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IN THE COURTS

Disclaiming Reliance on Extra-Contractual Representations under Delaware Law

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In *FdG Logistics LLC v. A&R Logistics Holdings, Inc.*,[1] the Delaware Court of Chancery clarified the type of language that must be included in an acquisition agreement for a party to demonstrate that the other party has effectively disclaimed reliance on extra-contractual representations. In sum, the *FdG Logistics* Court held that the anti-reliance language at issue, which was merely a statement *by the seller* that it was making no representations other than those included in the acquisition agreement, was not sufficient to demonstrate that the buyer had disclaimed reliance on extra-contractual relations—and was therefore not effective to foreclose the buyer's post-closing claim for common law fraud based on extra-contractual statements.

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In reaching this conclusion, the *FdG Logistics* Court contrasted the anti-reliance clause to the one at issue in *Prairie Capital III, L.P. v. Double E Holding Corp.*,[2] where the Court found that the anti-reliance clause was sufficient to demonstrate that the buyer had disclaimed reliance on extra-contractual representations. Because the seemingly slight variations in the language employed in each case resulted in completely different outcomes, practitioners would be well advised to review the Court's analyses closely to ensure that the specific anti-reliance language included in any purchase agreement accurately reflects the parties' agreement as to such matters.

The Facts

The opinion in *FdG Logistics* arose out of a transaction by which a private equity fund, Mason Wells, acquired trucking company A & R Logistics, Inc. (Company) by means of a reverse triangular merger. Prior to the merger, FdG Associates LP beneficially owned approximately 62 percent of the Company's outstanding stock, with the balance being held by a handful of individual stockholders.[3]

Following the consummation of the merger, FdG Logistics LLC, as representative of the pre-merger stockholders of the Company, initiated an action against the Buyer to recover a pre-closing tax refund.[4] In response, the Buyer asserted counterclaims for indemnification under the merger agreement, common law fraud and unilateral mistake.[5]

Of significance, the Buyer alleged it had discovered "illegal and improper" activities that the Sellers had concealed during the due diligence process.[6]

The Decision

The Court listed the pleading elements necessary to state a claim for common law fraud, including that the defendant made false representations, that it knew the representations were false, that the representations were intended to induce the plaintiff's action or inaction, and that the plaintiff acted with justifiable reliance on the representations and suffered harm.[7] In seeking to dismiss the Buyer's fraud claim, the Sellers argued that the Buyer was unable to demonstrate that it had justifiably relied on the alleged misrepresentations insofar as the Buyer's claims "relate[d] to alleged misrepresentations outside the four corners of the Merger Agreement."[8] The Sellers argued that, due to the provision of the merger agreement stating that the Seller was making no representations other than those specifically made in the agreement as well as the agreement's customary integration clause, the Buyer was unable to demonstrate that it had justifiably relied on representations outside the four corners of the agreement.[9]

Denying the Sellers' motion to dismiss, the Court found that the anti-reliance language on which their defense was based was not sufficient to result in a disclaimer on the part of the Buyer of the Sellers' extra-contractual representations and warranties.[10] The anti-reliance provision in question stated in relevant part as follows:

> EXCEPT AS EXPRESSLY SET FORTH IN THIS ARTICLE 5, THE COMPANY MAKES NO REPRESENTATION OR WARRANTY, EXPRESS OR IMPLIED, AT LAW OR IN EQUITY AND ANY SUCH OTHER REPRESENTATIONS OR WARRANTIES ARE HEREBY EXPRESSLY DISCLAIMED . . . .[11]

The merger agreement's integration clause, in turn, generally provided that the merger agreement, the other transaction documents referred to therein, and the other documents referred to in the merger agreement and the other transaction documents contained the entire agreement between the parties and superseded any prior understandings, agreements or representations, written or oral, that may have related to the subject matter of the merger agreement.[12]

In considering the effect of these provisions, the Court looked to its opinion in *Abry Partners V, L.P. v. F&W Acquisition LLC*.[13] In that case, the Court, when addressing the extent to which parties may contract around liability for extra-contractual misrepresentations, articulated an approach that it described as achieving "a sensible balance between fairness and equity"—namely, that "parties can protect themselves against unfounded fraud claims through explicit anti-reliance language" in the acquisition agreement, but if they fail to include such language in the agreement, "they will not be able to escape responsibility" for their own extra-contractual fraudulent representations.[14]

The Court held that the anti-reliance provisions on which the Sellers' defense was based did not amount to a disclaimer by the Buyer of the Sellers' extra-contractual representations and, therefore, was not sufficient to foreclose the Buyer's common law fraud claim. Specifically, the Court stated that while the merger agreement included language expressing *the selling company's* statement that it was making no representations other than those included in the agreement, it did not include an affirmative expression *by the Buyer* as to what it was relying on in deciding whether to enter into the merger agreement; nor did it include an affirmative representation from the Buyer that it is was not relying on extra-contractual representations.[15] In other words, the anti-reliance clause amounted only to "a disclaimer *by the selling company* . . . of what it was and was not representing and warranting," which alone was not sufficient to support a finding that the Buyer had disclaimed reliance on the Sellers' extra-contractual representations and warranties.[16] The Court also found that the integration clause did not constitute

an unambiguous statement on the part of the Buyer disclaiming reliance on the Sellers' extra-contractual statements.[17]

In reaching this conclusion, the Court reviewed the holdings in two other recent opinions—*Anvil Holding Corp. v. Iron Acquisition Co.*[18] and *Prairie Capital*.[19] In *Anvil*, after the buyer asserted fraud claims based on extra-contractual statements, the seller moved to dismiss the claims on the grounds that the agreement stated that the seller was not making any representations other than those contained in the agreement and contained a standard integration clause. Declining to dismiss buyer's fraud claim, the *Anvil* Court found that because the provisions at issue were expressed from the point of view of the seller rather than the buyer, they did not constitute a clear promise by the buyer that it would not rely on extra-contractual statements.[20]

By contrast, in *Prairie Capital*, the Court dismissed the buyer's extra-contractual fraud claims on the basis of the purchase agreement's anti-reliance provisions. The *Prairie Capital* Court held that the purchase agreement contained clear language by which the buyer affirmatively disclaimed reliance on extra-contractual claims. That is, the anti-reliance provisions were not "framed negatively" but rather contained an affirmative representation by the buyer that it had relied only on the representations and warranties in the agreement.[21] The *Prairie Capital* Court noted that where a party represents that it only relied on specified information, the party's statement establishes the "universe of information" on which it relied and that the use of "magic words," such as "expressly disclaim," is not required, so long as the language is sufficiently precise to demonstrate that the buyer had identified the scope of the information on which it was relying and affirmed that it was relying on no other information.[22]

Practical Implications

The *FdG Logistics* Court found that the provisions at issue were closer to those in *Anvil* than those in *Prairie Capital*. Accordingly, the Court declined to grant the Sellers' motion to dismiss. In light of this opinion, corporations and practitioners would be well advised to review the anti-reliance clauses in any acquisition agreement they negotiate to ensure that they meet the parties' expectations.

Notes

1. 2016 WL 819215 (Del. Ch. Feb. 23, 2016).
2. 2015 WL 7461807 (Del. Ch. Nov. 24, 2015).
3. For ease of reference, we refer to the private equity fund purchaser and its related entities as the "Buyer" and the Company (pre-merger) and the affiliated selling stockholders (and their affiliated parties) as the "Sellers."
4. *FdG Logistics*, 2016 WL 819215, at *1.
5. *Id.*
6. *Id.* at *5. Examples of such allegedly "illegal and improper" activities included, among other things, that the Company's drivers "systematically falsified their hours-of-service logs…to increase their daily miles driven by 30–40%"; that the Company "intentionally manipulated its drivers' scale tickets and time stamps"; that the principal seller "directed a massive operation to cut truck maintenance costs by nearly half before the merger, which caused personnel to falsely report regular maintenance as capital expenditures to avoid budget caps in order to keep the trucks running"; that the Company "systematically created fake 'wash tickets' indicating that its trucks had been properly cleaned before hauling sensitive loads and fraudulently charged customers for these never-performed services"; that two of the Company's facilities were in bad disrepair and required substantial improvements; and that the Company hired undocumented workers. *Id.*
7. *Id.* at *11.
8. *Id.*
9. *Id.*
10. *Id.* at *14.
11. *Id.* at *11.
12. *Id.*
13. 891 A.2d 1032 (Del. Ch. 2006).
14. *Id.* at 1059.
15. *FdG Logistics*, 2016 WL 819215, at *13.
16. *Id.* (emphasis in original).
17. *Id.*

18. 2013 WL 2249655 (Del. Ch. May 17, 2013).
19. 2015 WL 7461807 (Del. Ch. Nov. 24, 2015).
20. *Anvil*, 2013 WL 2249655, at *7-8.
21. *Prairie Capital*, 2015 WL 7461807, at *7-8. The exclusive representation provision in *Anvil* is as follows:

    > The Buyer acknowledges that it has conducted to its satisfaction an independent investigation of the financial condition, operations, assets, liabilities and properties of the Double E Companies. In making its determination to proceed with the Transaction, the Buyer has relied on (a) the results of its own independent investigation and (b) the representations and warranties of the Double E Parties expressly and specifically set forth in this Agreement, including the Schedules. SUCH REPRESENTATIONS AND WARRANTIES BY THE DOUBLE E PARTIES CONSTITUTE THE SOLE AND EXCLUSIVE REPRESENTATIONS AND WARRANTIES OF THE DOUBLE E PARTIES TO THE BUYER IN CONNECTION WITH THE TRANSACTION, AND THE BUYER UNDERSTANDS, ACKNOWLEDGES, AND AGREES THAT ALL OTHER REPRESENTATIONS AND WARRANTIES OF ANY KIND OR NATURE EXPRESS OR IMPLIED (INCLUDING, BUT NOT LIMITED TO, ANY RELATING TO THE FUTURE OR HISTORICAL FINANCIAL CONDITION, RESULTS OF OPERATIONS, ASSETS OR LIABILITIES OR PROSPECTS OF DOUBLE E AND THE SUBSIDIARIES) ARE SPECIFICALLY DISCLAIMED BY THE DOUBLE E PARTIES.

    Id. at *7.
22. *Id.* at *8.