

# Delaware Court of Chancery Pronounces Delaware a “Pro-Sandbagging” Jurisdiction

## Delaware Law Update

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### Related People:

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In *Arwood v. AW Site Services, LLC*, C.A. No. 2019-0904-JRS (Del. Ch. Mar. 9, 2022; corrected Mar. 10, 2022; amended Mar. 24, 2022) (hereinafter, *Arwood*), the Delaware Court of Chancery pronounced that Delaware is a “pro-sandbagging” jurisdiction. In the context of acquisitions, “sandbagging” is a term used to refer to a situation in which a buyer is aware or becomes aware that a representation and/or warranty made by the seller is false but nevertheless goes forward with the transaction and seeks post-closing damages from the seller for the breach. The Court reasoned that Delaware is “more contractarian” than most states and that Delaware law respects parties’ “right to enter into good and bad contracts.”

AW Site Services, LLC (AWS), sought to acquire a number of waste disposal businesses (the Waste Businesses) established by John D. Arwood (Arwood). At the time AWS expressed interest in acquiring the Waste Businesses, the businesses were not prepared for an acquisition and no valuations or financial records for the businesses were available. Arwood did not maintain any financial records for the Waste Businesses and did not know how to prepare them. AWS, along with its parent Broadtree Partners, LLC (Broadtree), was ultimately given full access to the Waste Businesses’ raw financial records. Broadtree in turn performed extensive due diligence and prepared financials for the Waste Businesses.

On October 19, 2018, AWS and Arwood entered into an asset purchase agreement (APA) whereby AWS acquired the Waste Businesses for \$16 million. The APA required Arwood to indemnify AWS against losses due to “any inaccuracy or breach of any representation or warranty” and any “breach of any covenant or agreement.” Arwood also represented and warranted in the APA that the Waste Businesses’ financial statements were accurate. The APA further provided that an indemnified party “shall be entitled to indemnification . . . notwithstanding whether an employee, representative or agent of the Indemnified Party seeking to enforce a remedy knew or had reason to know of such breach and regardless of any investigation by such Indemnified Party.”

The dispute began after Arwood accused AWS and Broadtree of wrongfully refusing to release approximately \$1.41 million of the transaction consideration from escrow. The parties filed a number of claims against each other. AWS asserted a breach of contract claim, among others, by alleging that Arwood breached the APA by falsely warranting that the Waste Businesses’ financials were accurate. Arwood raised a sandbagging defense to AWS’s breach of contract claim, arguing that the buyers could not rely on representations in the APA that they knew pre-closing were false.

The Court disagreed with Arwood and held that the “sandbagging defense is inconsistent with our profoundly contractarian predisposition.” According to the Court, “Delaware is, or should be, a pro-sandbagging

jurisdiction.” The Court further reasoned that the “reasonableness, or not, of AWS’s reliance upon the sellers’ representations is not a relevant consideration in assessing the *bona fides* of AWS’s indemnification claim.” The Court explained that a “pro-sandbagging rule supports the notion that ‘representations and warranties serve an important risk allocation function.’” Since the claim was ultimately a question of contract, the Court reasoned that the proper analysis was whether the warranty or representation in question was breached. The Court concluded that if so, then the buyer should recover regardless of whether the buyer relied on such warranty or representation or believed it to be true when made. The Court further explained that parties could easily include “anti-sandbagging” provisions in their agreements to prevent sandbagging. The Court ruled in favor of AWS on its breach of contract claim.

While the Delaware Supreme Court has yet to address the issue, the Delaware Court of Chancery has held that Delaware is a pro-sandbagging jurisdiction. Parties to asset purchase agreements and other sales contracts should be aware of language that either expressly permits or disallows sandbagging. Parties to such contracts should be aware that sandbagging is a risk if not disclaimed in the contract and that anti-sandbagging provisions may be included to prevent such risk.