PRESENTED AT

16th Annual Mergers and Acquisitions Institute

October 7-9, 2020
Live Webcast

Recent Delaware Cases Illustrating How Uncapped Fraud Claims Can and Cannot Be Premised Upon Written Representations

Glenn D. West

Recent Delaware Cases Illustrating How Uncapped Fraud Claims Can and Cannot Be Premised Upon Written Representations

August 17, 2020

Contributor(s)

Glenn D. West

In Delaware, a robust and properly placed disclaimer of reliance clause can effectively eliminate claims of fraudulent or negligent misrepresentation arising from extra-contractual statements made by or on behalf of a seller during the negotiation of a written acquisition agreement. And an effective exclusive remedy clause can limit the remedies available for any inaccuracy in the package of contractual representations and warranties that were expressly bargained for in that written acquisition agreement, as long as the persons making or causing those written representations and warranties to be made did not actually know that those written representations and warranties were false when made—*i.e.*, in Delaware, a fraud claim based upon written representations and warranties can always be made upon allegations that the makers (or persons controlling or participating with the makers) deliberately conveyed a knowing falsehood through those written representations and warranties, even in the absence of a negotiated fraud carve-out.[1] Two recent Delaware cases provide useful illustrations of how these concepts work in post-closing disputes arising from alleged fraud in connection with the sale of a portfolio company business by a private equity fund.

In *Infomedia Group, Inc. v. Orange Health Solutions, Inc.*, C.A. No. N19C-10-212 AML CCLD, 2020 WL 4384087 (Del Sup. Ct. July 31, 2020), a portfolio company of a private equity fund sold a business line through an asset purchase agreement. In the asset purchase agreement, the seller specifically represented and warranted that no counterparty to any of the contracts being transferred to the buyer had given "any *written* notice of any . . . intention to terminate, amend, or modify (including any material change in anticipated call volume) any Contract." Apparently it was true that no contract counterparty had provided any "written notice" to the seller of any intention to terminate, amend or modify any of the transferred contracts as of the date the acquisition agreement was both signed and closed. But according to the buyer, the seller (and its private equity fund owner) had "orally represented to [the buyer] on 'numerous occasions [before] the execution of any agreement that [the seller and its private equity fund owner] were not aware of any customer that intended to terminate any of the Contracts.'" The buyer alleged that a few weeks before the asset purchase agreement was signed and closed one of the top customers of the business line being purchased had in fact orally communicated to the seller its intention to terminate a number of the contracts that were being transferred to the buyer. And the buyer also alleged that the private equity fund owner had been advised of this communication, but neither the seller nor the private equity fund owner made the buyer aware of that oral communication. So, when the buyer later learned of the customer's intent to terminate its contracts, the buyer sued the seller and its private equity fund owner for fraud and negligent misrepresentation.

The seller and its private equity fund owner moved to dismiss the claim based on the express disclaimer of reliance clause whereby the buyer had agreed that, other than the written representations and warranties specifically set forth in the asset purchase agreement, it was not relying on any other representations or warranties made by the seller or any other person.[2] And the court, reviewing the consistent and overwhelming body of Delaware precedent, granted that motion in favor of the seller and its private equity fund owner. The buyer also argued, however, that the written representation regarding the fact that the seller had not received any written notice of any intention to terminate any of the contracts was itself fraudulent even though "facially true" because it created a "false impression as to the true state of affairs." But the court rejected this argument because "[t]he fact that oral notice might have been received does not make the representation about written notice misleading."[3] Instead, through the anti-reliance clause, the parties had bargained for the express written representations to "define the universe of information that is in play for the purposes of a fraud claim."[4] Thus, because the written representation was expressly limited to the absence of "written notice," and none had in fact been received, the suit was dismissed.

But even when fraud claims premised upon extra-contractual representations have been precluded by a non-reliance clause, the express written representations can sometimes provide a basis for a claim of fraud, at least at the motion to dismiss stage. In *Agspring Holdco, LLC v. NGP X US Holdings, L.P.*, C.A. No. 2019-0567-AGB, 2020 WL 4355555 (Del Ch. July 30, 2020), a private equity fund sold all of its membership interests in a portfolio company formed as a limited liability company to another private equity fund buyer pursuant to a Membership Interest Purchase and Contribution Agreement (the "MIPCA"). As is not uncommon, the management team for the purchased business also owned membership interests in the company and agreed to join in the MIPCA, sell part (and roll over the remainder) of their membership interests, and continue to serve on the management team (and as members of the board) of the acquired company post closing.