Letter of intent and pre-contractual liability issues under cross border M&A transactions. 
Current trends and a comparative approach in United States/Argentine Law

Professor
Rodolfo G. Papa

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1 Nothing contained in this paper is to be considered as the rendering of legal advice either generally or in connection with any specific issue or case. Readers are responsible for obtaining advice from their own lawyers. This paper is intended for educational and information purposes only.

2 Abogado (Universidad de Buenos Aires) (Graduated with Diploma de Honor). Master of Laws in International Economic Law (LL.M) (University of Warwick) (England). Following a full time practice as corporate lawyer in his home country, he has moved to develop an international academic career. He has addressed conferences, lectures and legal training courses in Perú, Colombia, Mexico and Panama. He has drafted more than 100 papers, articles and comments in the most important domestic law journals. Local correspondent of the leading international publication Latin Counsel (Spain) since 2005. Author of the following law books: “Due Diligence para abogados y contadores” (2011); “Transferencia del Control Accionario. Claves para su negociación contractual” (2012); and, “Fideicomiso para abogados y contadores. Aspectos jurídicos, contractuales, regulatorios, contables y tributarios” (2014). E-mail: rgp@cema.edu.ar
1. Abstract:

This paper aims to develop a comparative approach concerning the recognition of pre-contractual liability and the effects in executing a letter of intent, under both US and Argentine Law.

Certain material distinctions currently exists between both legal systems concerning the scope and enforceability of such subject matters, mainly when its interaction takes place, as a result of structuring a cross border transaction including parties incorporated in such jurisdictions, governed by Argentine Law.

It should be preliminary anticipated that the recognition of a pre-contractual liability event arising out of the sudden termination of negotiations that could cause a frustration over one of the parties’s reasonable belief to reach a binding agreement, as well as the compliance with an statutory and implied duty of good faith conduct within such stage, shows a conflicting view between the Laws of such countries.

Such opposed approach pursuant to which underlies the regulation of these matters, ranging from a more flexible standard found in the Common Law, against a strict pre-contractual liability enforceability, as developed by Civil Law jurisdictions, should be born in mind when a US based company would decide to doing business with an Argentine target or a domestic counterparty, including another form of business association (e.g. joint venture) in the mining and/or oil & gas rising sectors.

The second half of our survey is devoted to describe the latest generation framework introduced by the new Argentine Civil and Commercial Code, that among other sophisticated legal issues, expressly governs pre-contractual negotiations matters, that despite dedicating the freedom to its parties to start up and walk away from negotiations, aiming a future contract formation or the closing of a deal, it faces certain substantive limitations, such as the statutory duty to comply with both good faith and confidentiality (regarding the disclosure and use of the information exchanged) standards, as well as not to frustrate the other party’s belief to form a contract, without a reasonable cause.

From a corporate law practice standpoint, it suggests the establishment of certain measures of care and diligence that Common Law parties that wish to structure a cross border transaction, governed by Argentine Law should take into consideration, when its new unified Civil and Commercial Code provisions will be in full force and effect, and might be further adopted in order to prevent such entities from being exposed to certain litigation scenarios (i.e. how to anticipate “bad faith” events during preliminary stages of a negotiation process).

2. US-Argentine Law conflicting views regarding the enforcement of pre-contractual liabilities issues and the mandatory application of the good faith principle:

The start up of preliminary negotiations under a cross border M&A deal, often involves a high degree of complexity, on the basis it is unlikely that a binding offer or an agreement would already exist, since the early stages of the transaction, based upon the circumstance that the target company’s financial, legal, tax and accounting information would not be effectively known by the potential buyer until its due diligence investigation is closed.
The commencement of pre-contractual dealings regarding this corporate business model is exposed to different sources of legal conflicts, despite a definitive contract would not be reached.

As a general rule, pre-contractual liability refers to a compensation claim brought to cover all the expenses incurred during a negotiation process aiming to form a contract, and it arises as a result of a frustration of one party’s reasonable expectation that a binding agreement would be formed, caused by the other party’s wrongful conduct. There are several grounds to claim compensation damages by an aggrieved party under pre-contractual negotiation stages, mainly sustained in its sudden and abusive break-off without a reasonable cause, or throughout a breach of an implied duty to conduct preliminary negotiations in good faith, or an abusive withdrawal of a binding offer.

It is important to recall that a conflicting approach between Common Law and Civil Law concerning the recognition of pre-contractual liability appears as evident. In fact, as a key section of the information set out by this paper, this opposed view concerning compensation claim rights arising from an unlawful termination of pre-contractual negotiation exists, in the interaction of US and Argentine legal systems. Under Argentine Law\(^3\), pre-contractual liability has not been expressly recognized by its Civil Code, in force since January 1\(^{\text{st}}\) 1871, whose provisions will be replaced by the new Civil and Commercial Code, dated August 1\(^{\text{st}}\) 2015.

However, a set of both Civil and Commercial Case Law and the favourable opinion of the majority of specialized doctrine have admitted the enforceability of pre-contractual liability claims sustained in certain private law principles that implicitly impact on the parties’s conduct, such as, an abusive exercise of rights\(^4\), the duty to act in good faith that not only applies to the execution of contractual obligations, but also is in effect since the early steps of its formation, and the obligation not to infringe damages to third parties\(^5\).

On the contrary, under US Law, a Common Law jurisdiction, as a general rule, it has not granted recognition to pre-contractual liability claims, due to a broad right granted to the parties freedom either to enter into or abandon preliminary negotiations, on the basis that the application of the good faith and fair dealing standards, only applies to contractual obligations\(^6\) (i.e. once the offer/acceptance process has been settled), excluding pre-contractual negotiation steps.

Based upon such comparative approach, in pre-contractual subject-matters, a key issue should be borne in mind by all such US multinational companies that wish to structure a M&A deal involving an Argentine-incorporated target corporation, on the basis the former shall be bound to observe a mandatory duty to negotiate in good faith (as it has been expressly recognized by the new Argentine Civil and Commercial Code), and thus, being exposed to litigation and/or liability risk as a result of an unlawful breaking off negotiation event.

Whereas Argentine Case Law has traditionally uphold the enforceability of pre-contractual liability claims arising out of a sudden and arbitrarily termination of preliminary negotiations caused by one parties’ wrongful conduct that did frustrate the other parties’ reasonable belief to conclude a definitive agreement, US Case Law has

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\(^3\) Argentina is a tradicional Civil Law jurisdiction, whose Private Law has been structured in the existence of a dual Civil and Commercial Codification and complementary legislation. We recall that such nineteenth century dual Codification will be replaced by the new Civil and Commercial Code, in force since August 1\(^{\text{st}}\) 2015.

\(^4\) Section 1071 of its 1871 Civil Code.

\(^5\) Section 1109 of its 1871 Civil Code.

\(^6\) Under US Law, both U.C.C Section 1-304 and Section 205 of the Restatement (Second) of Contracts provide for a duty of good faith in contractual performance only.
adopted a more flexible response by granting the parties the freedom to abandon informal negotiations and/or a mutually agreed confidentiality written commitment, to include standard release of liability clauses, as valid and enforceable measures. In fact, pursuant to a recent Delaware Case Law, in Raa Management LLC v. Savage Sports Holding⁷, the Delaware Supreme Court, applying New York Law, dismissed a claim brought by the plaintiff, seeking due diligence and negotiations costs that the former incurred while following the purchase of the target, prior to learning late in the due diligence investigation of certain material liabilities that the defendant had failed to disclose earlier. The dismissal of the claim was upheld based on the non-disclosure agreement between the parties that included standard non-reliance and waiver clauses. The non-disclosure agreement stated that defendant was not making any representation or warranty, express or implied, as to the accuracy or completeness of any information it provided to the plaintiff during due diligence. Additionally, the non-disclosure agreement stated that only those representations or warranties that are made in the sale agreement when, as and if it is executed, and subject to such limitations and restrictions as may be specified in such a sale agreement, shall have any legal effect⁸.

The underlying ratio of that Delaware Supreme Court ruling strengthens the theory pursuant to which there are very isolated grounds to sustain a pre-contractual liability case arising from sudden termination of either informal negotiations or even these dealings covered by a confidentiality agreement, that would include irresponsibility clauses (i.e. non-reliance and waiver covenants), on the grounds of a broad recognition of the parties freedom to withdraw from pre-contractual negotiations, without facing adverse results.

There is also a contradictory view both under US and Argentine Law within pre-contractual stages of a transaction, with respect to the fulfilment of the parties obligation to conduct negotiations consistent with the good faith principle.

In certain State Laws of USA, parties would have the choice to start up pre-contractual negotiations, by either voluntarily exclude or expressly commit to negotiate in good faith.

Under the scope of the new Argentine Civil and Commercial Code, the good faith principle mandatory applies, following as a key source, provisions of the Unidroit International Commercial Contracts Principles, that provides parties can neither exclude nor limit such duty⁹.

This is another relevant subject matter that US or foreign companies must bear in mind since the early stages of a cross border transactions exposed to be governed by Argentine Law, the application of the good faith principle during the term comprising preliminary negotiations shall not be subject to any restriction or limitation.

In reaffirming a more flexible approach in the enforcement of the good faith principle during pre-contractual negotiations, under US Law, it must be pointed out another latest generation Delaware Supreme Court judgment.

In fact, in Siga Technologies, Inc. v. Pharmathene, Inc.¹⁰, it ruled that under Delaware Law: (i) agreements to negotiate in good faith even in preliminary agreements, are enforceable; (ii) proposing deal terms that deviate materially from terms set out in a term sheet may be deemed to evidence bad faith in negotiations; and, (iii) if an

⁸ Handy, Allison C.-Kucera, William R. Delaware Supreme Court ruling suggests potential buyers in M&A deals likely have limited recourse against sellers prior to signing agreement. Mayer Brown. Legal Update. June 20, 2012.
obligation to negotiate in good faith is breached and the aggrieved party is able to establish that a final, binding agreement would have been reached absent the other’s bad faith negotiations, the aggrieved party is entitled to expectation or benefit of the bargain damages (lost profits), rather than simply reliance damages (cost and expenses of the failed negotiations). In other words, we could conclude that under Delaware Case Law, it enforces the parties’ autonomy of the will during pre-contractual negotiation aiming either the avoidance of any duty to comply with good faith standards or to include it expressly. A last but not least substantive issue related to litigation and/or liability risks arising from pre-contractual negotiation cases governed by Argentine Law, is focused on the extent of the damages recovery caused by an abusive and sudden termination of negotiations, upon the lack of regulation of this issue under its current 1871 Civil Code. The Case Law developed by the Commercial Court of Appeal of the City of Buenos Aires, the only tribunal nation-wide with exclusive jurisdiction to adjudicate disputes on Commercial Law matters, has upheld to the benefit of an aggrieved party the right to recover an amount equivalent to the “negative interest damage” (“daño al interés negativo”) (i.e. all the expenses and costs incurred during pre-contractual negotiations, excluding loss of profits) only. However, in certain exceptional cases, it has extended such compensation amount to a “loss of chance”, as well as a moral damages award (in this latter case, it was granted by the Civil Court of Appeal).

3. The concept of a letter of intent as key documentation executed in the preliminary stages of a cross-border transaction. A description of US/Argentine leading cases:

The performance of a cross border M&A transaction involving an Argentine incorporated target company, assuming each of its steps (moving chronologically from an informal pre-contractual negotiation stage; the enter into a non-binding letter of intent; the opening of a due diligence investigation; negotiation and signing of a definitive stock purchase agreement; to closing; and, the post-closing survival of certain contractual obligations) would be governed by Argentine Law, has mainly mirrored the procedures and standard form of documentation developed by Common Law practices. In fact, within the scope of its preliminary acts, a straight basis negotiating parties scenario (as opposed to an auction selection procedure, that it is currently a small domestic market, commonly devoted to leading family owned companies), usually includes a separate negotiated and executed confidentiality agreement and a letter of intent, whose contents reflect practical clauses widely recognized by the Common Law, provided should be taylorized to certain local law requirements and commercial usages.

Normally, pre-contractual informal negotiations established between the parties of a cross border deal with Argentine Law contact points, solely covered by the “umbrella” of a confidentiality agreement, may later turn into the execution of a letter of intent,

12 The Commercial Court of Appeal of the City of Buenos Aires is divided into six sections of three Judges each, designated as A, B, C, D, E and F.
whose provisions reflect an standarized set of terms and conditions generally accepted in this type of non-binding documentation, subject to the exercise of the parties negotiation skills (e.g. structure of the proposed transaction; purchase price determination; method of payment of such price; closing conditions; scope of the prospective buyer’s due diligence; seller’s exclusivity covenant; set forth its binding or non-binding nature; and, governing law and jurisdiction).

It should be taken into consideration that the execution of a letter of intent, despite it has been generally qualified -under both US and Argentine Law- as a non-binding agreement, it could expose its parties to different litigation scenarios, either by challenging its non-binding nature, or by claiming the extent of damages to be reimbursed from breach of its terms and conditions.

As a matter of Argentine Law, there has not been developed -at least- until the incoming enforcement of the new Civil and Commercial Code, an undisputed concept of a letter of intent. In fact, Commercial Case Law has construed three separate views to the reach of its legal effects, which could be summarized as follows.

First, Section D of the Commercial Court of Appeal of the City of Buenos Aires has recognized non-binding effects of a so-called “irrevocable purchase offer”, named as such by its parties, based upon the circumstance that its issuer has given notice to the recipient to walk away from negotiations, on the basis the former had unilaterally reserved its right to either approve or reject the due diligence results conducted over the target company, as one of the condition precedents to enter into a final stock purchase agreement.

In such litigation, the plaintiff had brought a claim to collect the amount committed by the prospective buyer to secure the performance of such offer. The Court dismissed the claim. In fact, according to this Commercial Court’s ruling, in order such offer would be eligible for being qualified as binding, it should not be limited to any condition precedent, in order to be treated as a true binding offer\(^16\).

An related key issue adjudicated by such judgment was focused on stating that the approval of the due diligence findings, as a mutually agreed condition precedent to enter into a definitive stock purchase agreement, could not be deemed to be treated as a facultative condition (“condición potestativa”\(^15\)), being such conclusion sustained on the circumstance that due diligence findings did not depend on the discretionary power potentially exercised by the prospective buyer.

In rendering another approach, Section D of the above cited appeal Court has recognized the enforceability of its provisions, based on “the intent of the parties” test, to celebrate the transfer of a controlling stock over a target company, and therefore they had agreed to enter into a binding agreement (precontrato), whose legal nature must be distinguished from a non-binding letter of intent, on the grounds the former documentation has created a duty to enter into a definitive agreement. In other words, its contractual purpose had been the conclusion of a future agreement\(^18\).

Whereas a third Argentine Case Law view with respect to the legal effects arising out of the performance of a letter of intent, before the new Civil and Commercial Code will be

\(^{16}\) Vicente, Norberto Carlos José y otro c/ Sociedad Latinoamericana de Inversiones SA. CNCOM, Sec. D. Dated October 28th 2010.

\(^{17}\) Section 542 of the 1871 Argentine Civil Code, in force until the end of July of this year, defines a facultative condition (“condición potestativa”) as the one it shall fully depend on the debtor’s will, provided it qualifies as null and void as a conditioning to the performance of committed contractual obligations.

\(^{18}\) Kemancioglu, Dikran Ara c/ Kritz, Daniel E. CNCOM, Sec. E. Dated December 9th 2012. This ruling awards binding and operative effects to the execution of a preliminary agreement named as “precontrato”, by sustaining that a breach of its provisions is enforceable.
in force, that preliminary seems to be closely consistent with this non-binding documentation provisions introduced by the latter Codification framework, states that a letter of intent only creates a duty to conduct negotiations in good faith and exchange all such necessary information to gather a precise and complete knowledge of the contractual purpose and its complementary circumstances, provided however, each of its parties can walk away from negotiations contingent with their own business interests 19.

Based upon such separate opinions granted by the local Commercial Case Law concerning the nature and binding (or non-binding) effects of a letter of intent, under the dual Codification system, in the process of being removed, it could be summarized as follows: (i) whether it contains a mutual agreement concerning all the essential terms of a proposed transaction, it would be vested with binding effects to enter into a definitive agreement (precontrato); (ii) whether it has the purpose to bind the parties to start up negotiations and exchange information only, complying with an implied good faith duty; and, (iii) whether it qualifies under substantial similar terms than as set out in point (ii) above, but it might further include certain clauses with binding effects, agreed upon by its parties (e.g. no-shop/exclusivity seller’s covenant; regulation of the legal, financial and accounting due diligence investigation over the target company; and, future seller’s obligation to include standard representations & warranties in the definitive stock purchase agreement, among others).

On the other hand, and following our survey, under US Case Law, we could preliminary conclude, in substantial similar terms than discussed under the current status of Argentine Law, that we could neither find an unique approach.

In fact, there has been a debate regarding its enforceability (whether binding or non-binding), and from a practical standpoint –at least in US domestic transactions– it would seem that the execution of this documentation expose its parties to face litigation and/or liabilities risks concerning as the main sources of disputes, each of the following: fail to comply contractual obligations formed by a letter of intent; breach of the duty to negotiate in good faith and fair dealing, as well as the application of the “tortious interference with contract” doctrine.

US Case Law has issued a widely known leading case that analyzed the binding effects of a letter of intent, by testing certain facts following the intent of the parties, in order to decide whether they would have agreed to be bound (or not).

In Texaco v. Pennzoil 20, a Texas Court of Appeal, applying New York Law, solved a complex commercial conflict pursuant to which Pennzoil and Getty Oil had initially entered into a merger agreement whereby Pennzoil would acquire Getty.

Pennzoil and Getty later signed a memorandum of agreement subject to the approval of their respective boards, and issued a press release. However, Texaco made an alternative offer addressed to Getty’s board and as a result of this latter offer, Getty broke off its agreement with Pennzoil and finally accepted Texaco’s offer. Pennzoil sued Texaco for tortious interference with contract.

The Texas Court of Appeal found, under New York Law, that there had been a binding agreement between Getty and Pennzoil and Texaco knowingly interfered with such contract.

In issuing such judgment the Texas’s Court awarded US$ 10.53 BN. in damages to the plaintiff, by stating there was substantial evidence Pennzoil and Getty’s intention to be

bound, taking into consideration that it was shown by the terms of the memorandum of agreement entered into and the disclosure of the press release. The Texas Court concluded in affirming that despite the clear language of reservation, the parties intent to be bound is still to be evaluated as a question of fact to be determined from all the relevant circumstances of the case.

Further, under New York Case Law, the determination of whether a letter of intent is vested with a binding nature, depends on the intent of the parties, focusing on a four factors test rendered in *Winston v. Mediafare Entertainment Corporation*\(^{21}\), as follows: (i) whether there has been an express reservation of the right not to be bound in the absence of a writing; (ii) whether there has been partial performance of the contract; (iii) whether all of the terms of the alleged contract have been agreed upon; and, (iv) whether the agreement at issue is the type of contract that is usually committed to writing.

Following highly reliable doctrine, later New York cases place increasing importance on the explicit language of the preliminary writings between the parties to evaluate their intention as to the binding nature of the negotiations. Such trend culminated in *Arcadian Phosphates Inc. v. Arcadian Corporation*\(^{22}\), that held a preliminary agreement was not binding based upon the parties even though certain board approvals had been obtained and there had been some partial performance because the language of the agreement itself, demonstrating that there were open issues still to be negotiated with demonstrated that the parties did not intent to be bound\(^ {23}\).

To conclude, under New York Law it could be construed that the binding or non-binding effects arising from a letter of intent or other equivalent preliminary documentation, is a complex question of fact, that mainly depends on the intent of the parties that should be measured under individual basis, following the four factors test found in *Winston*, provided such factors were later expanded in *Teachers Insurance*\(^ {24}\), plus the language used by the parties in drafting its terms.

4. **Pre-contractual liability issues under the new Argentine Civil and Commercial Code and its impact over cross-border M&A transactions:**

Argentine Private Law is undergoing a major reform with the incoming birth of its new Civil and Commercial Code, in force since August 1\(^{st}\) 2015, and whose provisions will replace the eighteenth century dual Codification system composed by its 1871 Civil Code and the 1862 Commercial Code.

The new Argentine Civil and Commercial Code includes a total of 2,671 sections, that shows a lesser size than the current dual codification.

This latest generation Code introduces material amendments concerning Family Law and marriage matters, as well as over other traditional Civil Law products, such as contract law (including a separate general theory of consumer contract), real estate structures and the law of successions.

\(^{21}\) *Winston v. Mediafare Entertainment Corporation* 777 F.2d 78 (2d. Cir. 1985).

\(^{22}\) *Arcadian Phosphates Inc. v. Arcadian Corporation*, 884 F.2d. 69 (2d. Cir. 1989).


\(^{24}\) *Teachers Insurance & Annuity Ass’n of America v. Tribune Co*. 670 F. Supp. 492, 499-503 (S.D. N.Y. 1987). This New York Case Law ruling describes the following expanded factors: (i) language of the agreement; (ii) the context of the negotiations; (iii) the existence of open terms; (iv) partial performance and the necessity of putting the agreement in final form as indicated by the customary form of such transaction.
The new unified Code opens the door to host a detailed framework of Commercial Law subject matters, among others, the rendering of accounts, a wide array of sophisticated agreements (e.g. agency, concession and franchising), and a regulation of the arbitration agreement\textsuperscript{25}, for the first time whithin the scope of its substantive law, provided the Code applies nation wide.

It is also important to note that the new unified Code has not revoked certain specific statutes that have complemented provisions of the 1862 Commercial Code (e.g. the Maritime Act, the Financial Entities Act; the Bulk of Assets Transfer Act; the Public offering Act and the Antitrust Act, among others), whose enforcement shall survive the dual Codification scheme.

Further, the new Civil and Commercial Code amends certain provisions of the 1972 Argentine Commercial Companies Act\textsuperscript{26}, by creating unknown corporate structures at a domestic level.

It recognizes for the first time, the one-shareholder stock corporation (sociedad anónima unipersonal), and set out a more flexible regulation to the current unregistered or informal companies (sociedades irregulares y de hecho con objeto comercial\textsuperscript{25}), that will be replaced to a residual or simple partnership, by reducing its partners liability exposure and recognizing the exercise of their autonomy of the will setting forth in the non-incorporated partnership’s by-laws.

The separate category of contractual joint ventures vehicles (contratos asociativos), that originally were introduced by an amendment of the Argentine Commercial Company Act, dated 1983, that had originally been governed by such Statute, since the enactment of the new Civil and Commercial Code, will be moved to the latter main body of provisions.

One of the most relevant amendments made by the new unified Codification, as anticipated, is dealing with an express regulation of the early and informal stages of the contract formation, focused on pre-contractual negotiations that covers a great deal of issues, such as, the freedom to enter into negotiations, provided the parties rights to abandon such dealings will be limited not to frustrate the performing party’s reasonable expectation to conclude a definitive agreement; the mandatory and implied duty both to conduct negotiations in good faith and confidentiality, and a more precise regulation in executing a letter of intent.

We are of the view that in the analysis of the potential exposure to pre-contractual liability that will be expressly governed by Argentine Law shortly, that had been implicitly regulated by the old dual Codification system, all the set of Commercial Case Law generated during that time, would be useful to review, not only for transactions executed by domestic parties, but also to cross border deals in which Common Law companies wish to tap the Argentine market, and might being exposed to litigation and/or liability risks, once informal negotiations starts up.

The contents of pre-contractual liability provisions introduced by the new Civil and Commercial Code, has been strongly influenced by the widely known Private Law Unidroit International Commercial Contract Principles, whose terms in conjunction

\textsuperscript{25} Argentina has also ratified the 1958 New York Convention of recognition and enforcement of international commercial arbitration awards.

\textsuperscript{26} Since the enforcement of the new Civil and Commercial Code, this statute will be denominated as the “General Companies Act”, on the grounds it will include all the different forms of corporate structures (both duly incorporated, informal partnerships and the new single shareholder corporation, respectively), provided, contractual joint ventures have been moved from the Commercial Companies Act to the new unified Code set of provisions.

\textsuperscript{27} The legal existence of the so-called civil partnership (sociedades civiles) governed by the 1871 Civil Code, will be also derogated, once such Civil Code expires.
with its explanatory notes and practical examples, should be helpful as an useful tool of consultation enabling to clarify the interpretation of certain issues that may give rise in case of disputes arising from the scope of the new Code’s provisions.

The good faith principle recognized by the Unidroit International Commercial Contracts Principles has been stated as follows: (1) each party must act in accordance with good faith and fair dealing in international trade; (2) the parties may not exclude or limit this duty.

In fact, and fully consistent with the Unidroit Principles, the good faith standard under the Argentine Civil and Commercial Code holds a mandatory and implied nature once the course of pre-contractual negotiations takes place, provided, it has been vested with such a degree of materiality, that it can not be contractually excluded or even limited by the negotiating parties.

We understand that as a result of the enforcement of the new Codification framework, the good faith standard of conduct that mandatory applies to pre-contractual negotiations, shall also be construed in accordance with other references to it set forth in separate sections, as a whole body of provisions, such as to govern the exercise of rights and the execution, interpretation and performance of contractual obligations.

In addition, the good faith principle should be also applied in conjunction with a set of latest generation “secondary duties of behaviour” expressly introduced by the new Codification, such as, the “confidence protection duty” based on the reciprocal trust and loyalty mutually owed by its parties; the duty to provide collaboration mostly in long term contracts, and the obligation to disclose detailed and complete information regarding the main features of the services or goods offered, as well as any other material circumstances to conclude a contract.

The fulfilment of this latter duty as from the sellers’ standing, since the early steps of an M&A deal, is key in order to evaluate its good faith conduct during preliminary stages of the transaction, mostly during the time due diligence investigation was opened.

Although since the enactment of the new Argentine Civil and Commercial Code both the freedom to enter into negotiations and to walk away from such dealings will be expressly granted to its parties benefit, it will be limited to avoid any bad faith conduct that would cause the frustration of the other party’s expectation to close the contract, without a reasonable cause.

In fact, a conduct fully contradictory with the good faith standard could be generally defined as a “bad faith” event, that might take place within the course of pre-contractual negotiations and be further eligible to be compensated for losses that might give rise to a sudden and abusive termination of such negotiations.

Unidroit International Commercial Contract Principles defines a “bad faith” standard to conduct precontractual negotiations, as follows: “...Negotiations in bad faith: a) A party is free to negotiate and is not liable for failure to reach an agreement; b) However, a party who negotiates or breaks off negotiations in bad faith is liable for the losses caused to the other party; c) It is bad faith, in particular, for a party to enter into or continue negotiations when intending not to reach an agreement with the other party...”.

28 Section 1.7 of the Unidroit Principles of International Commercial Contracts (2010 version).
29 Section 9 the the Argentine Civil and Commercial Code.
30 Section 961 of the Argentine Civil and Commercial Code.
31 Section 1067 of the Argentine Civil and Commercial Code.
32 Section 1011 of the Argentine Civil and Commercial Code.
33 Section 1100 of the Argentine Civil and Commercial Code.
Within the scope of the explanatory note of such Unidroit section, it has been stated that the freedom to contract principle that grants the right to freely enter into negotiations and decide on the terms to be negotiated, is not unlimited and must not conflict with principles of good faith and fair dealing.\(^{35}\)

Further, following Unidroit explanatory guidelines, it states that the right to break off preliminary negotiations is also subject to the good faith and fair dealing standards compliance, even before an offer is reached. A party may no longer be free to break off negotiations abruptly and without justification. This scenario may take place when the aggrieved party would have reason to rely on the positive outcome of the negotiations on the number of issues relating to the future contract.\(^{36}\)

It is worth pointing out two leading Commercial Court rulings that despite heard conflicts arising from pre-contractual break off governed by the dual Codification scheme, it would be useful to take such precedents into consideration, as a guideline in order to ascertain the scope of the incoming pre-contractual provisions of the Argentine Civil and Commercial Code, on the basis we need to await the manner local Courts would react to settle disputes arising from such incoming legal framework.

In the first leading case, a compensation claim was brought by the plaintiff alleged its frustration to conclude an agreement upon a breaking off negotiation event. Such action was dismissed on the grounds the claimant failed to show evidence that the course of preliminary negotiations had met an advanced degree of agreement regarding the development of a business project as well as the defendant’s bad faith conduct (sudden withdrawal), that did cause the former frustration to execute the proposed transaction.\(^{37}\)

In the second leading precedent the plaintiff also brought a compensation action against a multinational company owner of a widely known trademark, with whom it had established pre-contractual negotiations aiming to agree on the terms and conditions of a definitive trademark license agreement.

The plaintiff sustained such claim in its frustration to successfully close the transaction, when it later discovered the defendant company was banned from freely disposing its ownership rights over such strategic asset.

The Court uphold the claim on the grounds of the evidence showed by the claimant concerning with certain relevant defendant’s acts conducted during the course of such preliminary negotiations, even though after a preliminary agreement had also been executed, that did frustrate its reasonable expectation to close the deal, such as, the receipt of the internal rules of procedure to use such trademark, held meetings with the defendant’s counsel, as well as the review of a final draft of trademark license agreement, written by the defendant’s external lawyers.

In accordance with the Court’s reasoning, all such set of facts that took place during the course of pre-contractual negotiations should be construed as the best explanation to prove the intent of the parties to enter into a binding contract, provided however, they failed to reach such goal, because these whole set of facts have caused the frustration on the plaintiff’s reasonable expectation to form an agreement.\(^{38}\)

In sustaining such judgment the Commercial Court follows certain interpretation rules for Commercial contracts found in the 1862 Commercial Code, that states parties

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37 Mancinelli, JC c/ Siemens IT. CNCOM, Sec F. Dated August 11st 2011.
38 Benettar SAIC c/ Benetton SPA. CNCOM, Sec C. Dated December 11st 2001.
behaviour executed as a result of concluding a contract with a reasonable nexus with the disputed matters, must be qualified as the best response of the parties’ purpose at the time of entering into such agreement. In conjunction with the recognition of the good faith principle, the new Argentine Civil and Commercial Code also imposes the implied duty to keep the information received during the course of pre-contractual negotiations, as confidential.

Under the scope of this provision, the party that receives such confidential information is forbidden both to disclose it and use improperly for its own benefit. In other words, it prevents the receipt to deviate from using it with a purpose other than to moving forward with preliminary deal negotiations.

Another material issue that remains uncertain as a result of the enforcement of this new pre-contractual framework, is focused on the extent of the damages that an aggrieved party would be entitled to recover. In fact, it should be asserted whether a plaintiff would become eligible to be awarded with a full compensation amount, comprising the loss or reduction of the victim’s patrimony, the loss of profits (lucro cesante) in its expected economy benefit in accordance with the objective probability of its obtention as well as the loss of chance. These compensation items have been expressly recognized by the new Argentine Codification.

On the other hand, if the traditional Commercial Case Law in force during the dual Codification system should be applied, the amount of damages that would be awarded to the claimant, should be limited to an equivalent of the negative interest damage (“daño al interés negativo”) (i.e. out of pocket expenses incurred during the course of preliminary negotiations), excluding –as a general rule- the loss of profits as a recoverable item.

It should be noted, however, that the recognition of the negative interest damage as a cap amount, had been included as part of the terms of a previous Bill of Civil and Commercial Code, dated 1998, whose passing was dismissed, taking into consideration that it had been the basis of the text of the new Argentine Civil and Commercial Code.

In order to preliminary settle this substantive uncertain matter that would govern all such future disputes arising from pre-contractual liability cases, we are of the view it might be useful to follow as a source of consultation, an explanatory note of the “bad faith negotiation” concept developed by the Unidroit International Commercial Contract Principles, stating that a party’s liability for negotiations in bad faith is limited to losses caused to the other party. The aggrieved party may recover expenses incurred in the negotiations and may be also compensated for the lost opportunity to conclude another contract with a third person (reliance or negative interest), but may generally not recover the profit which would have resulted had the original contract been concluded (expectation or positive interest).

Within the scope of this innovative pre-contractual dealings framework governed by the new Argentine Civil and Commercial Code, a more precise concept regarding the legal effects arising from the execution of a letter of intent has also been included. The treatment of such subject matter within the new Code’s pre-contractual negotiations chapter seems to be reasonable on the grounds that the moving forward of preliminary

39 Section 218 (4) of the 1862 Commercial Code.
40 Section 992 of the Argentine Civil and Commercial Code.
41 Section 1738 of the Argentine Civil and Commercial Code.
42 Explanatory note to section 2.1.15. of the Unidroit Principles of International Commercial Contracts (2010 version).
dealings, in accordance with the local business market practice often led to crystallize certain partial agreements by executing a letter of intent. It is important to note that this form of documentation has been generally granted a non-binding nature, however, its standardized content structure are the expression of the parties autonomy of the will (pacta sunt servanda\textsuperscript{43}), with the exception of all such clauses that parties may expressly recognize as “binding” and enforceable (e.g. the seller’s exclusivity covenant).

Section 993 of the new Argentine Civil and Commercial Code has defined a letter of intent as a document in whose execution its parties set forth their consent to conduct preliminary negotiations under certain basis, limited to matters related to celebrate a future contract, and whose legal existence has been vested with a restricted interpretation.

We deem appropriate to describe certain issues giving rise from that statutory broad definition.

As a general rule, the new unified Codification introduces the concept of a letter of intent, as a non-binding agreement, provided it only recognizes as main effect that its execution only creates a duty to set up good faith negotiations between its parties aiming to celebrate a future contract.

It could be argued that the new Code would closely follow one of the three approaches rendered by Commercial Case Law, cited above, that had stated it solely binds the parties to negotiate under good faith and exchange information relating to the contractual purpose\textsuperscript{44}.

To conclude, the only obligation owed by the negotiating parties themselves is merely to negotiate.

Also, the effects arising from the execution of a letter of intent, as regulated by the new Argentine Civil and Commercial Code, should be clearly distinguished to a binding offer\textsuperscript{45}, as well as the different forms of preliminary agreements (contratos preliminares), found in a separate chapter, immediately following pre-contractual negotiations matters.

Section 994 of the new Code provides the following definition of these kind of preliminary agreements, as the one pursuant to which the parties mutually agree over specific essential elements that identify the definitive future agreement, however, its duration has been statutory fixed up to one year term, provided, it may be renewable upon its expiration.

Among such categories of preliminary agreements, the new Code includes the promise to execute a contract\textsuperscript{46} and the option agreement\textsuperscript{47}.

We are of the view that preliminary agreements have been vested with the effects to bound the parties to execute a definitive contract, other than just simply to negotiate.

5. The standing of Common Law investors that would plan to tap the Argentine business market once the enactment of the pre-contractual liability framework introduced by the new unified Codification takes place:

\textsuperscript{43} The pacta sunt servanda or freedom to contact principle is recognized by Section 958 of the new Argentine Civil and Commercial Code, that states parties have the freedom to enter into a contract and set forth its terms and conditions, within certain limitations imposed by the law, the public order and moral and good costumes.

\textsuperscript{44} Neptan SA c/ International Container Terminal Services y otros. CNCOM, Sec. D. Dated February 17th 2010.

\textsuperscript{45} Section 972 of the new Argentine Civil and Commercial Code.

\textsuperscript{46} Section 995 of the new Argentine Civil and Commercial Code.

\textsuperscript{47} Section 996 of the new Argentine Civil and Commercial Code.
Pre-contractual liability provisions included in the new Argentine Civil and Commercial Code, in force since August 1st 2015, will hold a relevant impact in the structuring of early steps not only of an M&A deal involving a local target corporation, but also for the setting up other strategic associations or joint ventures -of either a contractual or corporate nature- in the mining and/or domestic rising oil & gas market, in which Common Law companies would take participation.

Based upon the foregoing, it would be advisable that Common Law investors which would expect doing business with an Argentine target and/or counter-party, should develop an strategy aiming to generate a reasonable protection scheme to its own benefit, in order to avoid being exposed to liability and/or litigation scenarios that could give rise upon the sudden break off such preliminary negotiations, governed by Argentine Law.

A basic conduct that should be observed by all such Common Law-based jurisdiction companies, upon the commencement of preliminary negotiations under a cross border M&A transaction with a local counter-party, covered under a confidentiality agreement “umbrella”, should be its full consistency with the good faith principle of behaviour, as it mandatory and implied applies within the scope of the new Argentine Civil and Commercial Code set of provisions.

Taking into consideration that the negotiation of a binding or non-binding form of a letter of intent, would carry a long time consuming process to settle its wording, it would be advisable to agree on a formal confidentiality agreement with standard clauses, once the start up of informal negotiations takes place, including release of liability provisions, such as non-reliance and waiver clauses that prevent the disclosing party from being liable for its contents.

Common law companies should be further aware of facing certain material risks while tapping a cross-border transaction governed by Argentine Law, once preliminary negotiations would reach certain basic terms agreed on structural deal issues that led to the execution of a letter of intent.

In fact, it might be undergoing two major breaking off events that may take place before a definitive agreement would be closed, stressing that these scenarios would normally occur once the legal, financial, tax and accounting due diligence over the target concludes, and whose findings would surely impact on the scope of the seller’s contractual representations & warranties.

These two deal threats are identified as, on the one hand, the so called “change of mind risk”, that covers the possibility that each of its parties early and discretionarily leave the deal without facing any liability or litigation consequences, or alternatively, the so called “deal jumping” event, being qualified as the right granted to each of the negotiating parties to break off pre-contractual dealings in order to look for a better transaction (e.g. a higher price to the seller’s benefit or a more attractive target from the purchaser perspective).

It should be assumed, from a practical standpoint, that the occurrence of each of such scenarios within the scope of pre-contractual negotiations in a M&A cross-border deal, that could cause its early termination, would be implied, and there should have been adopted a great deal of diligence and care, mostly reflected in the negotiation of the documentation governing such early stages of the transaction, in order to grant the parties a reasonable degree of contractual coverage.

The choices that can be evaluated as part of the drafting of the letter of intent are several, including but not limited to any of the following: a break fees clause (it has not been widely used in local operations); or a mutually agreed “irresponsibility or release
of liability clause” that may be discretionary enforceable by the prospective buyer. In fact, Argentine Commercial Case Law has upheld the validity of this clause as part of a letter of intent contents, as binding and enforceable; or to draft a non-binding offer subject to the fulfilment of certain standard condition precedents, as a mutually agreed definitive stock purchase agreement as well as due diligence results will be unilaterally approved by the potential buyer, provided, this latter event has also been admitted by Commercial Case Law, at least during the dual codification system shall be in force.

Within the scope of the making off the due diligence investigation over the target company, whose successful termination would enable the parties to moving forward with the negotiations, aiming to agree on a binding stock purchase agreement and other related final documentation, a key interaction based on two material conflicting behaviours, on the one hand, the seller’s duty to disclose material information concerning the target’s business, whereas, on the other hand, the prospective buyer’s duty to investigate that would enable to meet the standard known in the Common Law as “caveat emptor” (i.e. buyer must know what is purchasing), would be decisive to ascertain whether such parties should have followed a good faith conduct standard. We deem necessary to set out in accordance with current M&A market practice and Commercial Case Law certain conducts that could be qualified as being performed in breach of the good faith principle, and therefore eligible to be compensated if it would cause a frustration on the other party’s expectation to conclude a transaction, as follows: a) an scheme designed by the seller controlling shareholder and its management to artificially inflate the calculation valuation mechanism agreed upon by the contracting parties, as a reference to determine the purchase price. This behaviour has been preliminary qualified as a criminal offence (deceit), by a leading Criminal Case Law; b) the meeting of an “invincible hidden standard” (“ocultamiento invencible”), knowingly executed by the seller, as innovatively developed by Commercial Case Law, that it could be featured as a conduct carried by the seller, in order that the aggrieved party would be entitled to both claim a civil compensation and bring a criminal complaint, pursuant to which it must be evidenced the former would have acted with fraud, and such illicit conduct would be deemed treated as material, that means has been capable to prevail over all such diligence and care that should have performed by the plaintiff that reasonably manages its business, and provided further, such seller’s conduct would be construed as decisive to cause the closing of the deal. Such leading case concludes in stating that if such invincible hidden scheme had not been committed by the seller, the buyer would have not been agreed to enter into a definitive agreement; c) as part of its good faith conduct, the seller’s obligation to disclose all material information and/or register in the target’s financial statements all the existent, conditional or contingent liabilities, being the cause of a post-closing indemnification claim brought by the purchaser, by the losses suffered as a result of such seller’s negligent or fraud act, alleging the existence of a corporate hidden liability (pasivo oculto), and proving as plaintiff, that despite its reasonable due diligence investigation over the target’s financial and legal situation, it could not be possible to identify ex ante such liabilities.

49 Vicente, Norberto Carlos José y otro c/ Sociedad Latinoamericana de Inversiones SA. CNCOM, Sec. D. Dated October 28th 2010
This innovative view in the treatment of certain pre-contractual liabilities issues that Common Law companies may be exposed to face while accepting being subject to a Civil Law jurisdiction within Latin-America (other than Argentina), could be mirrored throughout the steady growing of M&A deals executed by the so-called “Multilatinas” (leading family owned companies with highly sophisticated corporate governance standards, incorporated in one of our region top rising economies –i.e. Brasil, Chile, Perú and Colombia-) during the last ten years.

Therefore, in order to enter into an M&A transaction with a target company incorporated in a Civil Law jurisdiction within Latin-America, Multilatinas should be aware of the legal risks that might be challenged in conducting pre-contractual negotiations with another Latin-american counterparty, being governed by a foreign law. In fact, it would be advisable to make a due diligence survey concerning the application of certain key foreign law issues that would govern the transaction (including but not limited to its exposure to pre-contractual liability and letter of intent matters) as follows: the recognition of an implied statutory good faith and confidentiality duty to conduct preliminary negotiations; the effects arising from a sudden termination of such negotiations without a reasonable cause; the extent of the damages to be reimbursed by an aggrieved party, and the consequences arising from executing a letter of intent or other preliminary non-binding documentation.

We summarize certain relevant subject matters governed by foreign law concerning pre-contractual negotiations, as follows: (i) whether the commencement of negotiations or the entering into an agreement to negotiate creates legally enforceable duties; (ii) whether the parties are under a duty to negotiate in good faith; (iii) whether there is a duty to continue negotiations until there is a proper risk to withdraw; (iv) whether the breaking off negotiations can be considered to constitute a breach of a legal duty under contract or tort law; and, (v) whether and which remedies are available to parties injured from breaking off negotiations.

Should we take a look at the new pre-contractual provisions of the Argentine Civil and Commercial Code, it could be argued that all the questions raised above have received a complete response from such framework, however, we would estimate essential they should be proactively reviewed by a Common Law investor that wish to tap its local market since the early steps of informal negotiations takes place, once it will be in force shortly.

**6. Final thought and conclusion:**

It seems undoubtedly that the application of the new Argentine Civil and Commercial Code, would materially affect the structuring of cross-border M&A transactions in which US companies would take an active role. We understand as advisable that all such Common Law based companies that would accept to be governed by Argentine Law, should proactively adopt a set of reasonable behaviours of diligence and care to avoid being exposed to a global litigation and/or liability risk, taking into further consideration that pre-contractual liability claims and the mandatory compliance of the good faith principle are –as a general rule– unknown by Common Law jurisdictions.

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Both Common Law and Civil Law parties have not been fully aware on the existence of different conflicting scenarios that might occur during preliminary stages of a local and/or cross-border deal, provided, if they would have not been reasonably identified, it could give rise to a complex, time consuming and expensive litigation. Among such conflicting scenarios, it is worth setting out, each of the followings: a compensation claim brought by a sudden break off pre-contractual dealings without a fair cause; an abusive and arbitrarily withdrawal of a binding offer; the breach of the good faith that could cause the frustration of the other party’s reasonable belief to conclude a contract; the breach of a confidentiality statutory duty; the lack or performance of contractual obligations wrongly formed by executing a letter of intent; and, the tortious interference with contract doctrine.

Also, within the timing pre-contractual negotiations are conducted, the due diligence investigation over the target company is often being performed, and once its results and findings are finally disclosed, negotiating parties might be exposed to face two major set-backs, known as the “change of mind risk”, and the “deal jumping”, respectively, as it was described in point 5 above.

In fact, we estimate that negotiating parties skills and their counsels advice would be decisive to set up ex ante certain coverage tools aiming to avoid being held liable against any litigation and/or liability risk arising out of the occurrence of any of such scenarios.

Based upon a major reform to the Argentine Private Law, in force since August 1st 2015, and on the grounds, for obvious reasons, that there will not be an available Case Law that would help to construe the scope of this new legal framework, that applies to pre-contractual negotiations and the liability arising therein, it would be of the essence that in cross border transactions in which Common Law companies would be involved, a joint and interactive work carried by both US and Argentine counsels in order to detect ex ante certain risks scenarios that might be facing these kind of investors upon the starting up negotiations with an Argentine target or counterparty governed by local Law, should be definitively structured.