BANKING ON CORPORATE

NARRATION ABOUT REPRESENTATIONS

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Representations in M&A agreements may take on a different spin if they were evaluated in the fashion of current political discourse. A representation that the purchased business is the "hugest of all time" may not seem to be objectively true, but if it were repeated enough times without apparent concern for reality, then it might come to be accepted as true — or at least best not challenged. If cracks appeared, there may be retrenchment, perhaps along the lines that the representation was never intended to have been accurate. Eventually, third-party reports about the representation's truth could simply be characterized as "fake news." We may even get to the point where lawyers defending their client's positions about M&A representations are denied service at their favourite restaurants.

Recent issues in commercial practice representations have, ironically, demonstrated that M&A representations, too, have their own unique dynamic. M&A practitioners will likely recall instances where clients mistook representations as statements of truth, as if sworn statements were being made. It can be a challenge for some to make a representation that they are not certain to be true, not simply because of the potential financial exposure but because a contract element that is really about risk allocation is mistaken for a form of personal oath.

One such issue is "sandbagging." In M&A-speak, sandbagging occurs where a buyer is permitted to sue on a seller's representations even if the buyer knew before the deal that the representations were false. This issue is often debated in M&A negotiations, and recent Delaware decisions have highlighted the point. To many casual observers, sandbagging would seem unfair. Buyers should not be compensated for damage of which they were aware. A buyer shouldn't play possum when it discovers something, relying on the seller's disclosures but having no obligation to share what it knows and let the seller address it. Case closed, right? Not so fast . . .

The countervailing arguments demonstrate some key roles of representations and about how M&A processes often work. From fond personal experience, I can relate that buyers (and their counsel) are often buried in disclosures from the seller that are challenging to digest. When a buyer suffers a loss, they are denied recovery because it's deemed to know the needle in the disclosed haystack would add non-recovery to injury. Anti-sandbagging rules may also put the buyer in a position of proving what it didn't know, which can be challenging (though in my daily life I unintentionally excel at this). Perhaps most significantly, sandbagging permits the parties to rely on the language of the agreement and encourages full and accurate disclosure by the seller.

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That is really the point that the sandbagging debate illustrates — representations in M&A agreements are not legalistic realities but rather primarily contractual allocations of risk that also help to spur relevant disclosures. The same theme arises from another current (and growing) phenomenon in M&A contracts, #MeToo representations. In the wake of recent sexual harassment scandals, the appearance of these representations was predictable. Given the nature of the representations, recovery for misrepresentation is part of the calculus, but the principal focus is likely on prompting disclosure. Reluctance to give the representation would be revealing, for example, and any due inquiry process might be educational for both parties. Disappointingly for those seeking rare prurient information in securities filing databases, any schedules disclosing exceptions to #MeToo representations will likely be redacted from public filings.

The discussion of sandbagging provisions, too, (clear stipulations that a buyer can or cannot make indemnity claims for misrepresentations of which it was aware) can significantly reflect key elements of the negotiation, such as the parties' acceptance of risk, the degree of diligence undertaken, the nature of the business and other factors. As more agreements are featuring no sexual harassment representations, large numbers are silent on sandbagging.

I am not certain of the source of the term "sandbagging," but I know that in sports it typically means a player competing at a level lower than their skill level for tactical advantage. I like to think that I've been competing intentionally at less than my skill level, not for any strategic purpose but just to rationalize my level of competition. And so, once again, the concept of sandbagging forces a disclosure.

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