

Strelia M&A Series

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SILENCE ISN'T ALWAYS GOLDEN FOR BUYERS IN M&A DEALS

M&A transactions are all about risk allocation between the buyer and the seller. Pro-sandbagging and anti-sandbagging clauses can seriously impact this risk allocation, so parties should negotiate and draft these carefully.

Sandbagging in an M&A context applies when the buyer learns of a breach of a representation, warranty or covenant before closing but says nothing about it until the deal has closed and brings a claim against the seller under the agreement at that point. Parties need to reflect on how to address this in a transaction and consider including a pro-sandbagging or an anti-sandbagging clause or remain silent.

A pro-sandbagging clause is buyer-friendly: the buyer will be entitled to post-closing indemnification even if the buyer knew about the breach prior to closing. The buyer's remedies are thus not impacted—at or prior to closing—by the buyer's knowledge of the facts giving rise to indemnification. A buyer will try to define *knowledge* as narrowly as possible. A pro-sandbagging clause will incentivize a seller to provide the buyer with accurate disclosure. A buyer should carefully consider how a pro-sandbagging clause interplays with other clauses that could potentially erode the pro-sandbagging clause, such as a damage-mitigation clause. Also, Belgian courts could be reluctant to accept a hard pro-sandbagging clause as it could be perceived to not be in good faith. Therefore, if a buyer successfully negotiates a pro-sandbagging clause, this should be drafted clearly and precisely and contain reasoning behind it.

On the other hand, sellers will seek to include an anti-sandbagging clause that can prevent the buyer from being indemnified for any breaches that the buyer had knowledge of prior to the transaction's closing. In such case, a buyer will first need to prove the existence of a breach and to refute any assertion by the seller that the buyer had knowledge of the breach prior to closing, before the merits of the claim can even be considered. Given the difficulty of proving that a buyer had knowledge, defining this *knowledge* is crucial in the negotiations and eventually in writing. A seller will seek to keep this definition as broad as possible by including constructive, implied or imputed knowledge of a buyer and by broadening the type of disclosures. Buyers will seek to narrow the definition of *knowledge* by including only actual knowledge possessed by a limited number of individuals and on the basis of written disclosures in the data room only. Such anti-sandbagging concept incentivizes the parties to inform each other as fully as possible prior to closing.

As flagged, it is not always easy for a buyer to negotiate a pro-sandbagging clause successfully because it is sometimes perceived as unfair or against the principle of good faith. Therefore, and as there could be justifying circumstances, it is in the interest of the buyer to agree with the seller on a precisely drafted pro-sandbagging clause that also contains the reasoning for it. Alternatively, a buyer might need to compromise and agree on a sort of anti-sandbagging clause. If it does so, it should seek to narrow the knowledge to actual knowledge.

If parties cannot find common ground on how to handle the sandbagging issue and want to proceed with the deal, parties could decide to remain silent and leave the sandbagging issue to be determined by the governing law of the agreement—or by the courts. This strategy implies an understanding of the default sandbagging rules under the applicable law and requires parties to carefully consider the consequences of being silent. As stated above, Belgian courts seem to consider hard pro-sandbagging clauses as going against the principle of good faith. A buyer should therefore pursue having a precisely drafted and justified pro-sandbagging clause to substantiate this perceived deviation from the good-faith principle.

In conclusion, parties need to carefully consider and address sandbagging clauses in M&A deals as well as the consequences of being silent on them.



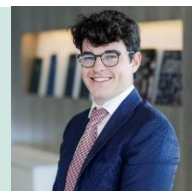
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