WARSAW CONFERENCE ON DISPUTE RESOLUTION IN M&A TRANSACTIONS - 13 AND 14 MAY 2010

„SETTLEMENT OF POST CLOSING DISPUTES: A DIFFERENT PACE?"

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Over the last 20 years, Spanish SPAs in large deals have followed the typical international-anglosaxon pattern.

They are quite different from the traditional legal regime: the usual practices and rules regarding due diligence, disclosure, representations and warranties, indemnities, closing and completion and price adjustment mechanisms are not regulated in the Civil code.

The main principles under Spanish law are (i) good faith and culpa in contrahendo, during negotiations, and (ii) once the SPA has been executed, good faith, literal interpretation of the contractual provisions, and liability arising from aliud pro alio and hidden defects. Absent specific contractual provisions, the legal regime will be as follows:

- The seller must deliver the object sold as it was when the SPA was executed ("as is")
- There is a rule providing for a reduction of the price when the price is determined by reference to units or quantity, but it is only applicable to the sale and purchase of real estate
- There is a rule whereby the purchaser has the option to (i) rescind the contract or (ii) adjust the price (quanti minoris) when there appear hidden defects that render the good unsuitable, but
- The seller will not be liable for non-hidden defects or for defects that a diligent purchaser should have known before the contract (constructive knowledge)
- The seller is supposed to disclose all hidden defects
- The time limit for this regime is six months or one year as from completion.
- Aliud pro alio (defects that render the object totally unsuitable) is considered a breach of the contract and entitles the purchaser to rescind the contract or to seek damages, and the time limit in that case is fifteen years

The legal formulation of these principles was made in the XIX century (Civil code) and do not cater for the sort of problems that today's SPA present

- Substantially
- Procedurally
- And in relation to limitation periods

In particular, when it comes to

- SPA of shares (as opposed to an SPA of assets and liabilities or a business) and to
- Disputes about financial statements and third party claims

State courts are not yet totally familiar with this patterns and hence there are appeal and Supreme courts decisions that clash with the international principles.

A SPA of shares can be viewed as having as its only object the shares, not the business, assets and liabilities comprising the enterprise.

Therefore, the legal or contractual provisions dealing with the liability of the seller risk being applied only to contingencies directly relating to the shares.

Appeal and Supreme Courts decisions relating to M&A disputes:

1. Hotel Bel Air: The Supreme Court held in 2009 that the acquisition of 100% of the shares of a company whose only activity was the operation of a hotel did not give rise to liability of the seller even when the building had serious structural defects. The reasons for this decision were: (i) the purchaser should have known about the problems beforehand, and (ii) the object of the sale and purchase was not a hotel, but shares.

2. Grupo Potasas: The Supreme Court held in 2009 the interpretation of the appellate court that a clause providing for the liability of the seller in relation to "non-existing assets" recorded in the balance sheet attached to the SPA did not give rise to liability because the assets in question did exists, even if they were totally useless.

   This judgment also held the view that the same clause providing for the liability of the seller in relation to liabilities of target not recorded (as a liability or as a provision) in the balance sheet did not give rise to liability because there had not been any actual claim by third parties.

   The appellate court held that because this was a large transaction, the purchaser had the opportunity to examine abundant information and used numerous external advisors and hence it had, at least, constructive knowledge.

3. Ena: The Supreme Court held in 2008 the view of the appellate court that the existence of hidden debts and overvalued assets in the context of the purchase of a majority stake in a company did not give rise to liability of the seller because the purchased object was shares and the purchaser got shares. Only if the company had been bankrupt could the purchaser have claimed to have received an aliud pro alio. the appellate court also held the purchaser (Deutsche Bank) had at least constructive knowledge.

4. Auxiliar del Juego: The Madrid Appeal Court held in 2006 that the requirement of communication of anything that could give rise to an indemnifiable third party claim within fifteen days was a valid one, essential to hold the seller liable (the purchaser served the notice some months later). The appearance of hidden debts does not amount to a breach of the contract, precisely because the SPA contemplated the possibility that there were hidden debts and laid down a specific regime applicable to them (ie, notification by the purchaser, etc.).

5. Frioalimientos d'Aragó: The Supreme Court set aside in 2000 a judgment of the Madrid Appeal Court according to which the liability of the seller under a representations and warranties clause is triggered only if there is a shortfall in the overall value of the company, which meant that negative adjustments could be compensated by positive adjustments.

6. Tauro: The Supreme Court held in 2000 that the lack of the appropriate permits for the premises was not a mere hidden defect, but a breach of the contract, given that the seller knew the representation was untrue and also given the importance of the problem.

7. Autogest: The Supreme Court held that the view of the Appeal Court that the quantum of the liability of the seller cannot be higher than the purchase price was not illogical. The Appeal Court based this on the claim that the price in a purchase and sale cannot be a negative amount.

8. OPA Gestión: The Supreme Court upheld the decision of the appeal court dismissing the argument of the sellers that they were not liable because the purchaser had not given them notice of a tax inspection resulting in a tax claim and the subsequent decision of target to pay the debt. The sellers claimed that lack of notification by the purchaser had resulted in them not being able to defend oppose the tax claim.