Managing Costs Strategies for M&A Disputes

Mergers and acquisitions (M&A) can be exciting ventures, but they can also lead to a whole range of disagreements between the parties post acquisition. When these disagreements turn into disputes, legal battles can ensue, and the costs can quickly spiral out of control. That's where cost management becomes crucial.

The good news? There are many strategies parties can use to keep costs in M&A disputes under control. In this article jointly co-authored by **Kudun and Partners**, **Aon**, **LCM** and **TIVACO Experts following a successful joint event held in March this year**, we address how costs can be managed throughout the life cycle of an M&A transaction and provide input from a diverse range of views including legal, insurance, third party funder and quantum expert to explore some of the practical and effective approaches to managing costs for parties.

Trends in M&A Disputes

The M&A market has shifted from the COVID era to an environment of high interest rates, large amounts of private equity “dry powder” and geopolitical uncertainty, ultimately resulting in a decline of deal count and value in 2023 in the Asia-Pacific region and globally. The gap in valuation expectations of sellers and buyers can stimulate the use of contingent / earn-out consideration structures in the sale and purchase agreement (SPA), and the inclusion of call / put option provisions to increase the flexibility for the stakeholders.

In a highly volatile market where buyers become even more cautious with their overall corporate risks, they are increasingly concerned over known risks identified in the due diligence process, potential breaches of the seller’s representations and warranties, along with the risk of deals being aborted. These have led to parties in a transaction becoming more careful in implementing risk management measures during and throughout the transaction process.

Despite these (and other) measures, disputes are sometimes inevitable. Parties are typically confronted with seller’s breaches of representations and warranties in the SPAs such as inaccurate financial statements and non-compliance with the law. The recent

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years have also seen disputes on the quantification of earn-outs and disagreements on option exercises.

Before the Dispute Even Starts

The best way to avoid expensive M&A disputes is to prevent one from happening. By taking proactive steps at the negotiations and drafting stages, parties can significantly reduce the chances of a full-blown legal battle.

Clear and Concise M&A Agreements

Solid M&A agreements are the first line of defence, and for businesses operating in Thailand, it's crucial to ensure these agreements comply with Thai law. This includes clear representations, warranties (guarantees) as outlined according to Thailand's Civil and Commercial Code (CCC). Whilst dispute resolution clauses are often ignored or not considered at length, it is one of the most important clauses to pay attention to in minimising future costs.

Some key considerations for Thai M&A agreements include:

- **Due diligence**: It is crucial to ensure that due diligence is thoroughly conducted. It is better to spend more on doing a proper due diligence than incurring damages at a later stage.

- **Representations and Warranties:** Ensure these accurately reflect the state of the business being acquired. Consider including specific language required under the CCC, such as warranties regarding ownership of assets and solvency.

- **Warranties and Indemnities Insurance (W&I):** Globally, there has been a surge in the utilization of W&I (or more commonly known as Representations and Warranties Insurance (RWI) in the United States) as parties, to a large extent, can be protected from financial losses arising from breaches of certain warranties and indemnities given under the SPA. This provides the seller with a clean exit whilst the buyer has recourse to the insurance policy when it suffers financial loss due to a breach of an insured representation or warranty, thereby facilitating a smooth negotiation process for the transaction.

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- **Escrow Arrangement**: Consider using escrow arrangement to hold a portion of the purchase price to cover potential breach of warranty/indemnity claims.

- **Contingent and litigation risk insurance:** Identified known risks (ranging from legal issues arising from permits, licenses as well as live disputes to regulatory issues and tax liability) may be identified as red flags in the due diligence process and consequently cause an impasse in transactions from proceeding as neither party wants to bear the ongoing risk. Contingent and litigation risk insurance protects against the adverse consequences of these known risks and ringfences the total financial exposure for parties. These insurance solutions could also act as an alternative to escrow arrangements so that the seller can walk away with a clean exit, with the buyer seeking recourse from the insurers instead.

- **Dispute Resolution Clause:** Parties should consider which dispute resolution mechanism (courts, arbitration and/or mediation) would be best suited for the transaction in question. Every mechanism has its advantages and disadvantages and the clause should be tailored to suit the needs of each party to the extent possible. Factors that need to be considered include enforceability (and where assets are located), convenience, costs, speed, flexibility and whether specialist knowledge is required for adjudicating the dispute. The clause should be drafted clearly and unambiguously, so as to avoid any disputes about the dispute resolution clause.

By following some of the above guidelines and seeking advice from local lawyers, parties can significantly reduce the risk of misunderstandings and disputes that could lead to costly litigation/arbitration.

Strategies When A Dispute Arises

When a dispute does arise, there are steps you can take to manage the associated costs. Here are some effective strategies to keep your finances in check:

1. **Early Case Assessment**

   It is essential to carry out an analysis of each claim's strengths and weaknesses early on in the process by considering the legal merits and the presence or absence of key evidence.

About Us

Dispute Resolution, Litigation & Arbitration

Kudun and Partners represents a wide and diverse range of well-known Thai and international companies, government agencies, state-owned enterprises, professionals and high net worth individuals across a broad spectrum of contentious litigation and arbitration matters.

Our litigation and arbitration lawyers, who are fluent in both Thai and English, are known for their responsiveness and no-nonsense approach to getting things done. We actively pursue all avenues of dispute resolution available and work closely with our clients and with other key practice areas of the firm to ensure that disputes are resolved as efficiently and cost-effectively as possible.

Identifying the strongest claims early, or the areas that need further work, are vital to developing a successful strategy going forward and ensuring costs are kept under control.

In terms of identifying key documentation and evidence, this can be done by pinpointing key custodians, document sets and document locations. One option that can keep costs down is using appropriate software and AI to quickly categorise and analyse the documents. Doing this early can help the team to develop its legal strategy and settle on appropriate methods of alternate dispute resolution to facilitate early settlement.

2. Obtain accurate cost forecasting and budgeting

To prevent cost overruns, it is important to obtain an accurate budget for the proceedings. Factors that affect costs include jurisdiction, the size and complexity of the dispute, the basis of the claim, the level of expert witness involvement and the overall strategy.

An accurate budget is also important if a third-party funder is involved in the proceedings (discussed in greater detail below). Firstly, for a funder to assess if it is able to fund the proceedings, an accurate and comprehensive budget is necessary. Such a budget should include all legal costs, expert costs, tribunal fees, and other disbursements. Secondly, once on board, the funder closely monitors the costs incurred against the agreed budget. This is in the interests of the client as well as the funder. This is because funding is often priced by reference to a multiple of the amount invested. If the amount invested increases, this reduces the recovery for the client.

3. Manage Financial Risks through insurance

Financial uncertainty is always an issue for any company going through a dispute. On top of escalating legal costs to consider, provisioning also has to be made for the potential losses in a suit. As part of a company's dispute management process, it should also consider various insurances which it can procure to ringfence its unlimited downside risks in a dispute.

After-the-Event Insurance (ATE): It is crucial to understand if the dispute takes place in a costs-shifting jurisdiction. For instance, if a Thai entity is facing a dispute in Singapore,

Australia or Hong Kong courts, the losing party in the litigation would need to pay the adverse costs of the opposing party ordered by the court. In arbitration, costs can also escalate as tribunals typically have the discretion to order costs in the winning party's favour. Disputing parties can be protected from any adverse legal costs exposure through After-the-Event insurance which protects against the risk of having to pay the other side's legal costs, the party's own disbursements and part of their own legal fees.

Adverse judgment insurance (AJI): As a defending party, the risk of facing a catastrophic loss from a judgment may cause cash flow concerns within the company and erode shareholder confidence. The defence-side AJI guards against an adverse award by insuring a large proportion of damages which the defendant is being sued for.

Judgment preservation insurance (JPI): Even when one party has secured a favourable judgment or arbitral award, there is a still a possibility that the losing party may appeal the judgment to a higher court or, in an arbitration, make an application to set the award aside. These proceedings take time, leading to duration and financial uncertainty for the company and its stakeholders. JPI removes these uncertainties by protecting the successful party against the risk of the judgment or award from being overturned or the quantum awarded from being reduced on appeal or setting aside respectively.

4. Engage Quantum Expert

Engage your damages expert as early as possible to understand the approximate amounts at stake (and whether these are "worth the fight"), requirements for evidence and/or external market expertise, and for expert assistance in any potential settlement of the dispute via means of mediation. In certain cases where quantum issues are less complex, the costs can be reduced by engaging an expert advisor, as opposed to an independent expert witness. Other potential avenues to save expert costs include: (a) using a common set of facts and/or instructions for expert witnesses; (b) sequential submission of expert reports; (c) Tribunal/Court-led "hot-tubbing" of experts; and (d) use of video conferencing for experts to give evidence remotely.

5. **Consider third party funding**

Third party funding is when a third party (a funder) pays the costs of the legal proceedings in return for a commission or premium, which is paid back only if and when the claimant makes a financial recovery. Historically, funding was used by impecunious claimants but is now being used by multinational corporates who are looking at a way of moving costs off their balance sheet.

Litigation finance is non-recourse, which means that if the claimant loses the case or is unable to enforce the judgment or award, the funder does not get paid its commission. As mentioned above, the commission or premium charged by the funder is often a multiple of what has been invested. It can also be a percentage of the recovery.

A funder can fund some or all of the cost of the proceedings, such as expert fees or security for costs ordered by a court or tribunal. It can also fund a portion of the proceedings.

It is important to note that in some jurisdictions, such as Thailand, third party funding is not established or well known yet. In others, such as Hong Kong, third party funding is permitted in arbitration and insolvency related proceedings but still prohibited in commercial litigation. Third party funding would be permitted in an arbitration seated in Singapore or Hong Kong between a Thai company and a foreign company, although this issue has not been raised in the Thai Courts as yet.

Aftermath of a dispute – enforcement

Once a judgment or award is obtained, parties will need to enforce the judgment/award in order to recover its damages. This is a separate procedure and the enforcement/execution process differs from one jurisdiction to another. In order to avoid throwing good money after bad, parties should instruct lawyers to determine which jurisdiction they can/should enforce their judgment/award in and instruct experienced local lawyers for the enforcement/execution process.

As mentioned above, a funder will fund proceedings all the way through to recovery, whether that happens by voluntary payment or as a result of enforcement proceedings. A funder can also fund only the enforcement proceedings, after a judgment or award has been

issued. As described above, a funder manages the budget carefully to prevent cost overruns. Further, professional and established funders have significant experience of enforcement globally and relationships with specialist asset tracers and business intelligence consultants, which are key benefits of working with a funder.

If the dispute is an arbitration that is against a wholly state-owned entity, the claimant may also consider insuring its outcome through arbitral award default insurance which ensures that the winning party is paid the amounts awarded in its favour after a waiting period of 120 days from the date of issuance of a legally enforceable award. This provides much financial certainty to the claimant as to when it can receive its payout of damages.

The Bottom Line

Costs cannot be avoided, particularly where a dispute arises. However, rather than being controlled by costs, by implementing the above strategies, parties will be able to control and manage the costs from spiraling out of control and save significant costs and resources. Parties do not have to be in the dark regarding costs when it comes to M&A disputes as costs can be managed at various stages of an M&A transaction, when a dispute arises and even at the enforcement stage.

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