

Sandbagging in M&A Transactions

Blogs

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When an important M&A contracting strategy goes by the moniker “sandbagging,” it is safe to assume the strategy is controversial.

The concept of sandbagging is relatively simple. In jurisdictions that allow M&A purchasers to sandbag sellers, a buyer has the right to rely on the verbatim text of the sale agreement and does not need to show that it relied on the accuracy of the representations and warranties in the sale agreement in order to sue if one of the representations or warranties is inaccurate. At its extreme, a purchaser can have specific knowledge prior to closing that a representation or warranty is inaccurate, keep that information to itself, and then sue for breach the day after closing. While the concept has been challenged as both inequitable and unethical by certain commentators and courts, some courts have endorsed it by relying on strict rules of contracting.

The issue can arise in several ways. At the drafting stage, the contracting parties may seek to include either pro-sandbagging or anti-sandbagging provisions in the agreement of sale. When sophisticated parties agree, the courts will generally enforce the agreed-upon terms. Most often in litigation, however, the issue arises where the sale agreement is silent, either because neither side raised the issue during the negotiations or because one or both sides rejected pro- or anti- sandbagging language proposed by the other.

As we have written elsewhere, Delaware has a complicated history of dealing with sandbagging: its lower courts grappled with the issue for decades, on parallel tracks and with inconsistent results. That history has not stopped Delaware’s Court of Chancery from describing the state as “pro-sandbagging.” *Arwood v. AW Site Services, LLC*, 2022 WL 705841 (Del. Ch. 2022).

The law across the country is equally inconsistent. In California, anti-sandbagging is the default common law rule — a buyer must have relied on the warranty to sue on it. *Grinnell v. Charles Pfizer & Co.*, 274 Cal.App.2d 424, 440 (Cal. Ct. App. 1969). New York takes a hybrid approach: because the seller’s warranties are part of the basis of the bargain, the buyer can sue on those warranties even if they believed they were false. *CBS Inc. v. Ziff-Davis Publishing Co.*, 75 N.Y.2d 496 (1990). However, when the seller discloses the inaccuracy of the warranties, “it

cannot be said that the buyer . . . believed he was purchasing the seller's promise as to the truth of the warranties." *Rogath v. Siebenmann*, 129 F.3d 261, 265 (2d Cir. 1997).

The continued uncertainty makes it all the more important that persons engaged in M&A transactions consider whether and how to address sandbagging as part of the transaction documents rather than leave the issue to state common law default rules.

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