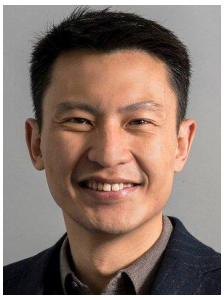
EU's AI Act May Lead To More M&A Arbitration

By **Nelson Goh and Benjamin Qiu** (January 9, 2025)



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Artificial intelligence has been the financial story of the last year, with soaring valuations for AI businesses dominating the markets pages of the financial press. Unsurprisingly, AI companies have been the targets of merger and acquisition activity.

But, with the European Union Artificial Intelligence Act beginning to take effect, deal participants opting to select arbitration as a means of dispute resolution in their M&A deal agreement should spend some time considering its use as a means of risk management.

EU AI Act

The long-anticipated European Union Artificial Intelligence Act came into force on Aug. 1, with the majority of the rules starting to apply in August 2026. The act is wide in scope and broadly affects EU-based companies using or supplying AI systems anywhere, international companies doing so in the EU, and any company generating AI content that is used in the EU.

The act classifies AI systems into risk profiles: (1) unacceptable risk, e.g., cognitive behavioral manipulation of people, in which case the system is banned; (2) high risk, e.g., systems used in education or law enforcement, in which case the system is subject to a range of regulatory safeguards including recordkeeping and transparency obligations; (3) specific transparency risk, in which case there is a transparency obligation; and (4) minimal risk, in which case there are no obligations.

The act also regulates other features of the AI landscape: For example, it requires deepfakes to be labeled as AI-generated material.

Notably, the act has teeth. The European Commission is empowered to levy giant cartel-style fines for failing to comply. At the most serious end, it can impose a fine of the higher of €35 million (approximately $36.4 million) or a whopping 7% of worldwide annual turnover for a breach of the rules on prohibited uses of AI.

M&A Disputes in AI

The number and size of deals are on the rise: According to GlobalData, AI-related deal activity in the first quarter of 2024 increased by 168% against the same period last year, with deal volume increasing by 27%.

With the act now in place, companies about to agree terms to buy an AI business will need to ask several questions:

- What if the AI system the target is developing, which the target says will be in the high-risk category, is determined to be in the unacceptable-risk category and banned? Can the acquirer walk away? What will any compensation look like?

- What if an international company is bought to roll out its system in the EU on the basis that it will fall in the limited-risk category — but the system is then designated "high risk" by the commission? How will they account for the cost of higher compliance?

- What if the target has breached the act in some way, and there is a significant commission fine hidden in the price?

M&A lawyers will try to deal with these risks in advance by including extensive representations and warranties in the acquisition agreement to flush out the information and discover the true price. They may also incorporate devices to deal with adverse regulatory decisions like purchase price adjustments, indemnities, deferred consideration or escrow arrangements, setoff rights, and material adverse change clauses.

But it may be inevitable that parties will disagree on the triggers and thresholds for those mechanisms and the extent of disclosure against warranties resulting in disputes.[1]

Dispute Resolution Options

M&A documents typically contain dispute resolution clauses. Traditionally, those clauses may select the courts of a particular jurisdiction. But courts need not be the only port of call.

In cross-border M&A — which will include AI-related M&A in the EU — parties are increasingly choosing to submit their disputes to arbitration. The International Chamber of Commerce, the London Court of International Arbitration and the Singapore International Arbitration Centre, for instance, have all reported an increase in M&A-related disputes in recent years.[2]

Classification and enforcement under the act will have the potential to derail or materially change the value of M&A transactions. Parties will need to take steps to mitigate these risks when conducting due diligence and drafting acquisition agreements, and as a backstop, agree on a dispute resolution mechanism that is suitable for resolving any attendant disputes.

Where the underlying technology is secret or very complicated, an arbitration clause may be apposite. As a mode of dispute resolution, arbitration is confidential and permits adjudicators of a technical background. The New York Convention also facilitates enforcement of arbitration awards globally.

Dispute Resolution Clause Considerations

In many M&A transactions, the dispute resolution clause tends to be a "midnight provision" — in other words, a boilerplate term looked at in passing on the eve of closing. Few parties anticipate a dispute when a deal is being struck; however, it is nonetheless advisable for parties to consider the dispute resolution provisions in the documentation as a means of risk management.

A boilerplate arbitration clause would typically stipulate the number of arbitrators — usually three, the language of the arbitration, the place or seat of the arbitration, i.e., the supervisory court, and the administering institution.

Of these, the following considerations are key.

In choosing the seat of arbitration, it is helpful to have some knowledge of the law of arbitration at the seat. The seat is the location of the court that will supervise the jurisdiction. Where the actual physical hearing will take place can, but does not need to be, the same as the seat. Most established arbitral seats (e.g., Singapore, London, Paris) have clear arbitration laws.

In the most general of terms, selecting Paris would tend to favor giving a tribunal a wide latitude and discretion to most things — French arbitral law shows deference to party autonomy. Selecting Singapore would mean inviting the application of Model Law jurisprudence to a putative arbitration. The English Arbitration Act 1996 famously did not follow the Model Law and takes its own unique approach.

Each jurisdiction has its own approach, and while not vastly different, this is something parties should be cognizant of as the law of the seat may affect issues of procedure, evidence, interim relief and enforcement, among others.

Do parties want a multitiered clause to de-escalate the dispute? In situations where the transaction involves longer-term commercial relationships, heading straight to a dispute may not be ideal. Anecdotally, once a dispute has commenced, parties can become entrenched in their legal positions and pay less attention to the broader commercial factors at stake.

Having a multitiered clause — one which requires negotiation or mediation before arbitration — can benefit the parties by encouraging them to seek out commercial solutions prior to formal proceedings. Any such clause should be worded clearly to be enforceable.

For completeness, even where parties have included a jurisdiction clause, i.e., for disputes to be resolved in the courts of a particular jurisdiction, it may be possible to agree to arbitrate ad hoc. This may be a meaningful choice given the potential benefits of arbitration.

Arbitration, like all modes of dispute resolution, has characteristics that may not make it suitable for every type of dispute. For instance, where parties envisage that a potential dispute may involve competition law or legal issues that involve the public policy of a particular jurisdiction, it may be that court proceedings may be better suited.

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[1] See for instance MDW Holdings Ltd v Norvill [2022] EWCA Civ 883. Many M&A documents now contain arbitration clauses which allow the dispute to be resolved privately.

[2] In 2023, the London Court of International Arbitration reported an increase in shareholder, share purchase and joint venture disputes (from 10% in 2022 to 15% in 2023) (Reports (lcia.org)).