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Avoiding the Other F-Word: An Anti-Reliance Clause Should Actually Disclaim Reliance on Extra-Contractual Representations Even When the Parties Agree that Non Were Made

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In a recent Delaware Court of Chancery opinion, Vice Chancellor Glasscock had occasion to consider the meaning of the past-tense of an expletive commonly referred to as the "f-word," which he described as "an Angelo-Saxon expression that, while generally unfit for publication, when used metaphorically has many meanings."[1] In the context in which that word was used in an email from a person that had apparently just discovered that a formal extension notice had not been given, and that the reverse break fee, which had been guaranteed by the firm of which he was a principal, may now be payable, Vice Chancellor Glasscock "was convinced … that the meaning the message attempted to convey was 'prejudiced in the extreme.'"[2] A more calm and polite way of conveying the message, of course, would have been to simple say: "we are in an extremely difficult situation here." But I digress.

An extremely difficult situation in which private equity sellers can sometimes find themselves involves a different "f-word" that also has "many meanings"—i.e., "fraud." The term fraud is used all too often in post-closing disputes between sellers and buyers of private companies. And a claim of fraud, even if unjustified, can result in "prejudice in the extreme" against the private equity seller who seeks to or has distributed the sales proceeds to its limited partners (less whatever limited holdback or escrow to cover contractual indemnification was agreed). Indeed, "[f]raud … claims have proven to be tough to define, easy to allege, hard to dismiss on a pre-discovery motion, difficult to disprove without expensive and lengthy litigation, and highly susceptible to the erroneous conclusions of judges and juries."[3] This is especially true when the fraud claim is based upon extra-contractual representations allegedly made during the negotiations of the deal, but which for whatever reason were never agreed to as express written representations to be incorporated in the acquisition agreement. And it is for that reason that the market has long-ago made "so-called" anti-reliance clauses a common feature of private company acquisition agreements. A well-crafted, true anti-reliance clause can eliminate (in many

states) the specter of most extra-contractual fraud claims and permit dismissal of a case at the pleading stage.

I call anti-reliance clauses "so called" because many clauses purporting to be anti-reliance clauses actually do not disclaim reliance upon any extra-contractual representations that may have in fact been made, but instead disclaim the existence of extra-contractual representations. And certain courts have found that distinction a critical one—failing to give effect to a clause that simply stated that there were no extra-contractual representations, while readily acknowledging that a clause disclaiming reliance upon any extra-contractual representations that had been made would have been effective.

In *Italian Cowboy Partners, Ltd. v. Prudential Insurance Co. of America*, the Texas Supreme Court famously recognized that distinction and held that an appropriate form or tense of the word "rely" is a critical element of an effective anti-reliance clause in defeating a claim based upon extra-contractual fraud. That is so, said the court, because "[t]here is a significant difference between a party disclaiming its *reliance* on certain representations, and therefore potentially relinquishing the right to pursue any claim for which reliance is an element, and disclaiming the *fact* that no other representations were made."[4] A strong dissenting opinion was mystified by the majority's "preference for a disclaimer of reliance over a disclaimer of representations."[5] After all, according to the majority's approach "a party who states (somewhat equivocally) that although representations may have been made, he is not relying on any of them, should be held to his word and his later claim of fraud foreclosed[,] [b]ut a party who unequivocally denies that any representations were made to induce his agreement, other than those in the agreement itself, may later sue for fraud on representations he denied were ever made."[6] But despite the dissents' view, this distinction continues to be recognized in Texas.

Because a significant number of private company acquisition agreements are governed by Delaware law, rather than Texas law, there may be a tendency to dismiss the importance of this distinction between "disclaiming the *fact* that no other representations were made," and disclaiming reliance upon any other representations that were made. After all, when addressing the need for a specific formulaic approach to the language used in an anti-reliance clause, a prior Delaware Court of Chancery opinion definitively declared that "Delaware law does not require magic words."[7] Indeed, that opinion specifically noted that using terms like "disclaim reliance" was not required; rather "[l]anguage is sufficiently powerful to reach the same end by multiple means, and drafters can use any of them to identify with sufficient clarity the universe of information on which the contracting parties relied."[8] But the court did not hold that stating

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