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Walking the Tightrope: Limiting Fraud Claims Based on Extra-contractual Statements and Omissions

By Roxanne L. Houtman and Catherine A. Schmierer

For decades, courts around the country have struggled with whether to enforce, and how to interpret, contractual disclaimers that limit liability for fraud based on extra-contractual statements and omissions. These disclaimers – typically referred to as "anti-reliance clauses" or "non-reliance clauses" – most often take the form of a representation by one or both of the parties disclaiming reliance on statements made outside the four corners of the agreement. Sophisticated parties typically include anti-reliance clauses in negotiated agreements to establish what information they did and did not rely upon when entering into the transaction. These provisions are also used as a means to eliminate the threat of tort claims (namely, fraud) based on oral statements that are not reduced to a representation within the definitive agreements. Anti-reliance provisions are particularly important for sellers: although indemnification deductibles and caps define the scope of a party's post-closing liability for breaches of contractual representations, the same often will not apply to tort-based claims premised on extra-contractual statements. As a result, selling parties are particularly motivated to eliminate the potential for fraud-based claims to the greatest extent possible.

In certain states (e.g., California), courts have declined to enforce such clauses based on a finding that they are against public policy. In other states (e.g., New York), courts have enforced anti-reliance clauses, but only under certain factual circumstances, and even then, such provisions are subject to strict scrutiny in determining whether they bar the specific claims alleged by the plaintiff. In Delaware, courts have held that clear anti-reliance clauses limiting fraud claims based on misrepresentations made outside of the agreement are generally enforceable, but such provisions will not bar fraud claims based on intentional misrepresentations within the agreement. Two recent decisions from the Delaware Court of Chancery, however, serve as important reminders that the Delaware courts will strictly construe non-reliance clauses and will not infer contractual limitations on the parties' ability to bring fraud claims. In light of these recent cases, sophisticated parties to commercial agreements, including non-disclosure agreements and purchase and sale agreements, would be well-advised to take additional care when drafting anti-reliance clauses so as to give full effect to the parties' bargain regarding the ability to rely on extra-contractual statements (or omissions therefrom) in making fraud claims.

Enforceability of Anti-Reliance Clauses

In the seminal case of *Abry Partners V, L.P. v. F&W Acquisition LLC*, 891 A.2d 1032 (Del. Ch. 2006), the Delaware Court of Chancery established that anti-reliance clauses are enforceable to bar fraud claims under Delaware law so long as the plaintiff clearly disclaims reliance on statements or promises made outside of the contract. The court also held, as a matter of Delaware public policy, that a party cannot fully absolve itself from liability for intentional misrepresentations within a purchase agreement.

Abry Partners involved a group of entities associated with a private equity firm that purchased all of the equity of a portfolio company indirectly owned by another private equity firm. After the closing, the buyers sought to rescind the purchase agreement based on allegedly false representations in the contract and extra-contractual statements. The sellers, however, contended that the claims were precluded because the purchase agreement contained, among other things, an anti-reliance clause and a provision purporting to make indemnification the parties' sole remedy for misrepresentations in the agreement. Specifically, the purchase agreement contained the following anti-reliance clause:

> [Buyers] acknowledge[] and agree[] that neither the [target] nor [the sellers] has made any representation or warranty, express or implied, as to the [target or its subsidiaries] or as to the accuracy or com-

> pleteness of any information regarding the [target or its subsidiaries] furnished or made available to [the buyers], except as expressly set forth in this Agreement . . . and neither the [target] nor [the sellers] shall have or be subject to any liability to [the buyers] or any other Person resulting from . . . [the buyers'] use of, or reliance on, any such information or any information, documents or material made available to [the buyers] in any 'data rooms,' 'virtual data rooms,' management presentations or in any other form in expectation of, or in connection with, the transactions contemplated hereby.

In addition, the purchase agreement's indemnification provisions capped the sellers' liability for misrepresentations and precluded the buyers from bringing claims for rescission.

The court indicated that the anti-reliance clause would – if given legal effect – preclude the buyers' claims. Importantly, the court stated that anti-reliance clauses are generally enforceable under Delaware law so long as they pertain only to representations *outside of the agreement*. The court explained, however, that a standard integration clause on its own will not bar a party from bringing suit based on fraudulent extra-contractual representations; the applicable clause must contain explicit anti-reliance language through which the party contractually promises that it is not relying upon statements outside the contract in deciding to sign the agreement. Explaining the policy basis for its holding, the court noted that if it failed to enforce such provisions, it would create a "double liar" scenario – allowing the plaintiff to prevail on its fraud claim by effectively sanctioning the plaintiff's own fraudulent conduct (i.e., its false assertion in a written contract that it was not relying on extra-contractual representations).

Following its general discussion on the enforceability of anti-reliance clauses, the court in *Abry Partners* then examined the extent to which a contracting party can limit its liability for claims based on false representations *within an agreement*. Recognizing that Delaware has a general policy against immunizing fraud, the court held that parties may only insulate a seller from liability (or preclude rescission claims) for false statements of fact in an agreement that are not intentionally made. However, if a seller intentionally misrepresents a fact in a contract – that is, if a seller lies – Delaware's public policy would not permit the enforcement of a contractual provision limiting the buyer's remedy to a capped damages claim.

The Delaware Supreme Court did not address the enforceability of anti-reliance clauses under Delaware law until five years later in *RAA Management, LLC v. Savage Sports Holdings, Inc.*, 45 A.3d 107 (Del. 2012). In *RAA*, the Delaware Supreme Court affirmed the dismissal of claims made by RAA Management, LLC, an investment firm, against Savage Sports Holdings, Inc., a privately-held sports equipment manufacturer. RAA, once a potential bidder for Savage, alleged that Savage fraudulently misled RAA regarding the existence of certain material liabilities and claims against Savage, and as a result, RAA incurred $1.2 million in due diligence and negotiation costs that it allegedly would not have incurred had RAA known of such matters at the outset.

In connection with the due diligence process, the parties executed a nondisclosure agreement that contained an anti-reliance clause. In the non-reliance provision, RAA expressly agreed to the following:

> [RAA] understand[s] and acknowledge[s] that neither [Savage nor any of its representatives] is making any representation or warranty, express or implied, as to the accuracy or completeness of . . . any other information concerning [Savage] provided or prepared by or for [Savage], and . . . [o]nly those representations or warranties that are made to [RAA] in the [purchase agreement] when, as and if it is executed, and subject to such limitations and restrictions as may be specified [in] such [purchase agreement], shall have any legal effect.

Accordingly, because RAA terminated the negotiations prior to the execution of a definitive agreement, the Court held that the NDA's anti-reliance clause precluded RAA's fraud claim because such claim was based solely on extra-contractual representations. Although the Court decided *RAA* under New York law, its decision confirmed that the result would be the same under Delaware law and specifically noted that "*Abry Partners* accurately states Delaware law and explains Delaware's public policy in favor or enforcing contractually binding written disclaimers of reliance on [extra-contractual representations]." By virtue of this decision, the Delaware Supreme Court also extended the rule in *Abry Partners* to anti-reliance clauses present in other commercial agreements entered into by sophisticated parties, like NDAs. The Court emphasized that the purpose of NDAs and confidentiality agreements is to facilitate due diligence and the negotiation of purchase and sale agreements, and anti-reliance clauses are particularly effective tools to limit the target company's liability for misrepresentations made during these processes.

Recent Developments: The Dangers of Imprecise Drafting

Recent Delaware cases have provided further insight into the Delaware courts' approach to determining the scope of anti-reliance clauses. The general rule of *Abry Partners* remains unchanged. Nonetheless, these decisions demonstrate the increased level of scrutiny the Delaware courts will use to determine whether an anti-reliance clause operates to bar the particular fraud claims alleged by the plaintiff. In these cases, the Delaware Court of Chancery rejected motions to dismiss fraud claims arising out of equity purchase agreements, finding that, notwithstanding the inclusion of broad anti-reliance clauses, such agreements specifically left open the possibility that certain fraud claims could be based on extra-contractual statements. Parties drafting and negotiating agreements containing anti-reliance clauses should take care to avoid the drafting missteps exemplified by these most recent decisions.

In *Anvil Holding Corp. v. Iron Acquisi-*

tion Co., Inc., 2013 WL 2249655 (Del. Ch. May 17, 2013), the Court of Chancery reiterated the holdings of *Abry Partners* and *RAA*, but suggested, in dicta, that a broad fraud carve-out could operate to nullify the intended effects of anti-reliance clauses. In this case, Indigo Holding Company, Inc., and Iron Acquisition Corp. purchased the outstanding securities of Iron Data Solutions, LLC. After the purchase, the buyers brought suit alleging that they had been defrauded by the sellers. Specifically, the buyers alleged that certain of the sellers, who were also members of the management team, were aware that the acquired company's most important customer intended to change the pricing mechanism in its contract with the company and that such sellers deliberately withheld this information. As a result, the buyers claimed that the sellers breached a key representation in the purchase agreement and that the sellers knew the representation was false when made. The buyers based their claims on both the representations and warranties made within the purchase agreement and extra-contractual statements made prior to its execution.

With respect to the buyers' claims based on extra-contractual statements, the sellers initially relied only on two provisions of the purchase agreement – a disclaimer by the sellers as to the making of any express or implied warranties except as set forth in the purchase agreement and a typical integration clause. Although the purchase agreement contained a specific anti-reliance clause, pursuant to which the buyers represented that the sellers made no representations or warranties other than those expressly set forth in the purchase agreement, the sellers did not include reference to this provision in their briefs, and the court declined to consider arguments based on the anti-reliance clause. Relying on *Abry Partners*, the court found that the buyers did not disclaim reliance on extra-contractual statements, and as a result, the buyers were not precluded from pursuing a fraud claim based thereon. In the court's view, the sellers' disclaimer, together with the integration clause, did not create the "double liar" problem where allowing the buyers to prevail on their fraud claim would sanction the buyers own fraudulent conduct in having falsely asserted that they would not rely on extra-contractual representations. In addition, and perhaps more importantly, the court also observed that the parties agreed in the purchase agreement to "reserve all rights with respect to" claims based on fraud or the bad faith of any party. The court concluded that this language provided further evidence that the parties intended to permit reliance on extra-contractual representations in establishing post-closing fraud claims.

Although the sellers' arguments regarding the anti-reliance disclaimer were deemed waived for purposes of the motion to dismiss, the court noted, in dicta, that even if the court had considered the anti-reliance language in making its decision, the outcome may not have differed. In this regard, the court pointed to the broad fraud carve-out and cited the Delaware Supreme Court's decision in *Airborne Health, Inc. v. Squid Soap, LP*, 984 A.2d 126, 141 (Del. 2009). In *Airborne*, the Delaware Supreme Court held that when drafters specifically preserve the right to assert fraud claims, the agreement must specify whether the carve-out applies only to claims based on written representations within the agreement, as the court will not infer such a limitation.

Two weeks following *Anvil*, the Court of Chancery declined to dismiss a fraudulent concealment claim in another case, finding that the anti-reliance clause in the purchase agreement did not clearly disclaim reliance on pre-signing omissions by the sellers. In *TransDigm Inc. v. Alcoa Global Fasteners, Inc.*, 2013 WL 2326881 (Del. Ch. May 29, 2013), the underlying purchase agreement contained an anti-reliance clause, but the provision only disclaimed reliance on extra-contractual representations, and was silent as to the disclaimer of reliance on extra-contractual omissions.

The dispute in *TransDigm* arose out of the acquisition of Linread Ltd. During the course of due diligence, the buyer inquired as to the relationships between Linread and its customers, the most important of which was Airbus. The indirect owner of Linread's equity advised the buyer that there were no disputes or requests for price re-negotiations, notwithstanding the fact that at that time, the seller allegedly had information to the contrary. Following the execution of the purchase agreement, the buyer learned that Airbus expressed dissatisfaction with certain Linread products and that the seller's CEO verbally offered Airbus a 5 percent discount, which was scheduled to commence following the consummation of the acquisition by the buyer. The buyer also learned that at a meeting that took place shortly before the execution of the purchase agreement, Airbus advised Linread that it was considering moving 50 percent of its business to a European competitor. In light of the foregoing, the buyer brought claims for, among other things, fraudulent concealment.

The seller, relying exclusively on the Delaware Supreme Court's decision in *RAA*, premised its arguments in favor of its motion to dismiss on the purchase agreement's express anti-reliance clause. That provision stated, in pertinent part:

> [B]uyer has undertaken such investigation and has been provided with and has evaluated such documents and information as it has deemed necessary to enable it to make an informed decision with respect to the execution, delivery and performance of this Agreement and the transactions contemplated hereby. Buyer agrees to accept the [equity] without reliance upon any express or implied representations or warranties of any nature, whether in writing, orally or otherwise, made by or on behalf of or imputed to [the seller] or any of its affiliates, except as expressly set forth in [the purchase agreement].

The buyer argued, however, that its claim was not based on extra-contractual representations, but rather on the intentional and active concealment of material facts by the seller. In particular, the buyer alleged that it reasonably and justifiably relied on the lack

of a negative response to its inquiries as to Linread's business relationship with Airbus in making its decision to purchase Linread.

Denying the seller's motion to dismiss, the court distinguished the facts in *Trans-Digm* from *RAA*, pointing out that under the instant facts, the buyer did not agree that the seller was making no representa-tions as to the "accuracy and complete-ness" of the information provided. The buyer likewise did not disclaim reliance on extra-contractual omissions. In so holding, the court noted that the buyer reasonably could have relied on the assumption that the seller was not actively concealing in-formation that was responsive to inquiries made with respect to Linread's customers. The court further observed that the two cas-es discussed in detail in *RAA* both involved challenges to agreements that contained language expressly disclaiming reliance on both extra-contractual representations and omissions. *See Great Lakes Chemical Corp. v. Pharmacia Corp.*, 788 A.2d 544, 552 (Del. Ch. 2001) (stating that the buyer represented, among other things, that "[e]ach of [the sellers] expressly disclaims any and all liability that may be based on such information or errors therein or omissions therefrom"); *In re IBP, Inc. Shareholders Litig.*, 789 A.3d 14 (Del. Ch. 2001) (noting that the buyer represented, among other things, that none of the sellers "shall have any liability whatsoever to us or our [r]epresentatives relating to or resulting from the use of [certain materials] or any errors therein or omissions therefrom").

Conclusion

Following the Delaware Court of Chancery's decision in *Abry Partners* and its subsequent confirmation by the Delaware Supreme Court in *RAA*, drafters of commercial agreements between sophisticated parties governed by Delaware law could be confident that clearly drafted anti-reliance clauses that disclaimed reliance on statements made outside of the agreement would be enforced by the Delaware courts and would limit the buyer's ability to bring fraud claims based on extra-contractual representations. While neither *Anvil* nor *TransDigm* modify the holdings of those earlier decisions, these cases are important insofar as they offer helpful guidance to practitioners on the drafting of anti-reliance clauses.

The Court of Chancery's decision in *Anvil* demonstrates the possible unintended consequences of a broad reservation by the parties of the right to bring fraud claims. Although sellers of equity or assets may intend to insulate themselves from post-closing claims for fraudulent misrepresentations through the inclusion of carefully drafted anti-reliance clauses, the insertion of language preserving the parties' rights to bring fraud claims could negate such efforts. Accordingly, to the extent that sellers are unable to negotiate around the broad reservation of rights in respect of fraud, practitioners representing the selling parties should seek to include language limiting the right to bring fraud claims to claims based on the representations and warranties expressly set forth in the purchase agreement.

The *TransDigm* decision, on the other hand, reflects the need for vigilance in the drafting of anti-reliance language. Provisions that disclaim reliance only as to representations made outside of the purchase agreement may be insufficient to avoid claims for fraudulent concealment. To the extent the parties intend to preclude all claims based on extra-contractual statements and omissions, anti-reliance disclaimers should also include express disclaimers of reliance on the "accuracy and completeness" of the information provided and the omission of material facts outside of the agreement.

Roxanne L. Houtman *and* Catherine A. Schmierer *practice law in the Corporate Group of Potter Anderson & Corroon LLP. The views expressed in this article are solely those of the authors, and are not necessarily shared or endorsed by Potter Anderson & Corroon LLP or its clients.*