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Buyers Beware of Non-Reliance Provisions in M&A Transactions

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Most buyers expect to be able to recover damages when a seller commits fraud in connection with an M&A transaction, and many of these buyers believe that they will be able to pursue a fraud claim post-closing against a seller without regard to any limitations imposed by the purchase agreement. However, it is becoming more common for sellers to insert provisions into a purchase agreement that require the buyer to disclaim reliance on any extra-contractual representations and warranties made by a seller to a buyer. These provisions are called “non-reliance provisions” and may effectively limit a buyer’s ability to bring fraud claims post-closing against a seller even if (a) the indemnification provisions in the purchase agreement appear to provide a buyer with a right to indemnification for fraud and (b) such fraud claims are expressly excluded from any caps, baskets or other indemnification limitations. With the rise in popularity of these non-reliance provisions, buyers in the M&A market should (1) be aware of these provisions, (2) understand how they operate and (3) understand the potential consequences of including such provisions in the purchase agreement.

Indemnification Provisions and Fraud Carve-Outs

To ensure that a buyer can adequately recover for breaches of a purchase agreement, certain carve-outs, including carve-outs for fraud, are usually incorporated into the indemnification provisions. These carve-outs permit buyers to bring claims outside of the indemnification provisions and its limitations, such as caps and baskets. However, even with a fraud carve-out present in a purchase agreement, a buyer may not be able to recover for all types of fraud if a non-reliance provision is also present in the agreement.

Non-Reliance Provisions

A non-reliance provision requires a buyer to specifically disclaim reliance on any extra-contractual representations and warranties made by a seller to a buyer. These provisions are also called “no-reliance provisions,” “anti-reliance provisions” and “big boy provisions.” The intent of a non-reliance provision is to bar the use of extra-contractual evidence that might otherwise establish a fraud-based claim in tort

(most commonly fraudulent inducement and fraudulent misrepresentation, but also potentially negligent misrepresentation).

In most situations, a buyer must prove that it relied on a statement/representation/warranty made by a seller in order to recover on a fraud claim. Therefore, if a buyer specifically disclaims reliance on certain statements made by a seller outside of the purchase agreement, it is unlikely that a buyer will be able to prove that it relied on such statements when bringing a fraud claim against a seller.

An example of a non-reliance provision can be found below:

“Non-Reliance. *The Buyer acknowledges and agrees that in entering into this Agreement it has not relied and is not relying on any representations, warranties or other statements whatsoever, whether written or oral (from or by the Company or any Person acting on their behalf) other than those expressly set out in this Agreement (or other related documents referred to herein) and that it will not have any right or remedy rising out of any representation, warranty or other statement not expressly set out in this Agreement.”*

Delaware courts have upheld the validity of non-reliance provisions in barring extra-contractual fraud claims. Because of this, non-reliance provisions have become increasingly popular in M&A transactions over the past few years as a way to protect sellers from extra-contractual fraud claims post-closing.

Fraud Carve-Outs and Non-Reliance Provisions

With the increased prevalence of non-reliance provisions in M&A transactions, it is not uncommon to have a fraud carve-out provision and a non-reliance provision in the same purchase agreement. There is a tension between these two provisions – the intent of a fraud carve-out provision is to ensure that a party (usually the buyer) has the ability to recover for any fraud claim while not being limited by the indemnification provisions. On the other hand, the intent of a non-reliance provision is to prevent a buyer from being able to recover for extra-contractual fraud claims. The question then is which provision controls if both are present in an agreement.

Delaware courts have held that a non-reliance provision can prevent a buyer from bringing an extra-contractual fraud claim even if a fraud carve-out is included in the purchase agreement. While there is no “magic language” needed in a non-reliance provision for it to be effective, a seller’s inclusion of some sort of “reliance” language in the non-reliance provision will likely make it effective at barring extra-contractual fraud claims. Therefore, Buyers should be on the lookout for provisions in the purchase agreement that include certain phrases, such as “Buyer has not relied”, “Buyer has disclaimed reliance”, “Buyer is not relying”, etc. These are likely signs that a non-reliance provision has been inserted into the purchase agreement.

Conclusion

Non-reliance provisions are becoming increasingly prevalent in M&A transactions. If not properly identified and addressed during the negotiation process, non-reliance provisions can have drastic consequences for buyers who seek recovery on extra-contractual fraud claims post-closing. For example, many sellers provide financial projections of the target company to buyers during the negotiation/sale process. If a seller

provides knowingly false projections to a buyer and the purchase agreement (1) does not include a representation or warranty regarding such projections and (2) includes a non-reliance provision, then a buyer may not be able to recover for any losses it has incurred when relying on those false financial projections in entering into the purchase agreement.

Buyers may mistakenly believe that a fraud carve-out provision will preserve their ability to bring *any* fraud claim, including extra-contractual fraud claims, against sellers post-closing. However, Delaware courts have stated that a non-reliance provision can bar extra-contractual fraud claims even when a fraud carve-out provision is present in the purchase agreement.

Buyers should identify these provisions during the negotiation process and understand their potential consequences if included in the final agreement. Buyers should consult with their legal counsel and discuss how to effectively draft and/or revise non-reliance provisions to best preserve their ability to recover for fraud claims post-closing.

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