



M&A Disputes: Deceit, Avoidance of Contract and Restitution

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Remedies for a Fraudulent Misrepresentation

- I. Criminal complaint for fraud
- II. Avoidance (Rescission) of the contract
- III. Damages in tort or under the concept of *culpa in contrahendo*

I. Advantages and Disadvantages of a Criminal Complaint

■ Advantages

- Support of the civil claim if the fraud is prosecuted and sentenced
- Prosecution authorities will investigate *ex officio* and provide for more evidence
- publicity

■ Disadvantages:

- Negative effect if the alleged fraud is not prosecuted
- publicity

II. Avoidance (Rescission) of the Contract

Sect. 123 German Civil Code:

„A person who was induced to make a declaration of intent by wilful deceit (...) is entitled to avoid that declaration.“

Requirements for an avoidance of the contract under German law:

- (1) A wilful deceit (active wilful deceit or wilful deceit by concealment)
- (2) Declaration of intent by the deceived party
- (3) Causal link between deceit and the declaration of intent
- (4) Declaration of avoidance by the deceived party vis-à-vis the deceiving party within one year after discovery of the deceit

Legal consequence and effect of the avoidance:

The contract is null and void *ab initio* (Sect. 142 German Civil Code)

II.1. Wilful Deceit according to Sect. 123 German Civil Code

■ Active deceit

- Providing buyer with wrong information on the target
- Submitting incorrect documents in the dataroom
- Giving wrong answers in Q&A sessions

■ Deceit by concealment

- Non-disclosure of defects of the target
- Non-disclosure of certain documents and information in the dataroom
- Concealment of certain facts in Q&A sessions

II.2. Deceit by Concealment

- Precontractual duty to act in good faith (Sect. 242 German Civil Code)
- Duty to disclose all facts which have a material impact on the decision of the buyer to make the acquisition and which can frustrate the purpose of the contract if the buyer could expect such information pursuant to the common usage (*German Supreme Court*, 06.12.1995, NJW-RR 1996, 429)
- The seller of an enterprise has an augmented duty to disclose all circumstances which put the viability of the company seriously at risk (e.g. imminent or actual illiquidity or over-indebtedness) as the sale is difficult to evaluate and because of its remarkable economic importance (landmark decision by the *German Supreme Court*, 04.04.2001, NJW 2001, 2163).
- Buyer's opportunity to perform a due diligence does not affect seller's augmented duty to disclose, in particular if the documents were not fully disclosed in the dataroom.

II.3. Wilful Intent

- The deceit has to be intentional.
- *Dolus eventualis* is sufficient (the party holds that its statement might be incorrect and approvingly accepts that the other party might be induced to conclude the contract by deceit).
- Objectively incorrect statements regularly indicate a wilful intent.

II.4. Can the Knowledge of Employees of the Target be Attributed to the Seller?

- The knowledge of the seller's legal representative will be attributed to the seller (Sect. 166 German Civil Code).
- Duty to organize and transfer knowledge within legal entities in particular with regard to information which is regularly documented and stored
- Breach of this duty leads to the consequence that the company is not entitled to invoke the lack of knowledge (*German Supreme Court*, 02.02.1996, NJW 1996, 1339).
- The attribution of knowledge was also affirmed regarding two different authorities if they exchange information due to a certain event (*German Supreme Court*, 30.06.2011, NJW 2011, 2791).
- If employees of the target company are involved in the transaction, according to the German legal literature, the knowledge of these employees shall be attributed to the seller.

II.5. Causal Link between Deceit and Conclusion of the Contract

- The deceit must have caused the conclusion of the contract.
- Relevant question: Would the avoiding party still have concluded the contract if the deceit had not occurred?
- The misrepresentation does not need to be the sole inducement.
- Causal link must be affirmed if the deceived party discovered the deceit, but only to a certain extent without being aware of the real extent (*German Supreme Court, 23.10.1975, DB 1976, 141*).
- Avoiding party bears the burden of proof.

II.6. Limitations of Liability in the SPA?

- Under German law, a limitation of liability for wilful intent is not admissible (Sect. 202, 276 para 3, 444 German Civil Code).
- Avoidance on the grounds of wilful intent cannot be excluded in advance (*German Supreme Court*, 17.01.2007, NJW 2007, 1058).

II.7. Restitution

- Although unwinding the M&A transaction leads to severe factual problems, an avoidance (rescission) leads to the application of the German rules on unjustified enrichment (*German Supreme Court*, 17.01.2007, NJW 2007, 1058).
 - > Repayment of the purchase price and return of the shares
 - > Reimbursement of the benefits which were obtained by the buyer (e. g. profits of the company attributed to the assets of the company).
- The risk of adverse changes should be borne by the seller (*obiter dictum* of the *German Supreme Court*, 17.01.2007, NJW 2007, 1058).

III. Claims for Damages

- Damages in tort (Sect. 826, 823 German Civil Code in connection with Sect. 263 German Criminal Code)
- Damages on the basis of *culpa in contrahendo*
- Warranties provided by the seller in the SPA (if the SPA is not avoided)
- Statutory warranty claims (if the SPA is not avoided and the limitations in the SPA are null and void)



Thank you for your attention !

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