Attribution of knowledge

Obligation to provide information, fraud and fraudulent retention of information - but who actually possesses the information?

Dr. Iur., Antje Luke, Partner,

Avocat au Barreau de Paris, Rechtsanwältin (Freiburg)

Vincent Capelle, Avocat au Barreau de Paris

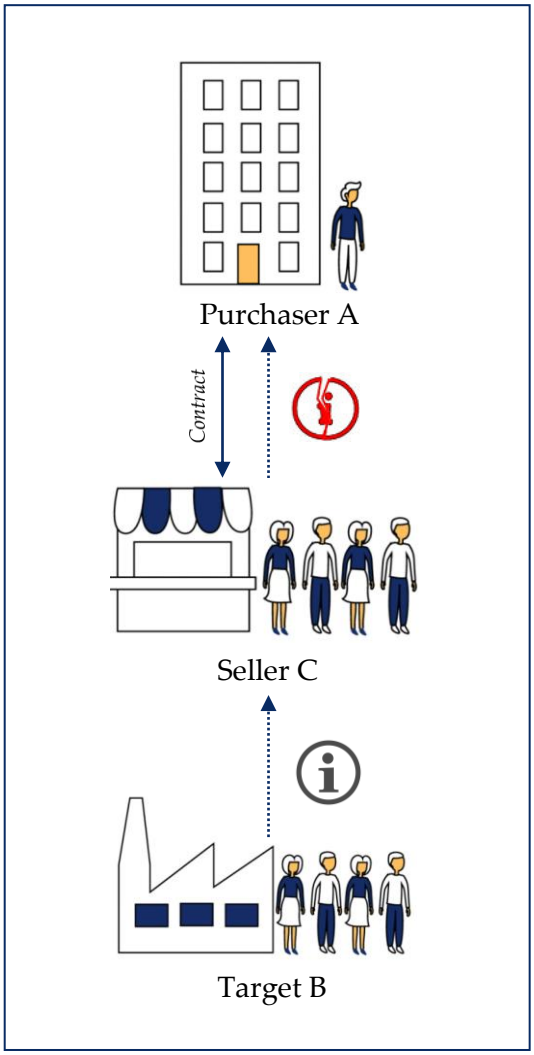
It happens frequently that following the acquisition of a business, the acquirer, dissatisfied with the deal, attempts to obtain compensation for damages on the grounds that seller withheld decisive information. Another frequently used strategy is to try to have the contract annulled on the grounds of fraud or fraudulent retention of information.

The acquirer is confronted with two sets of problems:

- In practice, the target company holds most of the information relevant to the acquirer. However, the contracting party subject to a duty of information, and therefore the one most likely to commit fraud, is usually the seller.

- In addition, if the seller is a legal person, there is the thorny question of the knowledge attributed to a company. Since a legal person cannot actually hold information – indeed, it has no memory - knowledge will necessarily have to be attributed to physical persons, who are typically either the managers or employees of the seller or those of the target company.

When confronted with these questions, how can we identify the relevant physical persons and storage media whose knowledge or content will be attributed with legal effect to the seller, very often a legal person, during precontractual negotiations?



These questions are all the more relevant today since the pre-contractual obligation to provide information, originally developed in French case law, has been codified in the recent reform of French contract law in article 1112-1 of the Civil Code. According to the new text, this obligation is limited to information of which a party is actually aware, thus implicitly excluding information to which it does not have access. The final version of the reform did not include an obligation to inform oneself.

Such information could be the existence of a serious pollution on the target's property.

In matters of fraud, the contract law reform codified in article 1138 of the French Civil Code the jurisprudence allowing for the imputation of an act of fraud committed by a third party to a contracting party in exceptional cases.

It is interesting to approach this issue from the perspective of comparative law, and more particularly German law, which in recent years has seen several judgments and rich doctrinal discussions in this field. While the issue of knowledge attribution (*Wissenszurechnung*) has been addressed in German law, even going beyond the fields of pre-contractual information and fraud, it has only been timidly addressed in French law.

I. Knowledge attribution in German law

German case law and doctrine have developed two approaches to attributing (or not) the knowledge of a third party to a seller, and in particular a legal person: first, under German law, the acts and faults of the person acting on behalf of the contracting company while executing its pre-contractual or contractual obligations may be imputed to the company (*Erfüllungsgehilfe*, "agent") (**a**); second, German case law uses analogous reasoning with the provisions concerning representation (**b**)).

a) « The agent » (*Verhaltenszurechnung*)

While the acts and knowledge of a legal person's corporate bodies are normally attributed to the legal person, German case law uses the concept of *Erfüllungsgehilfe* to attribute to a contracting party either the fraudulent retention of information or an active act of fraud, or the violation of the obligation to provide information to

AVOCATS RECHTSANWÄLTE LAWYERS
29, RUE DU FAUBOURG SAINT-HONORÉ,75008 PARIS
EMAIL bmh@bmhavocats.com TÉL (33)(0)1 42 66 63 19

another contracting party, notably the seller. It is thus possible to attribute to the legal person the acts of its own employees tasked with organising a data room or conducting negotiations, to give only two examples. The same principle applies to the target company regarding its corporate bodies and employees involved in negotiations. The question of whether a selling company has actually made use of a given person must be analysed on a case-by-case basis. The seller must therefore be very careful in organising the negotiation process.

b) Knowledge and representation (*Wissenszurechnung*)

A second approach uses the provisions relative to representation : if the validity of consent depends on the knowledge of a party, the knowledge of the representative and not that of the represented party itself is considered (§ 166 of the German Civil Code *Bürgerliches Gesetzbuch, „BGB"*). The knowledge of a company's representative is thus in principle attributed to the company itself.

By an analogous application of this text, German judges extended these provisions to other persons qualified as "knowledge representatives" (*Wissensvertreter*), in particular when a physical person is entrusted with the task of obtaining and recording information on behalf of a legal person and, where appropriate, transmitting it. This can also be the case with persons involved in due diligence but who are not employees of the selling company. The concept is also applied for the definition of "*best knowledge"* in representation and warranty clauses.

This analogy is justified by the concept of contractual equality (*Gleichstellung*): the idea is to avoid that a person negotiating with a legal person finds himself in a less favourable position than if he were negotiating with a physical person.

c) Contractual arrangement

It is important to note that under German law, parties may contractually amend these provisions. It is thus possible to exclude liability of the *Erfüllungsgehilfe*, even for intentional conduct (except in the case of non-negotiable general clauses), as well as the attribution of the knowledge to the "representative".

BGHZ 117, 104 (106 ff.); NJW 1992, 1099 (1100):

"every person who, according to his superior's instructions, is in charge of representing him judicially, accomplishing certain tasks under his/her own responsibility and taking notice of the resulting information and, if necessary, transmitting it."

AVOCATS RECHTSANWÄLTE LAWYERS
29, RUE DU FAUBOURG SAINT-HONORÉ,75008 PARIS
EMAIL bmh@bmhavocats.com TÉL (33)(0)1 42 66 63 19

Such clauses must be formulated very carefully and clearly in order to determine their exact scope. Liability for fraud, however, cannot be excluded.

II. The incomplete system of knowledge attribution in French law

In contrast with German law, no legal provision of French law uses representatives as indicators of the knowledge of the represented company and therefore *a fortiori* the knowledge of a physical person as an indicator of the knowledge attributed to a legal person. Similarly, the former provisions of the Civil Code stipulated without further clarification that fraud can only be committed by a party to the contract, excluding in principle fraud by a third party.

With regard to the knowledge of a legal person, the Court of Cassation had only recognised the attribution of knowledge held by its legal representative. Thus, in the field of acquisitions, the legal representative's knowledge was in principle attributed to the selling company, and the retention of this knowledge could lead to liability for fraud, or *a fortiori* to a simple retention of decisive information.

Case law had developed other exceptions to this rule in the area of fraud. The contract law reform has now confirmed these exceptions in the Civil Code (Art. 1138): an act of fraud committed by a "*representative, business manager, employee or representative of the contracting party*" as well as by a third party "*through complicity*" are to be attributed to the contracting party. The incorporation of these principles, originally developed in case law, into the French Civil Code and the reference to "complicity" could reinforce this broad approach to fraud through the attribution of knowledge. This could be the basis for identifying the physical persons - including third parties to the contract - and the recording devices whose knowledge/content can be attributed to a legal person.

On the other hand - and this would be more difficult to accept under German law - a third party (such as the target company) who commits fraudulent misconduct may be required to pay damages to the victim of fraud on the basis of tort liability.

CCom 31 mars 2015 n° 14-10.965.

"use of false certificates of conformity by the target – requirement to prove the knowledge of the circumstances by the seller's manager"

CCom 7 octobre 2014 n° 13-19.758

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29, RUE DU FAUBOURG SAINT-HONORÉ,75008 PARIS
EMAIL bmh@bmhavocats.com TÉL (33)(0)1 42 66 63 19

However, these concepts remain unclear. Could the "knowledge representative" be, as in German law, a person mandated by the seller to organise a Data Room or to negotiate contracts? The question has not been clearly settled.

Furthermore, the question of the extent to which article 1138 of the Civil Code can be regarded as identifying the individuals whose knowledge should be attributed to the party subject to an obligation to give information (excepting cases of fraud) has not been the subject of any debate. However, it is a crucial question. Because of the difference between fraudulent retention of information and the obligation to give information, it is not possible to apply article 1138 in an analogous way. German law distinguishes between the attribution of behaviour (*Verhaltenszurechnung*) and the attribution of knowledge. However, we cannot exclude the possibility that similar concepts will be developed in France through case law.

Pending new developments in French law on the attribution of knowledge, it is up to the parties to negotiate this issue in their contracts. From the selling company's perspective, it will be important to restrict the scope of the persons whose knowledge is attributed to it, or even to exclude certain persons by name as much as possible, since liability for fraud or for a violation of the obligation to provide information cannot be excluded. Conversely, it will be in the buyer's interest to define the seller's knowledge as broadly as possible. The drafters of these clauses will have to very carefully and clearly define the purposes for which information carriers are listed (for the new guarantee, for the obligation to inform, for fraud...).

CCom 13 juin 1995 n°93-17.409
In relation to fraud case law even recognises fraud without an explicit mandate

Key points

Identifying exactly all the "knowledge representatives" in *M&A* negotiations is a difficult issue, especially when many third parties participate or when the deal is international.

According to the applicable law, the liability of a contracting party for a third party's knowledge is more or less difficult to establish depending on whether German or French law is applicable.