"Wilful misconduct of the directors will be attributable to each of the sellers"

Anatomy of a business acquisition contract clause

Clause deemed essential by the purchaser of the majority of share capital when the sellers are minority shareholders.

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1. Notice of wilful misconduct clause

Let us assume a mixed operation involving the purchase of the target's share capital (just 50.1% of the share capital) and a recapitalisation commitment in a post-purchase share capital increase operation. The warranties or indemnities are granted by all current selling shareholders. To simplify the assumption, we posit that the company's directors have no equity stake and that the equity capital is highly dispersed. The concern of new investors is that there may be "wilful misconduct on the part of the company" (for instance, grossly false accounting) and that such "wilful misconduct" cannot be attributed to the current shareholders who give the warranties and keep (part of) the price. The purchaser thus seeks to "extend" this wilful misconduct to all the shareholders by way of the following clause:

> In case of willful misconduct or fraud by a Party none of the exclusions or limitations of liability contained in this Agreement shall apply to the liability of such Party (...). For the sake of clarity, the consequences deriving from willful misconduct or fraud by a Party (ie. the non-application of the exclusions or limitations of liability contained in this Agreement) shall apply exclusively to the Party to which such willful misconduct or fraud is attributable

(...). *As an exception to the foregoing, the Parties expressly acknowledge and agree that the fraud or willful misconduct of the directors and executive managers of the Company will be attributable to the Current Shareholders, so that the Current Shareholders shall assume the negative consequences and damages caused to the Investor by the fraud or willful misconduct of such directors and executive managers.*

2. Analysis

§ 1. The company's directors are liable for the harm caused to the company, even at the behest of new shareholders, provided that these meet the requirements of standing to file a (main or alternative) derivative claim. However, there is no direct harm for the purposes of the non-corporate liability claim if the directors were not a party to the sale and purchase contract, not being therefore responsible for the active or omissive wilful misconduct *in contrahendo* (that is, in the preparation of the contract). Unless special conditions apply.

§ 2. Special conditions apply, for example, when in any way the directors have made representations to the purchasers or have made representations to the sellers which have the purchasers as a direct beneficiary of such representations, that is, the representations have been made with the common purpose that the purchasers can rely on them. In this case there is direct harm, and its basis - of dubious traceability - is the classic *actio doli* purely for redress.

§ 3. The sellers or directors will in such cases want to cover themselves by a non-reliance clause signed by the purchaser. The value of these clauses is relative. They are valid as statements of fact (which can be neutralised by other facts) but, in their ordinary wording, they do not contain waivers of rights, nor can such waivers be presumed.

§ 4. But the problem that arises in the present case is another, namely, to what extent the directors' *knowledge* of the contingency can be attributed to wilful misconduct on the part of the sellers for the purposes, among others, of the latter not being able to take advantage of the *quantitative limitations of liability* (Art. 1102 of the Civil Code). This is not the only effect of wilful misconduct *in contrahendo*, but we will limit ourselves to this point.

§ 5. This clause that we are examining goes beyond a simple clause whereby the sellers accept that their *relevant or attributed knowledge* is shaped by the directors' actual or attributed knowledge. Thus worded, the clause would (which is no small thing) merely state that *a warranty is deemed given* in this respect, and that such knowledge is part of the *best of our knowledge* promised by the sellers, but it does not mean that the sellers will be liable for its occurrence as if they themselves had engaged in wilful misconduct, that is, without limitation of liability.

§ 6. We now turn to the clause under consideration. The clause is unconditionally valid, since Article 1105 of the Civil Code (CC) expressly allows the obligor to assume by agreement the negative pecuniary consequences of what for him constitutes a no-causation and no-fault case.

§ 7. By an *a contrario* rule inferred from Article 1268 CC (which refers to violence and intimidation, not wilful misconduct), the wilful misconduct of a third party "not intervening in the contract" will not nullify the obligation.

Note that the rule does not mean that the redress owed by the seller for wilful misconduct *in contrahendo* (Art. 1270) does not accrue when it is the third party who engaged in the wilful misconduct. Nor does it follow (on the contrary) that such redress is owed by the seller. It merely excludes nullification.

§ 8. We assume that the seller has not engaged in wilful misconduct for having colluded with the director in the handling of certain information. Aside from specific agreements, the seller is only *liable* for the wilful misconduct of the director in three situations (in the factual circumstances set out above - non-shareholder directors and dispersed distribution of the share capital), none of these conditions will prima facie arise:

The seller cannot be found to have engaged in wilful misconduct because of the directors' knowledge of the contingency

1.st) If the seller's *duty to know* (omissive wilful misconduct), if any, should extend to contingencies that remain under the (unshared) control of the directors; but in such a case, the seller's failure to know will not be wilful misconduct, but rather fault, thus escaping the special sanctioning rule.

2.nd) When the conditions exist between seller and puchaser that allow the veil of separate personalities to be lifted.

3.rd) When it can be argued that the director is an aid to the performance owed by the seller.

§ 9. If the director is an obvious representative, agent or signatory of the seller, the former's wilful misconduct is attributed to the latter, as if it were his own. In the same way, the seller's specific misconduct is attributed to him as such, even if the contract has been made through a director as representative, and that director did not personally engage in wilful misconduct.

§ 10. The *seller cannot assume the wilful misconduct of a third party as his own*, but *he can assume the consequences of the wilful misconduct of a third party as his own*, provided that there is no conspiracy between the director and the purchaser. The seller can bind himself to anything. And if his knowledge or his will is not sufficient to know or control the contingency in question, then it will be understood that a warranty is provided that the thing will or will not happen. In more usual terms in share purchase agreements, the seller may provide the purchaser with a warranty and assume a liability for that which is not within the seller's control. The parties agree in this case on a rule of allocation of risk to the seller. Nothing to object between non-consumer parties.

§ 11. This does not mean that the seller has engaged in wilful misconduct by virtue of this clause. It only means that the seller warrants the occurrence or non-occurrence of a state of affairs. But for other purposes he will not have engaged in wilful misconduct. For example (but not only) for the purposes of the scope of losses recoverable under Article 1107.II CC or for the purposes of criminal responsibility (for fraud, for example) or the insurability of his liability.

§ 12. As can be easily inferred, the clause to which we are referring can have very serious consequences for the sellers of small shareholdings

in a company. And they will not always have available an action for contribution against the directors, since as a matter of principle, and unless requested as corporate information that must be provided, directors are not obliged to inform selling shareholders of what is part of the ordinary business of the company, they do not have a duty of care in relation to the private negotiation that the shareholders make with their shareholdings. Of course, as such a negotiation will most likely have been orchestrated by the directors and not by the shareholders, it must be accepted that the former assume by law (Art. 1258 CC) *inter partes* the consequences of their own relevant silence or their lies.

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