overturned.

Some other cases from the New York federal courts are illustrative of the distinction between expert determination and arbitral award. In the insurance context, the Second Circuit Court of Appeals, interpreting New York law, considered an appraisal of a clothing distributor's damages due to an accidental triggering of a sprinkler system in its warehouse and whether the amount of lost business and profits was under the limit of its primary insurance policy or whether the excess insurers also had to contribute.[73] After a lengthy proceeding, a three-person panel of appraisers determined that the damages were under the primary policy limit and that the excess insurers had no liability. The clothing distributor challenged the appraisal, saying that the panel of appraisers determined a question of coverage and acted as arbitrators, such that the distributor was denied due process rights. The Second Circuit disagreed, saying that the appraisers did not determine questions of coverage, only the amount of the loss, such that there was no denial of due process to the distributor.

Frydman v Cosmair, Inc., a decision of the Southern District, presents an interesting comparative law study of the distinction between an expert evaluation and an arbitral award. In that case, the Court considered a dispute among French parties relating to the valuation of shares upon the termination of a business relationship between two co-venturers.[74] The majority (75%) co-venturer was L'Oréal, which agreed to buy out the minority (25%) venturer's stake at a purchase price based on the value of the shares as determined by an individual appointed by the parties. The individual made a decision on the value of the shares based on a certain provision of the French civil code (Art. 1592). In other respects, he acted as an arbitrator in disputes between the parties on certain film rights. In

[73] *Amerex Group, Inc. v. Lexington Insurance Company*, 678 F.3d 193, 207 (2d Cir. 2012).

[74] No. 94 CIV. 3772 (LAP), 1995 WL 404841, at *6 (S.D.N.Y. July 6, 1995)).

April 1992, the Paris Court of Appeals cancelled the film rights award and in December 1992, the Paris *Tribunal de Grande Instance* invalidated the share valuation decision on grounds of fraud. The minority shareholders commenced an action in New York State Court on grounds of fraud and L'Oréal and other defendants moved to have the case removed to federal court. The Southern District's decision arises from the removal petition where the issue to be determined was whether the action was one relating to an arbitration falling under the New York Convention on the Recognition and Enforcement of Arbitral Awards. The minority shareholders argued that it was not an arbitration award. To make the determination, the Court looked to French law, which it found, based on expert testimony and opinions, also recognized a distinction between expert determinations and arbitral awards. It found that a price appraisal under Article 1592 of the French Civil Code merely supplies the price term for a contract of sale. If one party refused to comply with that term, it was a breach of contract, which would not amount to a failure to comply with a court judgment. Thus, the Court found that it was not presented with a petition to enforce an arbitral award and did not take jurisdiction.

B. Differing Law in Delaware and California

Interestingly, courts in some important U.S. jurisdictions other than New York do not really recognize the distinction between expert determination and arbitration. This is the case in Delaware, where courts assume that expert determination procedures are treated the same as any arbitration.[75] California's arbitration statute defines an arbitration agreement to include "agreement providing for valuations, appraisals and similar proceedings",[76] such that the Federal Arbitration Act's provisions on the enforcement of arbitral awards should apply to the expert determination.[77]

Thus practitioners drafting acquisition and merger agreements can take note that if their client wishes to retain the ability to challenge a purchase price or working capital adjustment, that possibility remains open if New York law governs the agreement in the event of

---

[75] Practical Law, *Purchase Price Adjustment Determinations in the U.S.*, citing *Vicom Int'l, Inc. v. Winshall*, 72 A.3d 78 (Del. 2013).

[76] Cal. Civ. Proc. Code, §1280(a).

[77] *Wasyl, Inc. v First Boston Corp.*, 813 F.2d 1579. 1582 (9th Cir. 1987), cited in Practical Law, *Purchase Price Adjustment Determinations in the U.S.*

"palpable error" or something similar, as the cases discussed below suggest, but that an expert determination will be treated as an arbitral award if Delaware or California law governs the agreement, thus effectively foreclosing the possibility of any challenge except for fraud and the other grounds allowed under the Federal Arbitration Act or relevant state statutes for setting aside an award.

C. Standard of Review of Expert Determinations

The following is a discussion of some of the key New York cases that establish the principle that an expert determination is subject to greater court scrutiny than arbitral awards. Different approaches are considered, with the New York courts generally being willing to call into question or revise an expert determination.

1. Palpable Error

The term "palpable error" turns up a lot in the case law. This standard appears to have been stated by the New York State Appellate Division in *Tufano Contr. Corp. v. Port of N.Y. Authority*,[78] an older case involving an engineer's determination – that the decision of the engineer is conclusive and final as a matter of law unless it was "infected" by "fraud, bad faith or palpable error".

2. Failure to Follow Accepted Procedures

In *European-Am. Banking Corp. v. Chock Full O'Nuts Corp*[79] the Appellate Division, First Department, cited with approval a practice commentary to the CPLR dealing with court review of appraisals to the effect that, at least where the appraisal is not conducted with the formalities of arbitration, the court is not as "hidebound" as it would be with an arbitration award, and may reject an appraisal if the court believes that the appraiser did not review the case with sufficient thoroughness. This gives the courts greater control over appraisals than arbitration awards.[80] In the *European-Am*. decision, the Court acknowledged the greater degree of judicial control over appraisal as

---

[78] 18 A.D.2d 1001, 238 N.Y.S.2d 607, *aff'd* 13 N.Y.2d 848, 242 N.Y.S.2d 489, 192 N.E.2d 270.

[79] *442 N.Y.S.2d 715, 718 (1st Dep't 1981)*).

[80] Prof. Joseph M. McLaughlin's Practice Commentaries to CPLR, C7601:1), 661-662, citing *Clark V Kraftco Corp.,* DCNY, 1971, 323 F.Supp. 358.

opposed to arbitral awards but nonetheless concluded that the appraisal before it, which involved the fair market rent of a property, should be respected.

In *Cities Serv. Co. v. Derby & Co.,*[81] the Southern District, in a case involving petroleum quality inspections, stated the general principle that the determination of an independent inspector is conclusive and binding on the parties in the absence of fraud, bad faith or gross error. However, that case involved a claim by one party that the expert inspector did not follow proper procedures. The Court cited previous cases to the effect that if there appears to be no reasonable basis for the [engineer's] action or if it is "patently erroneous", then the courts have found the equivalent of bad faith and the contractor is not bound by the [engineer's] decision.[82] The Court also noted that fraud, bad faith or gross error on the part of an independent inspector has been inferred (1) where customary practice or procedure is not followed when making a determination or certification and (2) where the results of the determination of certification deviate significantly from the normal or reasonably expected results.[83] In the *Cities Serv. Co.* decision itself, the Court found that the independent third party did not follow the standards or procedure prescribed in the contract and that such failure will invalidate any certification or determination so made "*even if the contract makes such certification or determination conclusive and binding.*" One can read this decision for the proposition that there are many tools courts can use to overturn expert determinations should they be minded to do so.

3. Cases Where Expert Determinations on Post-Closing Adjustments were Upheld

As New York Courts are regularly called upon to hear disputes of purchase price or working capital adjustments, some recent decisions where expert determinations were upheld are summarized below.

In *Kumiva Group, LLC v. Garda USA Inc*., a case from 2015,[84] the parties entered into a plan of merger agreement which provided for a portion of the $341 million purchase price to be held in escrow for a

---

[81] 654 F. Supp. 492 (S.D.N.Y. 1987)*)*.

[82] Citing *Savin Brothers, Inc. v State of New York*, 62 A.D.2d 511, 405 N.Y.S.2d 516 (4th Dept. 1978), *aff'd*, 47 N.Y.2d 934, 393 N.E.2d 1041.

[83] Citations omitted.

[84] 2015 N.Y. Misc LEXIS 2721, (N.Y. Sup. Ct. July 24, 2015).

potential closing price adjustment based on the acquired entities' net working capital. The merger agreement detailed the minimum net working capital requirement ($35 million) which needed to be maintained before the escrow amount would be released to the acquired entity. A dispute arose regarding the exact amount of the new entity's net working capital upon closing, and, pursuant to the agreement, a determination was rendered by Deloitte's accounting division. Despite the expert determination decision, the acquiring company refused to pay out the purchase price that remained in escrow. The court enforced Deloitte's expert determination based on the parties' clear intention that issues of fact relating to net working capital would be handled by an expert determination, and that no allegations of fraud, bath faith or palpable error were raised.

Similarly, in *Pavonix, Inc. v Vista Equity Partners, LLC*,[85] a seller agreed to sell its software company to a buyer for $48 million, subject to post-purchase adjustments based on the net working capital of the software company. In the event that a dispute relating to net working capital arose, the parties agreed to submit their dispute "by an independent team of auditors of KPMG LLC." When the seller refused to submit the net working capital dispute to KPMG, the court determined that the seller was in breach of the Agreement and allowed for a subsequent factual determination by KPMG to control. Again, here there were no allegations of fraud, bad faith or palpable error, and the court enforced the parties' clear intent to submit questions of fact relating to net working capital to expert determination.

D. Standard of Review of Arbitral Awards

If a procedure to determine a working capital or purchase price adjustment is drafted or found to be an agreement to arbitrate, the grounds on which arbitral awards might be overturned come into play. A detailed review of those grounds under New York law, which are the subject of extensive commentary elsewhere, would be well beyond the scope of this article. The following is meant as a short summary of some of the main theories under as a means to illustrate how difficult it is for a party unhappy with an arbitral award to succeed in any court action to have it vacated and thus the contrast between that body of law and the grounds on which an expert determination might be invalidated by a New York court.

[85] 2013 N.Y. Misc. LEXIS 3866, (N.Y. Sup. Ct. Aug. 21, 2013).

The starting point for any discussion on this subject concerning awards issued in the United States is the Federal Arbitration Act, which list four main grounds under which an arbitral award could be overturned at the application of a party.[86]

Fraud or Corruption – Where the award was procured by fraud corruption, fraud or undue means.[87]

Evident Partiality – Where there was evident partiality or corruption in the arbitrators, or one of them.[88]

Arbitrator Misconduct - Where the arbitrators were guilty of misconduct in refusing to postpone the hearing (upon sufficient cause shown) or in refusing to hear evidence pertinent and material to the controversy; or of any other misbehavior by which the right of any party have been prejudiced.[89]

Excess of Powers – Where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final and definite award upon the subject matter submitted was not made.[90]

These are the main statutory grounds under the Federal Arbitration Act. There is some disagreement between certain of the federal circuits as to whether manifest disregard of the law is a fifth, non-statutory grounds for vacating an arbitral award or whether manifest disregard really falls under the "excess of powers" grounds.[91] In all

---

[86] The grounds under which a foreign arbitral award could be overturned in the United States are set out in Article V of the New York Convention. While similar to the Federal Arbitration Act's grounds, there are some differences that will not be discussed here.

[87] 9 U.S.C. § 10(a)(1).

[88] 9 U.S.C. § 10(a)(2).

[89] 9 U.S.C. § 10(a)(3). Courts have interpreted section 10(a)(3) to mean that except where fundamental fairness is violated, arbitration determinations will not be opened up to evidentiary review." *Tempo Shain Corp. v Bertek, Inc.*, 120 F.3d 16, 20 (2d Cir. 1997). Arbitrators must give each of the parties to the dispute an adequate opportunity to present its evidence and argument, but they are not required to hear all the evidence proffered by a party. Although arbitrators must have before them enough evidence to make an informed decision, they need not compromise the speed and efficiency that are the goals of arbitration by allowing the parties to present every piece of relevant evidence. *Areca, Inc. v Oppenheimer & Co., Inc.*, 960 F.Supp. 52, 55 (S.D.N.Y. 1997).

[90] 9 U.S.C. § 10(a)(4). This includes when the award deals with a difference not contemplated by or not falling within the terms of the submission to arbitration or contains decisions or matters beyond the scope of the submission to arbitration.

[91] At least the Fifth and Eleventh Circuits seem to think that the statutory grounds listed in the Federal Arbitration Act are the exclusive means of vacatur and that the manifest disregard of the law standard is not an independent ground for vacating arbitral awards.

events, the manifest disregard standard has been articulated as coming into play when the arbitrators are "fully aware of the existence of a clearly defined governing legal principle, but refuse to apply it, in effect, ignoring it."[92] As described by the Second Circuit, the manifest disregard standard is "severely limited, highly deferential, and confined to those exceedingly rare instances of egregious impropriety on the part of the arbitrators.[93] To satisfy the manifest disregard of law standard, a party objecting to an arbitration decision must establish that the law that was allegedly ignored was clear, that the law was in fact improperly applied, leading to an erroneous outcome, and that the arbitrator knew of the law and intentionally disregarded it.[94] Concerning contract interpretation, this standard essentially bars review of whether an arbitrator misconstrued a contract.

Finally, for disputes where all parties are from New York State and there is no jurisdiction to appear before the federal courts, there are separately articulated standards under New York's CPLR, which are found in Article 7511, although they are virtually identical to the standards in the Federal Arbitration Act. The New York standards for vacatur are: (1) corruption, fraud or misconduct in procuring the award, (2) the partiality of an arbitrator appointed as a neutral or (3) where an arbitrator, agency or person making the award exceeded his power or so imperfectly executed it that a final and definitive award upon the subject matter submitted was not made. There is a fourth standard which is a failure to follow the due process standards in the CPLR on arbitration.

As has been emphasized by many commentators, it is exceedingly difficult for an aggrieved party to overturn an arbitral award.[95] There

Frazier v Citifinancial, LLC, 6-4 F.3d 1313, 1323 (11th Cir. 2010), quoting *Citigroup Global Mkss. V Bacon*, 562 F.3d 349. 350 (5th Cir. 2009). The Second Circuit has stated that the manafest disregard standard is merely a "judicial gloss on the specific ground for vacatur enumerated in Section 10 of the FAA." *Stolt-Nielsen SA v. AnimalFeeds Int'l Corp.* 548 F.3d 85 (2d Cir. 2008)(citation omitted), rev'd on other grounds 559 U.S. 662, 130 S.Ct. 1758, 176 L.Ed. 2d 605 (2010) ("*Stolt-Nielsen*").

[92] *Stolt-Nielsen*, 548 F.3d 85, 96.

[93] *Stolt-Nielsen*, F48 F.3d at 95; See also *Schwartz v. Merrill Lynch & Co.*, 665 F.3d 444, 45152 (2d Cir. 2011)(confirming the continued validity of the "manifest disregard" standard).

[94] *T. Co Metals, LLC v Dempsey Pipe & Supply, Inc.*, 592 F.3d 329, 339 (2d Cir 2010).

[95] See e.g. for a few recent examples, Mitchell C. Shapiro, *Courts Drastically Limit Review of Arbitration Awards*, New York Law Journal (Oct. 19, 2015), Chad Cron and K. Stefan Chin, *Advising Clients of Arbitration Awards and Vacatur of an* Award, ABA

is a strong federal and New York State policy favoring arbitration and considerable skepticism on the part of courts when a party that agrees to have disputes resolved by arbitration then tries to upset the result when it is unhappy with it. As Judge Paterson of the Southern District put it in a dispute between Yahoo and Microsoft over the outcome of an emergency arbitrator proceeding (discussed in the last section of this article), "If the parties agreed to submit an issue for arbitration, we will uphold a challenged award as long as the arbitrator offers a barely colorable justification for the outcome reached."[96] The point as regards the use of arbitration in M&A and in particular with respect to post-closing purchase price or working capital adjustments is that there is some chance that a party who is unhappy with a post-closing adjustment characterized as an expert determination could have it invalidated by a court but a much lesser one if the post-closing procedure is called arbitration or the clause has characteristics that will cause the courts to characterize it as arbitration.

Example of Arbitral Award and Court Enforcement Procedure dealing in the Context of an Acquisition with the Difference between Expert Determination and Arbitral Award - ***Edgewater Growth Capital Partners L.P., et al v Greenstar North America Holdings, Inc.***

One dispute decided under New York law, which includes an award rendered by a panel and a court action to enforce it, highlights precisely the dichotomy between expert determinations and agreements to arbitrate, and the consequences that result.[97] The dispute arose out of a purchase by an entity known as Greenstar North American Holdings of a recycling business (Recycled Holdings Corporation) from its owner, Edgewater Growth Capital Partners. The parties entered into a Purchase and Sale Agreement for the

---

Section of Litigation – Construction Litigation (http://apps.americanbar.org/litigation/committees/construction/articles/spring2014-0514-advising-clients.html), Claudia Salomon and Samuel de Villiers, *The United States Federal Arbitration Act: A Powerful Tool for Enforcing Arbitration Agreements and Arbitral Awards*, LexisPSL Arbitration (Apr. 17, 2014).

[96] *Yahoo! Inc., v Microsoft Corporation*, 13 CV 7237 (Part I), Opinion & Order, Paterson, Robert P, S.D.N.Y. (Oct. 21, 2013).

[97] Decision on arbitral award enforcement action reported at *Edgewater Growth Capital Partners L.P., et al v Greenstar North America Holdings, Inc.*, 44 Misc. 3d 1215(a); 997 N.Y.S.2d 688, 2013 N.Y. Misc. LEXIS 6593; 2013 NY Slip Op 52327 (N.Y. Sup. Ct. 2013)("Confirmation Order").

acquisition of the capital stock, which closed on October 3, 2007. The purchase price was $127 million, $14 million of which was held back in escrow to cover various contingencies. The buyer considered that an agreement the target company was negotiating with a Chinese entity known as Wing Fat Printing Co. to become Wing Fat's exclusive U.S. supplier of a type of paper product was important to the business and the valuation the buyer had given. The parties had expected the Wing Fat supply agreement to be final by the time of the acquisition, but the most that the target had obtained was a letter of intent with Wing Fat and a relevant Chinese license still was lacking. As a result, the parties drafted the PSA to provide for certain contingencies, basically that if the Wing Fat agreement was not obtained in 180 days on terms at least as favorable as those set forth in the letter of intent then the buyer would be damaged. The holdback associated with the Wing Fat agreement was $5 million and the parties agreed that the amount could be greater, but that the damages would be capped at $7.5 million.[98] There was also a specific provision to the effect that the buyer would be harmed as well if the license was secured and the Wing Fat contract was entered into between 180 days and one year after closing. In those circumstances, the buyer would be entitled to recover damages up to the damage cap, as determined in accordance with a specific dispute resolution provision. The disputes provision began by saying that if the Wing Fat contract closed before the one-year anniversary of closing but the buyer "believes that it is entitled to retain all or a portion of the holdback amount", the buyer had to give seller notice and the seller had a chance to object. If the parties could not resolve their differences through good faith negotiations within 30 days after the notice, then they …

> "*shall* submit the dispute to a nationally recognized accounting firm... whose determination of the China Damage Claim shall be made in accordance with this *Section 2.6* and shall be final and binding (the *'China Damage Arbitrator'*) If [the parties] are unable to agree on a China Damage Arbitrator, each will select a nationally recognized accounting firm, who will then select a third nationally recognized accounting firm to serve as 'China

[98] Recitation of facts taken from *Edgewater Growth Capital Partners L.P., et al v Greenstar North America Holdings, Inc.*, 2009 WL 9980307 (N.Y. Sup), 2009 N.Y. Slip Op. 33341(U)(Trial Order), Supreme Court, New York County (Apr. 26, 2009) (the "Trial Order).

> Damage Arbitrator' hereunder. In submitting a dispute to the China Damage Arbitrator..., each party shall prepare a detailed statement in support of their respective calculation of the China Damage Claim. The China Damage Arbitrator shall be required to accept any determinations for which there is agreement between [the parties], and will only decide upon matters *on which there is a substantive dispute.* The party whose calculation of the China Damage Claim is mathematically furthest from that of the Final China Damage Claim (as defined below) shall pay the fees and expenses of the China Damage Arbitrator. The value of the China Damage Claim determined by the China Damage Arbitrator will be binding on the parties, and shall be referred to as the "*Final China Damage Claim.*"[99]

While the exact circumstances of the execution of the Wing Fat supply agreement were disputed, basically it occurred in April 2008, i.e. in the period between 180 days and one year after closing, albeit with an effective date as of February 1st. The buyer claimed that the effective date of February was illusory and that it was not in any case on substantially the same terms as the letter of intent and gave notice to the seller that it was harmed and entitled to damages, to be paid at least in part from the $5 million escrow holdback. It initially claimed over $5.7 million in damages. The seller actually commenced litigation, starting a declaratory judgment proceeding that it was due the money held back and that the buyer had no contractual right to invoke the dispute resolution procedure quoted above. The buyer moved to compel arbitration in accordance with the quoted clause. Seller asserted that the dispute resolution procedure was an "appraisal" clause and not an agreement to arbitrate because it "presumes liability and relates solely to the amount of damages" and should not be understood as an agreement to arbitrate what it considered "the substantive dispute as to when the Wing Fat supply agreement was in fact signed and whether it was on terms at least as favorable as the Letter of Intent."[100] The seller invoked the general disputes clause of the agreement to claim that New York state courts had jurisdiction to resolve the underlying dispute, not any panel constituted under the special China Damage Claim clause.

[99] Quoted in Trial Order cited above.

[100] Seller's memorandum quoted in the Trial Order.

The judge hearing the matter sided with the buyer. She looked at the language of the clause itself, citing the phrase that if [Buyer] "believes" it is entitled to retain all or part of the holdback to suggest that the parties intended the special China Damage arbitrator to resolve disputes concerning liability. She also noted, though not itself determinative, that it was "telling" that the parties called a dispute related to the Wind Fat contract a "China Damage Claim" and called the accounting firm(s) chosen to resolve disputes the "China Damage *Arbitrator*."[101] Finally, she found that the parties agreed to a procedure that where they would submit detailed statements to the arbitrator who are then empowered to decided matters "on which there is a substantive dispute". In sum, she granted the buyer's motion to compel arbitration. The seller appealed but the Appellate Division upheld the trail judge's ruling.[102] It held that the claims brought by the buyer "fit within the scope of damages contemplated" by the dispute resolution clause and that, contrary to seller's contention, the existence of a general jurisdiction provision in the PSA did not "warrant a different determination."[103]

The arbitration then proceeded before a panel of three accountants (the parties could not agree on a single one) and the actual letter award of the panel dated Feb. 1, 2012 is available as part of the docket of the enforcement case.[104] By this time, the buyer's estimate of its damages was $9 million, but claimed only $7.5 million due to the China Damages cap in the agreement. Buyer's damages methodology was to compare the actual tonnage anticipated under the Letter of Intent with the tonnage actually shipped and apply a profit margin of $4.99 per ton to the shortfall. The seller asserted defenses, one of which was that due to a worldwide shipping shortage at the time, it would not have been possible in any case for the target company to meet the volumes anticipated.

The panel compared the letter of intent and the final supply agreement and found that the actual agreement did not provide for exclusivity, as did the letter of intent. They also did not accept the

---

[101] Trial Order, emphasis in original.

[102] *Edgewater Growth Capital Partners L.P., et al v Greenstar North America Holdings, Inc.,* 69 A.D.3d (1st Dept. 2010).

[103] *Id*.

[104] Letter dated Feb. 1, 2012 from Jeffrey M. Katz, Theodore Martens and Jonathan D. Vanderveen re The Arbitration of Greenstar North American Holdings, Inc. and Edgewater Growth Capital Partners, L.P., et al.

seller's other defenses. Thus, the panel ruled in favor of the buyer, but did not fully accept its damages argument, finding that the amount of the buyer's harm was slightly over $4 million.

The buyer then moved to have the award confirmed and reduced to judgment under the CPLR §7510 procedure and seller resisted, raising many of the same arguments in had made in the prior cases but also claiming that the award was "irrational."[105] The same trial judge as heard the initial declaratory judgment case also heard the motion to confirm the award. She continued to dismiss the seller's arguments previously made and also found, after examining the arguments, that the award was not irrational, since there was some basis in the record for it. To prevail under New York law, the seller would have had to show that there was no basis in the record for the Panel's decision.[106] She found that each of the seller's defenses was considered and rejected by the panel. As a result, the buyer's motion to confirm the award was granted.

AFTERWORD ON NEW YORK AND DELAWARE COURT TERMINOLOGY

The terminology used for the various courts in New York can be confusing to outsiders. For starters, the trial level courts in the New York State system are called the "Supreme Court" for the applicable county, while in most other U.S. states the highest court in the state is called the Supreme Court. Conversely, the highest court in New York State is called the Court of Appeals, while in most other states that refers to an intermediate level appellate court. In the New York State system, the intermediate appeals courts are called the Appellate Division for four "departments" around the state. Judges for the Supreme Court and the Appellate Division are called "Justices."

Most of the cases filed to enforce domestic arbitral awards are filed in the Supreme Court sitting in Manhattan in New York City, which is referred to as New York County. The Appellate Division to which appeal from this court is taken is the First Department. The last level of appeal in the New York State system is to the Court of Appeals, where the judges are actually called "Judges."

---

[105] Confirmation Order.

[106] Confirmation Order, p. 15-16, citing *Matter of Eastman Assoc. Inc*, 90 AD3d at 1284.

Foreign practitioners might also be confused by the fact that a parallel federal court system also operates in New York. The federal courts have particular jurisdiction which, broadly speaking, relates to certain defined federal legal questions, but they also have jurisdiction over ordinary commercial disputes where the parties to the case are from different states in the U.S., or there is a New York based party and a foreign party (called in each case "diversity of citizenship").

The terminology for the federal courts based in New York does not differ from the rest of the federal system, so the trial level court is called the United States District Court. The one based in Manhattan where most enforcement cases are heard is for the Southern District of New York, or the "Southern District" as New York lawyers refer to it. Sometimes cases are heard in the District Court based in Brooklyn, known as the "Eastern District." Appeal from federal District Courts is taken to a federal Circuit Court of Appeals, which is one of eleven such circuits in the U.S. The one with jurisdiction over the Southern District and the Eastern District is the Second Circuit Court of Appeals, called the "Second Circuit". The judges in the District Court and the Circuit Courts of Appeal are called "Judges." Appeal from the Second Circuit is taken to the Supreme Court of the United States in Washington, if the Supreme Court gives permission for the appeal. Judges on the Supreme Court are called "Justices."

Most of the substantive law applied in mergers and acquisition disputes heard by the state and federal courts sitting in New York is the contract law of the State of New York, as there tend to be no federal questions involved unless federal securities law violations are alleged. As a result, when federal courts apply New York law, they look to New York State statutes and the case law developed by the New York State courts, the highest arbiter of which is the Court of Appeals.

Foreign observers will note that there are hardly any statutes mentioned in this article. The common law tradition lives on in New York, as nearly all of the relevant law is established in decisions of the state and federal courts.

State System	Federal System
Supreme Court of the State of New York, New York County ("Supreme Court, New York County")	United States District Court for the Southern District of New York (the "Southern District")
Supreme Court of the State of New York, Appellate Division, First Department (the "Appellate Division" or the "First Department"	United States Circuit Court of Appeals Second Circuit (the "Second Circuit")
New York State Court of Appeals (the "Court of	Supreme Court of the United Appeals") States (the "Supreme Court")

In Delaware, as in all U.S. states, there are parallel state and federal court systems as well. Almost all Delaware state law cases related to corporate law and mergers and acquisitions are heard in the Delaware Chancery Court based in Wilmington. Judges of that court are referred to as "Chancellors". There is no intermediate level appeals court in Delaware, so appeal is taken in the state system directly to the Delaware Supreme Court. Some of the cases applying Delaware law mentioned in this article are from the federal court based in Delaware, the United States District Court for the District of Delaware when jurisdiction is based on diversity of citizenship. Appeal from that court is taken to the Third Circuit Court of Appeals, based in Philadelphia.