Post-Closing Fraud Claims in the Acquisition Context: Protecting the Seller

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During a company sale process, it is no surprise that sellers sometimes act like, well, sellers. In an effort to keep the process moving, and to satisfy buyers’ requests for information, sellers often fill data rooms with material that has not been carefully scrutinized for accuracy. And due diligence meetings between management and buyer can, realistically, only be scripted to a limited degree. In those meetings there will likely be some free flowing discussions about the business and its prospects.

Sellers have historically not worried about legal liability for these activities because they are told by their legal advisors that the only “real” representations about the business (the ones that buyer will be able to rely on as a legal matter) will be contained exclusively in the final acquisition agreement. To that end, acquisition agreements typically include express “anti-reliance” language which provides that the representations in the agreement are the sole representations on which the buyer relied, as well as “exclusive remedy” language which provides that the agreed indemnification framework in the agreement (including baskets, caps and time limitations) is buyers’ sole remedy for post-closing claims.

However, recent developments in the Delaware courts serve as a reminder to sellers (and their counsel) that, in this context, a focus on precise language and often-ignored “boilerplate” provisions can make all the difference if after the closing a disgruntled buyer comes a-calling.

Recent Developments in Delaware

Two opinions issued by the Delaware courts in the last quarter of 2015 provide some clarity and insight into the treatment of fraud claims in the acquisition context under Delaware law:

- TrueBlue, Inc. v. Leeds Equity Partners IV, LP: In TrueBlue, the claimed fraud was that the seller allegedly told the buyer (extra-contractually) that it would pay an earn-out payment to the extent it became due and owing by the purchased company’s subsidiary after the closing date. The stock purchase agreement, however, clearly failed to provide that this potential earn-out payment was a retained liability for which the seller would be liable, and to the contrary specifically provided that a separate and distinct earn-out payment was a retained liability. Even though the court had no difficulty ruling that the contract was an integrated agreement and, by its express terms, the disputed earn-out liability was not a retained liability, the court separately held that the promissory fraud claim could nonetheless proceed. In this case, although the stock purchase agreement included typical “anti-reliance”
language, the court held that the inclusion of a broad “fraud exception” providing that nothing in the agreement would limit a claim by the buyer for “actual fraud” was enough to preserve extra-contractual fraud claims. Accordingly, *TrueBlue* makes clear that “anti-reliance” language may not, in and of itself, prevent a buyer from bringing a fraud claim post-closing based on information it was provided outside of the acquisition agreement and emphasized the importance of an “explicit and unambiguous” anti-reliance provision in order to effectively preclude extra-contractual fraud claims.

- *Prairie Capital III, L.P. v. Double E Holding Corp.*: As in *TrueBlue*, *Prairie* involved a fraud claim against the seller based on alleged extra-contractual representations and omissions. In this case, the “Exclusive Representations” clause stated that the buyer relied solely on representations within the stock purchase agreement in question, which the buyer argued was insufficient to preclude reliance on extra-contractual representations because the buyer did not affirmatively disclaim that the buyer did not rely on extrinsic representations. The court dismissed this argument, noting that there is no specific formula or magic words that a seller must incant to disclaim reliance—as long as a party represents that it only relied on particular information, then “that statement establishes the universe of information on which that party relied” and so parties can disclaim reliance by “multiple means” so long as “the universe of information” that is being relied upon is sufficiently clear. Accordingly, the court found that the language in the “Exclusive Representations” clause, in combination with the integration clause, “add[ed] up to a clear anti-reliance clause.”

With respect to the fraud carve-out to the exclusive remedy provision, the court noted that while such a carve-out allows the parties to pursue remedies outside the stock purchase agreement’s indemnification framework while claiming fraud, it does not expand the universe of representations on which a party can base its fraud claim. Thus, the universe of representations remains limited by the “Exclusive Representations” provision and the buyer is not entitled to base its fraud claims on the alleged extra-contractual representations simply due to this fraud carve-out.

**What’s a Seller to Do?**

Fraud claims brought by buyers typically fall into one of two categories: claims based on information provided by the seller in the due diligence process (i.e., “extra-contractual” claims) and those based upon disclosures (including financial information) provided in connection with the definitive transaction agreements (i.e., “contractual” claims).

As illustrated in *TrueBlue* and *Prairie*, sellers seeking to preclude a buyer from having the ability to bring extra-contractual fraud claims should include a clear anti-reliance provision in the acquisition agreement with no fraud exceptions. Taking such a position should not be viewed as a suggestion of potential deception. Rather, it conveys that the seller does not expect that the buyer should be able to circumvent an often highly-negotiated indemnification framework by asserting that the acquirer entered into such agreement based on statements made, or information provided, by the seller or its advisors in the course of due diligence. By limiting the scope of information ultimately relied on to the representations (and schedules) provided in connection with the definitive transaction agreements, both seller and buyer can properly assess the risk involved with making such representations, on the one hand, and relying on them, on the other.
With respect to contractual fraud claims, a seller may seek to require buyer to represent that it has conducted its own independent investigation, review and analysis of the business, results of operations, prospects, condition (financial or otherwise) or assets of the seller, and acknowledge that it has been provided adequate access to the personnel, properties, assets, premises, books and records, and other documents and data of seller for such purpose. Although this language will not preclude a buyer from bringing a contractual fraud claim, it can lessen the buyer’s chances of success by making it harder for the buyer to prove that its reliance on the seller’s contractual statements caused its injury.

Finally, sellers should also be aware of the increasingly common practice in private transactions to have a defined term of “Fraud” as an exception to the “anti-reliance” and “exclusive remedy” provisions. Sellers should seek as limited a definition as possible and avoid including descriptive adjectives such as “intentional,” “knowing” or simply “common law,” which attempt to eliminate claims of equitable, negligent or perhaps reckless fraud from being captured by the carve-out. For example: “Fraud” means “a claim for common law fraud with a specific intent to deceive based on a representation or warranty contained in this Agreement or with reckless disregard as to the accuracy or inaccuracy of a representation or warranty contained in this Agreement; provided that, at the time such representation was made, (a) such representation was inaccurate, (b) the Party making such representation had ‘knowledge’ of the inaccuracy of such representation or warranty or the Party made such representation or warranty with reckless disregard as to the accuracy of such representation and (c) the other Party acted in reliance on such inaccurate representation and suffered any Loss as a result of such inaccuracy.”

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