

Knowing When To Put The Brakes On When Negotiating Your M&A Deal



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When negotiating M&A deals, parties might tend to overlook the legal consequences of starting and terminating these negotiations. In this Strelia M&A Series, we would like to share with you how parties that start negotiations can avoid becoming bound to each other, earlier than desired, and how they can avoid the risk of being held liable precontractually for terminating negotiations unilaterally wrongfully.

Starting Negotiations

Parties often kick-off an M&A deal with a letter of intent, a memorandum of understanding, heads of terms, or terms sheet. Below, we refer to all these types of documents as Letter of Intent.

What they all have in common is that their binding nature depends on the actual contents or wording, and they should thus be assessed on a case-by-case basis. To avoid any ambiguity regarding its legal nature, the Letter of Intent needs to be drafted with particular care. The difficulty in doing so stems from the fact that one of the parties may want a binding commitment whereas the other does not or, at least, not yet.



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Under Belgian law, whether a Letter of Intent is binding or not depends on the intention of the parties. Contrary to what is laid down in Anglo-Saxon law, under Belgian law the descriptive title that the parties have given to the Letter of Intent, e.g., “non-binding”, is not determinant. According to abundant case-law on the matter, a Letter of Intent will bind the parties if—based on its contents—it can be established that the parties have agreed on “all essential elements” of the transaction. For a share deal, these “essential elements” are the shares to be transferred, the price (Article 1583 Civil Code) as well as any other element that the parties have *in concreto* considered essential to the transaction. For example, courts have rejected claims from prospective buyers (the aggrieved party) whose negotiations were terminated and who tried to argue that a sale had been concluded because there would have been consensus on the price and the shares. In this case, the court analysed the wording used in the Letter of Intent and held that it was evident that consensus on the representations and warranties (e.g. the time limits and cap) was essential for the parties. And since these were not agreed upon, the prospective buyers could not validly assert that a sale had been concluded.

If the parties want to avoid that a Letter of Intent would be found to be a binding instrument, the parties would have to draft precisely and state explicitly in it that (i) they do not intend to create a binding commitment except for certain subject matters such as exclusivity, confidentiality and costs, (ii) the negotiations may be terminated at any time by either party and for any reason, (iii) the Letter of Intent does not address all the substantial elements of the transaction; and (iv) there will only be an agreement to proceed with the transaction if there is consensus on all aspects of the transaction, including the entire contents of the share purchase agreement. In addition, the Letter of Intent could state that the transaction is subject to certain specific assumptions and conditions precedent, such as satisfactory due diligence (e.g. no findings having an impact exceeding a certain threshold) and approval of the transaction by third parties or financing of the transaction. To achieve the desired effect, these conditions must be validly stipulated.

A judge will determine what the intention of the parties was by not only analysing the wording used in the Letter of Intent but also by assessing the behaviour of the parties during the negotiations (e.g. email correspondence and meetings and documents exchanged). It is therefore vital that the behaviour of the parties reflect, at least not contradict, their intention according to what is described in the Letter of Intent.

Terminating Negotiations

Belgian law, specifically the *Decret D'allarde*, grants parties the freedom to start and end negotiations whenever they wish unless they have entered into a binding agreement with each other. According to established case-law of the Court of Cassation (which has now been incorporated into the new Book V of the Civil Code that will enter into force in November 2020), this freedom is not unlimited, and each party must act in good faith not only regarding the initiative and the continuation but also regarding the termination of the negotiations.

A court can conclude that the party that terminates the negotiations abruptly and without any justification commits a precontractual fault (*culpa in contrahendo*). The aggrieved party must prove the wrongful act, the loss, and the causal link between the wrongful act and the loss. Whether a party has committed a wrongful act by terminating negotiations will have to be assessed by the court on a case-by-case basis. Case-law on this states that what is important to determine in this analysis is whether the aggrieved party's legitimate trust in the transaction completing has been breached. The court will analyse the conduct of the parties throughout the entire transaction (length negotiations, costs involved). If the court concludes that there is wrongful termination, it can either grant the aggrieved party a so-called negative-contract interest remedy (i.e., the parties are restored in the position they were in prior to the negotiations) or a so-called positive-interest remedy (i.e., granting the aggrieved party a right to seek financial compensation for having lost the positive interest deriving from the contract). Compensation for the positive interest is in principle only granted exceptionally when the terminating party has given the impression to the other party that the transaction would be completed without any doubt (Article 5:21 of the new Book V of the Civil Code).

Considering the above, for the terminating party to end negotiations without incurring liability, it should do so in good faith. This would have to imply that the terminating party did not intentionally or unnecessarily prolong the negotiations and did not intentionally or unnecessarily create the impression that the contemplated transaction would proceed and had to abruptly end the negotiations. Also, a party should not be precluded from terminating the negotiations if the due diligence outcome (as set out in the Letter of Intent or SPA) is not satisfactory and reveals a fact that has a negative impact on the transaction, and all this, to the extent that it is done in good faith. It goes without saying that terminating negotiations without incurring liability will become more challenging when the parties' negotiations reach near the signing/closing date because the costs will have increased as well as the legitimate trust given to the transaction's continued progressing towards completion.