DISPUTE RESOLUTION PROVISIONS IN ACQUISITION AGREEMENTS

After potential acquirers experienced the shock of the multibillion dollar verdict rendered by a Texas jury against a New York acquirer in *Pennzoil v. Texaco*, 729 S.W.2d 768 (Texas 1987), it became common for out-of-state acquirers to attempt to include in their acquisition agreements provisions requiring the law of the acquirer's own state to apply to the acquisition agreement and that any related litigation must be conducted in the courts of the state of the acquirer (*e.g.* New York). Of course, to a Texas based company (particularly a small or medium sized company), the prospect of being required to hire a New York law firm and litigate in New York is as unpleasant at the prospect of litigating in Texas is to a New York based acquirer.

This article will address various alternative dispute resolution provisions which might be considered for inclusion in an acquisition agreement when faced with the acquirer's draft which includes the dreaded "New-York-law-applies-and-all-litigation-will-be-conducted-in-New-York-courts" boilerplate.

In *DeSantis v. Wackenhut*, 793 S.W.2d 670 (Texas 1990), the Texas Supreme Court held that a choice of law provision in an employment agreement between a Florida company and a Texas based employee which selected Florida law was unenforceable on public policy grounds. In view of such a holding, one might have considered accepting the offending choice-of-forum provision of the New York acquirer's in hopes that, if the provision was invoked by the acquirer, it would be held unenforceable by Texas courts. However, that approach (and it was really never a good one) has been foreclosed by the Texas Supreme Court's decision in *AIU Insurance Company*, 148 S.W.2d 109 (Texas 2004). In this case, the Texas Supreme Court upheld a provision in an insurance policy issued by AIU that required all litigation regarding the policy to

take place in the courts of the State of New York. In upholding the contract provision, the Texas Supreme Court specifically declined to accept the insured's challenges based on public policy grounds.

The best approach for the Texas based target from a legal standpoint is to stand firm and insist that the acquisition agreement provide that any litigation be conducted in Texas. However, based on the writer's experience, unless the target has a very strong bargaining position, such insistence may well be a deal killer. So if the best result cannot be obtained, what other types of provisions are possible?

One alternative compromise is to provide in the acquisition agreement that a neutral state, both as to applicable law and location of the forum, will be applicable. The writer has seen such an approach in a number of deals, *e.g.* providing that Delaware law is applicable and that any litigation will be brought in Delaware courts. The choice of a neutral forum will be enforceable as a matter of Texas law under the holding of the *AIU Insurance* case. But one wonders whether a Delaware court would accept a contractual invocation of venue if the statutory venue requirements of Delaware have not been satisfied. Typically venue statutes require some type of relationship of the transaction or the parties to the county in which suit is brought. Accordingly, the selected out-of-state court may not accept the agreement of the parties as to the location of the dispute resolution forum in the absence of satisfaction of the statutory venue requirements of the particular state. With respect to the enforceability of the choice of the law of a neutral state, one must also consider the provisions of Section 35.51 of the Texas Business and Commerce Code. Section 35.51 of the Texas Business and Commerce Code generally validates contractual choice of law provisions in transactions involving $1 million or more but also requires that the state of the law chosen must have a reasonable relationship to the transaction. This suggests that

the state law chosen (*e.g* Delaware) cannot be so "neutral" that it has no reasonable relationship to the acquisition transaction or the parties.

Another approach is to argue that since the acquirer's real concern is the fear of a run-away Texas jury, such concern can be appropriately addressed by the target waiving the right to a jury trial with respect to resolution of disputes concerning the acquisition agreement. The Houston Court of Appeals (14th District) has held that a waiver of the right to a jury trial which knowingly and voluntarily entered into is enforceable. *See In re Wells* Fargo, 115 S.W.3d 600 (Tex. App. - - Houston (14th) 2003). Of course, the acquirer may respond that its concern is not only with Texas juries but also with being "hometowned" by judges elected by Texas voters and reject such a proposed compromise.

A third approach is to agree that any disputes regarding the acquisition will be settled by binding arbitration and specify that the arbitration proceedings will be conducted in a major city which is approximately equal distance from the target and the acquirer and also provide that the law of a neutral state will be applied by the arbitrator(s). Such a provision could be accompanied by a requirement that non-binding mediation be undertaken before binding arbitration can be invoked. This approach avoids any hometown judge or jury objection since the process of selecting a mediator or arbitrator will be designed to select either a single neutral arbitrator or one neutral arbitrator on a three-arbitrator panel. As to the choice of forum, this type of provision is sanctioned by the Texas Arbitration Act, Texas Civil Practice & Remedies Code § 171.005. Also the Texas Arbitration Act generally provides that the parties may agree on how the arbitration proceedings will be conducted and an agreement that the law of a neutral forum (*e.g.* Delaware) will be applied by the arbitrator(s) would be enforceable. While arbitration is generally thought to be a less expensive form of dispute resolution, unless the agreement to

arbitrate sets forth special rules restricting the scope of discovery and/or the length of the arbitration hearings, it may well turn out to still be a very expensive process. Accordingly, if the target is the smaller player, the target should consider limiting the scope of discovery and/or the duration of the hearing process in the arbitration provisions. In considering whether or not to use this alternative it should be remembered that an arbitration proceeding is final at the arbitration hearing level and that there is no appeal process to correct errors that are made by the arbitrator or arbitrators.

Finally, if the target's principals and the acquirer's principals have a good working relationship and a high level of trust, the target might agree to the out-of-state acquirer's choice-of-law and forum selection provisions and obtain the oral understanding of the principals of the acquirer that any problems will be worked out by good faith negotiation and that a dispute will only be turned over to the litigators as the last resort after all reasonable efforts to agree have been exhausted. This is not a legal solution (since such an oral understanding would not be legally enforceable), but may, in the right circumstances, be a good practical solution that allows the deal to proceed in the face of adamant insistence by the acquirer (or an inflexible corporate policy on the issue) that any legal proceedings must take place in the home state of the acquirer.

While the specific dispute resolution provisions of any acquisition agreement that are negotiated will be a product to the bargaining strength and tenacity of the parties, consideration of the alternatives discussed above should help facilitate finding an acceptable solution.

* * * * *

Mr. Gangstad is a partner with the Austin firm of Bickerstaff, Heath, Smiley, Pollan, Kever & McDaniel, L.L.P. He has practiced in the fields of mergers and acquisitions, securities and general corporate law since 1974.