

## **Cross-Border Contractual Complexities: Applying Civil Law Concepts to Sellers' Indemnities under New York Law**

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In cross-border M&A transactions in Latin America, a counterparty will often request the inclusion of one or more foreign law concepts in a New York law governed purchase agreement. However, including terms that are based on the civil law of Latin American countries (e.g., Mexico, Chile or Colombia) may have significant consequences that all of the contracting parties should be aware of. This article addresses these consequences in a particularly high stakes situation: negotiating the indemnification provisions of a New York law purchase agreement.

### **Examining *Dolo* in an Indemnification Provision**

Consider the following scenario: a US buyer of a target company in Mexico is negotiating a purchase agreement governed by New York law. During negotiation of the indemnities, the buyer asks the seller to revise the agreement so that any limitations on the indemnity will not apply to *dolo*, a civil law fraud-related concept,<sup>1</sup> as well as the agreement's customary fraud exclusions based on common law concepts. The buyer's suggested revision might result in a clause that looks like this:

“Notwithstanding anything in this Agreement that may be deemed to the contrary, nothing in this Agreement, any Exhibit or Schedule hereto, or any other Transaction Document shall limit in any respect any claim by any Person for fraud or *dolo*, or any right of any Person to any remedy in respect thereof.”

The buyer may argue that the inclusion of *dolo* is not a substantive change (on the basis that *dolo* is similar to common law fraud). However, that argument is incorrect for several reasons, and, as discussed in detail below, the insertion of *dolo* gives the buyer a significant amount of additional leverage in a misrepresentation-related dispute with the seller.

If the seller were to accept the buyer's revisions as written above, the buyer would have two potential avenues to seek indemnification under the purchase agreement: (i) the seller is liable based on common law fraud under New York law and (ii) the seller is liable based on Mexico's concept of *dolo*. Many articles have already been written about how sellers can limit the common law fraud indemnity exclusion simply by defining “Fraud” narrowly to, for example, an intentional misrepresentation based on the knowledge of specific actors. As a result, we will focus on the potential consequences on the extent of the seller's liability as a result of *dolo*.

### **The *Dolo* Effect**

Given the amorphous nature of *dolo*, the effects of its inclusion in a New York law purchase agreement indemnity limitation may be significant. The concept of *dolo* in civil law countries in Latin America usually refers to a person's willful misconduct, or scienter, to commit a crime or obtain an unlawful benefit, but interpretation and consequences vary in different contexts. In certain circumstances, courts have found that *dolo* may mean that a party committed gross negligence, and, in other circumstances, courts have even found that, due to a party committing

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<sup>1</sup> We describe *dolo* as a “fraud-related concept” as it is not simply the parallel to common law fraud.

*dolo*, the plaintiff was entitled to rescission rights with respect to a transaction. In the case of the sample clause above, the seller may have inadvertently agreed to a gross negligence exclusion to the contractual limitations on indemnity, as well as possibly granting the buyer a rescission right with respect to a transaction if the buyer can prove that *dolo* was committed.<sup>23</sup> This would be a stunning outcome for an unwary seller.

To be clear, the foregoing was merely an example of one possible outcome from including *dolo* in the exclusion to the limits on an indemnity. The second prong of the sample clause requires a New York judge or arbitrator (presuming New York venue) to determine how civil law *dolo* should be applied under a New York law purchase agreement. The buyer will be very keen to argue that the inclusion of *dolo* entitles the buyer to pursue *multiple* claims based on various lower standards of culpability (e.g., gross negligence) and entitles the buyer to various additional remedies (e.g., rescission) that *dolo* would have provided under Mexican law. To illustrate the strength of the buyer's argument, one can simply read a simplified version of the sample clause solely focusing on its references to *dolo*:

“...nothing in this Agreement...shall limit in any respect any claim by any Person for... *dolo*, or any right of any Person to any remedy in respect thereof.”

Common law judges and arbitrators will likely focus on general rules of construction that indicate that the inclusion of a particular word in a contract must have some meaning. Whether they will “read in” lower levels of culpability or a rescission right or any other remedy based on the sample clause's inclusion of *dolo* above is hard to predict. The point is that the mere inclusion of *dolo* affords the buyer the *opportunity* to make these kinds of arguments.

As a practical matter, such a judge or arbitrator may not have much experience applying *dolo* under New York law, especially given the varied usage of *dolo* under the civil law (which is further complicated by the fact that civil law judges do not follow case precedents in the way that common law practitioners might expect). The buyer and seller would likely have to hire foreign law expert witnesses to testify as to what constitutes *dolo* under the civil law and how the concept can correctly be applied under a New York law purchase agreement. This battle of experts, so to speak, will be time consuming and expensive.

While this discussion has centered primarily on what would happen in the context of a litigated dispute with respect to *dolo*, it should also be noted that the mere presence of *dolo* in the sample clause could lead a seller to settle an indemnity claim that they would have litigated had the indemnity exclusion been limited to common law fraud.

### **What is a Seller to Do?**

What is a seller to do when negotiating the inclusion/exclusion of *dolo* or similar concepts in their New York law purchase agreements? Staying within our example, the arguments for and against the inclusion of *dolo* in a purchase agreement are similar to those for and against the insertion of a defined term “Fraud” in a fraud exclusion to the indemnity (e.g., each party will have arguments for limiting or expanding the universe of fraud claims that the buyer will have the ability to bring

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<sup>2</sup> Whether a buyer can prevail on such claims will be fact specific and will vary by jurisdiction.

<sup>3</sup> Local counsel in the relevant jurisdiction in Latin America would have to be consulted to walk through the myriad of potential arguments that a buyer may have based on the inclusion of the undefined term “*dolo*” in the purchase agreement.

against the seller). Much of the negotiations will depend on the comparative leverage of the buyer and seller, but the sample clause can easily be modified to be much less buyer-friendly. The most seller-friendly approach would be to simply delete *dolo* altogether and include a defined term for “Fraud”. If a buyer absolutely insisted on the inclusion of *dolo*, a compromise position might be to include *dolo* as a defined term and have local counsel draft the definition to specify the applicable standard of culpability, as well as what additional remedies are contemplated.