

Delaware Court of Chancery Signals That Delaware Is a Pro-Sandbagging Jurisdiction

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A recent post-trial decision from the Delaware Court of Chancery has become the latest authority in the debate over whether Delaware is or is not a “pro-sandbagging” jurisdiction. In *Arwood v. AW Site Services*, Vice Chancellor Slight stated that Delaware is, or should be, a pro-sandbagging jurisdiction.^[1]

The case arose from AW Services’ (AWS) acquisition of Arwood’s waste management business. After the deal closed, Arwood initiated litigation against AWS for, among other claims, their failure to release a portion of funds that had been escrowed at closing. AWS counterclaimed for fraud, but that claim ultimately failed because AWS could not prove its scienter and justifiable reliance elements. However, AWS also asserted a breach of contract claim, arguing that Arwood had breached certain of the representations and warranties in the purchase agreement related to the financial condition of the acquired business. Given that the deal had closed and suspecting that the breach of contract claim may implicate sandbagging, Vice Chancellor Slight asked the parties to brief the current landscape of sandbagging in Delaware and the extent to which sandbagging would apply in the presence of constructive rather than actual knowledge of falsity.

Delaware has long been considered by practitioners and commentators alike to be a pro-sandbagging state — one that allows parties to sandbag the opposing party with claims it knew it had pre-closing but declined to bring until after closing. As Vice Chancellor Slight notes, however, this pro-sandbagging position was questioned in a recent Delaware Supreme Court decision, *Eagle Force Holdings, LLC v. Campbell*. In *Eagle Force*, the Supreme Court majority acknowledged there was a debate as to whether a party could recover under a breach of warranty claim where that party knew of the warranty’s falsity at signing. While concurring in part and dissenting in part, then-Chief Justice Strine took that finding a step further and expressed doubt that a buyer could sue a seller because “what he knew to be false remained so.”

Capitalizing on the opportunity to clarify the state of sandbagging in Delaware, Vice Chancellor Slight held (1) that Delaware is indeed a pro-sandbagging jurisdiction, and (2) that even if Delaware is not a pro-sandbagging state, a sandbagging defense to a breach of contract claim would only be viable where a buyer *knew* a seller’s representation to be false, as opposed to where the buyer *should have known* it was false. This conclusion was based on Delaware’s “strong contractarian propensities,” namely its emphasis on parties’ rights to allocate risk, to enter into good and bad contracts alike, and the courts’ propensity to enforce those contracts. As a practical matter, the court also explained that reliance is not an element of a breach of contract claim, which means that a buyer’s knowledge of a representation’s falsity (implying the absence of reliance) will not as a matter of law prevent it from asserting a breach claim post-closing.

Arwood represents the clearest post-*Eagle Force* delineation of the law on sandbagging in Delaware, and it does so with thorough and sound reliance on some of Delaware's well-settled contractual principles. With this case in mind, sellers and buyers alike should pay close attention to their agreements' sandbagging provisions. Parties can choose to prohibit sandbagging by adding such language to their agreements. Where a contract is silent, however, parties should remember that under Delaware law, the buyer may rest on the seller's "implicit promise to be truthful in its representations," permitting the buyer to bring a claim even where the buyer may have doubted the truthfulness of a representation.

[1] C.A. No. 2019-0904-JRS (Del. Ch. March 9, 2022).

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