Delaware Law Developments Part 2—Practical Use of Delaware Litigation Holdings In M&A Deal Context

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The Real Deal

A Webinar Series for M&A and Securities Professionals

WINSTON & STRAWN LLP

Speakers

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Agenda

- **Initial Thoughts**
- The Transaction
- “Sign and Consent”/“Openlane” Structure
- Latent Disclosure Obligations
- Use of Joinder Agreements in Private Merger Transactions
- Business Judgment Rule; Director and Stockholder Approval Process
- Appraisal Rights: The Current Lay of the Land
- Reliance Disclaimers & the Fraud Carve-Out

Initial Thoughts

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Initial Thoughts

- September 26, 2017: Part 1 – Review of Recent Delaware Law Developments in the M&A Context
- Presented by Winston & Strawn NY Partner Jim Smith, Chair of Securities Litigation Practice
- Jim's Focus:
  - The New Delaware Litigation Landscape
  - Evolution of Take-Private Transactions Involving Controlling Stockholders
  - The "Sea Change:" The MFW Structure
  - 2017 Controlling Stockholder Take-Private Decisions
  - Other Key 2017 Decisions Relevant To Take-Privates: The Future of Appraisal

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Initial Thoughts

- Today we examine many of these issues in the context of a specific transaction.
- One can reasonably conclude that the same case law relating to deals with public company targets applies in certain fashions to deals with private company targets.
- Jim's presentation is available on our website.
- Throughout presentation we include a number of Practice Points for transaction attorneys in addition to a discussion of case law.

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The Transaction

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The Transaction

- Sale of a privately held Delaware corporation
- Transaction value: $80 million
- Strategic or private equity acquirer
- Acquirer holds 40% of target equity will acquire the target
- Acquirer has done extensive due diligence and projections have been shared
- Asset sale not favorable

The Transaction

- 75 common stockholders
- Statutory merger under Delaware law
- Stockholders not party to merger agreement
- Eight members of target board of directors—five directors hold or represent 70% of equity on a fully diluted basis and enough stockholders votes to approve merger
- No third party/government consents or financing required
- Buyer not willing to do a “public” style deal

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“Sign and Consent”/“Openlane” Structure

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“Sign and Consent”/“Openlane” Structure

Question: Can the transaction be signed simultaneously and closed?

Answer: No.

Why: *Omnicare, Inc. v. NCS Healthcare, Inc*.

- NCS Healthcare and Genesis Health Ventures entered into a transaction that included (i) a “force-the-vote” provision; (ii) no “fiduciary out” provision; and (iii) voting agreements executed concurrently with the Merger Agreement by shareholders sufficient to approve merger.
- Omnicare then submitted a superior proposal to NCS.
- The Delaware Supreme Court refused to enforce the NCS/Genesis merger agreement and found that the NCS board had breached their fiduciary duties by agreeing to a structure that rendered the Genesis merger a “fait accompli” and prohibited the board or the stockholders from accepting a superior proposal.

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“Sign and Consent”/“Openlane” Structure

Solution: The “sign and consent” / “Openlane” structure

Target stockholders controlling the required vote deliver written consents approving the deal promptly following signing.

- *Optima Int’l of Miami, Inc. v. WCI Steel, Inc*. Court refused to enjoin merger agreement requiring target to deliver written consents of stockholders within 24 hours of the board’s approval of merger agreement, noting that Delaware law does not provide a minimum time period between approval of the merger agreement and the stockholder vote.
- *In re Openlane, Inc. Stockholders Litig*. Court refused to enjoin merger agreement that (a) contemplated approval by stockholders within 24 hours of execution of merger agreement and (b) contained no fiduciary out, reasoning that, unlike in *Omnicare*, the consents were not technically locked up via voting agreement, and reiterating that Delaware law does not prescribe a minimum time period between sign and close.

Practitioners continue to debate the minimum “window shop” period mandated by Omnicare, but 24 hours has become an unofficial safe harbor.

The Court’s statement that a fiduciary out is not a *per se* requirement under Delaware law must be viewed in context.

Any change to this structure (e.g. – voting agreements) could swing the analysis.

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“Sign and Consent”/“Openlane” Structure

Practice Points

- Key Provision: Closing condition allowing either party to terminate within twenty-four hours of signing if stockholder consent is not received.
- Other provisions to consider in any merger transaction:
  - Representation regarding requisite stockholder approval
  - Covenant that the target will use “best efforts” to obtain requisite stockholder approval.
  - Covenant to require delivery of information statement within specified number of days following signing.
  - Payment of a termination fee by target if consents are not delivered.
  - Closing conditions regarding (a) receipt of consent from stockholders holding agreed upon percentage of shares greater than requisite stockholder approval and (b) no exercise of appraisal rights / exercise of appraisal rights by holders of less than specified percentage of shares
  - Specific indemnity for shareholder claims

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Latent Disclosure Obligations

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Latent Disclosure Obligations

Question: Are there concerns regarding disclosure beyond statutory requirements in the Sign and Consent Structure?

Answer: Yes, and such concerns extend to any transaction where (i) action is taken by written consent or (ii) notice of appraisal rights is provided to stockholders.

- Latent Disclosure Obligations in Connection with Private Company Transactions
  - DGCL sections governing action by written consent (DGCL Section 228) and notice of appraisal (DGCL Section 262), both of which are often implicated in sign and consent mergers (among other transactions), provide non-consenting stockholders only the right to prompt notice of the corporate action consummated through written consent and of their appraisal rights, respectively.
  - Through case law, the Delaware Court of Chancery has vastly expanded the disclosure obligations of companies acting pursuant to either section of the DGCL.

Latent Disclosure Obligations

- *Dubroff v. Wren Holdings, LLC*, 2009 WL 1478697 (Del. Ch. May 22, 2009). Court found that company's disclosure of recapitalization approved by written consent breached the board's fiduciary duty to communicate honestly with stockholders. While notice accurately described the recapitalization (and thus complied with the statutory requirements of Section 228), it failed to describe **practical effects of the transaction, *i.e.*, "who benefited from the Recapitalization and what benefits" they received**.
- *Berger v. Pubco Corp.*, 2008 WL 2224107 (Del. Ch. May 30, 2008). Court evaluated disclosures accompanying notice of appraisal rights provided to minority stockholders in connection with a short form merger under DGCL Section 153 (which, like Sections 228 and 262, contains no disclosure obligations). While notice informed minority stockholders of their appraisal rights and provided descriptions of the transactions, it breached the board's fiduciary duty to disclose all material information when seeking stockholder action by omitting **the methodology used to arrive at the per share valuation for minority stockholders (*i.e.*, the offer price)**, which was necessary for minority stockholders to make an informed decision as to whether to accept the offer or seek appraisal.

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Latent Disclosure Obligations

Practice Points

- Absent a change in case law, net result – substantive disclosure obligations for private transactions implicating Sections 228 and 262 at the minimum should include:
  - Merger agreement (along with a summary description);
  - Financial statements;
  - Revenue projections;
  - Instructions for executing and filing a valid objection or demand for payment;
  - Valuation methodology; and
  - Practical effect on interested parties.
- To the extent a particular type of information is not available, the company should provide a statement expressly saying so.
- Balance: Required disclosure under case law v. interest of private corporation and its stockholders in keeping information confidential

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Use of Joinder Agreements in Private Merger Transactions

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Use of Joinder Agreements in Private Merger Transactions

Question: Can the non-consenting stockholders be bound by the indemnification and other terms of the Merger Agreement?

Answer: Arguably yes, if structured correctly.

Solution: Require execution of a joinder agreement.

Rule #1 - A contract generally cannot bind a non-party.

Rule #2 - A contract must have consideration to be enforceable.

Rule #3 - DGCL §251(b)(5). Requires a merger agreement to state clearly what consideration each stockholder would receive for its shares.

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Use of Joinder Agreements in Private Merger Transactions

- *Roam-Tel Partners v. AT&T Mobility,* 2010 WL 5276991 (Del. Ch. Dec. 17, 2010). Delaware Chancery held that a letter of transmittal was not a binding contract as non-executing stockholders already was entitled to merger proceeds and thus provision in letter of transmittal forbidding appraisal was not enforceable.
- *Cigna v. Audax, 107 A.3d 1082 (Del. Ch. 2014).* Court held (a) a non-signatory stockholder was not bound by release provisions included in a letter of transmittal when the release provisions were not mentioned in the merger agreement and no consideration provided for the release and (b) indemnity obligations relating to breaches of "fundamental representations" survived indefinitely and were only capped at the pro rata merger consideration received by stockholder were not enforceable because a stockholder could never definitively ascertain the consideration being received in connection with the merger.

Use of Joinder Agreements in Private Merger Transactions

Practice Points

- Bolstering enforceability:
  - Include all terms to which stockholders will be required to agree in merger agreement
  - Make clear in merger agreement that execution of joinder agreement is condition to receiving merger consideration
  - Attach form of joinder agreement to merger agreement
  - Consider limiting indemnification / purchase price adjustment obligation to escrow / holdback
  - Consider indemnification of limited duration and/or capped amount
- Mitigating risk if finding of non-enforceability:
  - Consider whether to require separate, consensual agreements with specific stockholders as a condition to closing
  - Consider making merger contingent upon joinder agreements being executed
  - Consider providing additional consideration to those that execute merger agreement
  - Get rep and warranty insurance

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Use of Joinder Agreements in Private Merger Transactions

Terms of Joinder Agreements

- Agreement to be bound to merger agreement
- Acknowledges merger consideration constitutes satisfaction in full of all obligations with respect to shares held of target
- Agrees to indemnification obligations
- Includes reps and warranties typical of an equity seller in an M&A transaction
- Release and confidentiality provisions in favor of acquirer / target
- Agreement not to transfer shares other than pursuant to merger agreement
- Waiver of appraisal rights under Section 262 of Delaware General Corporation Law
- Acknowledges provisions re stockholder representative and amendment
- Governing Law; Jurisdiction

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Business Judgment Rule; Director and Stockholder Approval Process

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Business Judgment Rule; Director and Stockholder Approval Process

Question: Does recent case suggest that there are steps to be taken re director and stockholder consent to maximize prospect of obtaining presumption of the Business Judgment Rule*?*

Answer: Yes (Corwin), including with respect to controlling stockholder transactions (MFW). These are significant developments.

Corwin "Cleansing"

- ***Corwin v. KKR Financial Holdings*, 125 A.3d 304 (Del. 2015)**
  - Shareholder ratification of a deal via a fully informed, uncoerced vote of unaffiliated stockholders results in irrebuttable business judgment rule presumption
  - Significant development on business judgment rule front
  - An uncoerced vote of unaffiliated stockholders with sufficient disclosure resulting in an informed stockholder vote can cure flaws in transaction process for business judgment rule purposes
  - *Huff Energy Fund, L.P. v. Gershen*, 2016 WL 5462958 (Del. Ch. Sept. 29, 2016) (applying Corwin and its progeny to private company for the first time, finding that even if plaintiff alleged facts generating inference that adoption of dissolution plan was subject to enhanced scrutiny, stockholders approved the plan in a fully informed, uncoerced vote, which cleansed the transaction and irrebuttably reinstated the business-judgment rule).

Business Judgment Rule; Director and Stockholder Approval Process

Legal Challenges to Take-Private Transactions Involving Controlling Stockholders

Fiduciary Duty Recap:

- Duty of care requires fiduciary to exercise the "care which ordinarily careful and prudent [people] would use in similar circumstances."
  - Fiduciaries must act on an informed basis after considering relevant information, including the input of financial and legal experts
  - Duty of loyalty obligates fiduciary to act in "good faith" and refrain from putting his or her interests ahead of the corporation
    - A plaintiff can challenge a fiduciary's loyalty by demonstrating that he or she (i) was interested in the transaction under consideration or not independent of someone who was, or (ii) failed to pursue the best interests of the corporation and its stockholders and therefore failed to act in good faith

Business Judgment Rule; Director and Stockholder Approval Process

Legal Challenges to Take-Private Transactions Involving Controlling Stockholders (con't)

Standard of Review Recap:

- Business Judgment Rule ("BJR")
  - Has been characterized as a "principle of ***non-review*** that reflects and promotes the role of the board of directors as the proper body to manage the business and affairs of the corporation" – not the stockholders or the courts
  - Presumes that, in reaching a business decision, directors are informed, operating in good faith, and believe that the "action taken was in the best interests of the company."
  - Under this forgiving standard, a business decision must "lack[] any rationally conceivable basis" for a court to "infer bad faith and a breach of duty."
- "Entire Fairness" – Until recently, applied in all controlling stockholder or other "interested" transactions
  - Burden of proof with defendants to demonstrate that transaction was "entirely fair" – *i.e.*, that it mirrored an arm's-length negotiated transaction
  - Standard has two components: fair dealing and fair price

Business Judgment Rule; Director and Stockholder Approval Process

Legal Challenges to Take-Private Transactions Involving Controlling Stockholders (con't)

- Historically, defendants could ***shift*** burden of proof to plaintiff by showing that the transaction was approved by ***either***:

  (1) a well-functioning committee of independent directors; ***or***

  (2) an informed vote of a majority of the minority (unaffiliated) stockholders ("majority of the minority" provision)

Business Judgment Rule; Director and Stockholder Approval Process

The "Sea Change" in Controller Stockholder Transactions—The MFW Structure and the Return of the BJR

- ***Kahn v. M&F Worldwide Corp.*, 88 A.3d 635 (Del. 2014)**
  - MacAndrews and Forbes ("M&F") was the controlling stockholder (43%) of M&F Worldwide ("MFW") and offered to purchase MFW's outstanding equity for $24 per share
  - The stock was trading at $16.96 at the close of the last business day prior to M&F's offer
  - Shareholders brought suit alleging that the merger was unfair and seeking a post-closing damages remedy
  - **At the outset**, M&F conditioned consummation of any going-private transaction on the transaction being approved by **both** (i) an independent special committee **and** (ii) a vote of a majority of the disinterested stockholders
  - The Court of Chancery held that the appropriate standard of review, given those two procedural protections, was the BJR and granted judgment in favor of defendants

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Business Judgment Rule; Director and Stockholder Approval Process

The "Sea Change" in Controller Stockholder Transactions—The MFW Structure and the Return of the BJR (con't)

- The Delaware Supreme Court affirmed
  - Controller-led take-private transactions will be subject to BJR review when conditioned – *from the outset* – on the approval of both:

    (i) a fully empowered, disinterested and independent special committee, and

    (ii) a fully informed and uncoerced "majority-of-the-minority" vote

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Business Judgment Rule; Director and Stockholder Approval Process

Practice Points

To Summarize, BJR Protection Can Be Achieved in Controller Stockholder Transactions If:

1. The controlling stockholder conditions the transaction on both a special committee approval and a majority-of-the-minority vote of stockholders;
2. The special committee is independent;
3. The special committee is empowered to freely select its own advisors and definitively say "no" to the transaction;
4. The special committee fulfills its duty of care in negotiating a fair price;
5. The vote of the minority stockholders is informed; ***and***
6. There is no coercion of the minority stockholders.

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Business Judgment Rule; Director and Stockholder Approval Process

BUT the structure, once in place, *can be subverted* – to disastrous effect

- ***In re Dole Food Co., Inc., Stockholder Litig.*, C.A. No. 8703-VCL (Del. Ch. Aug. 27, 2015)**
  - Controller and management strayed from the straight and narrow
    - Two sets of projections, unauthorized meetings, etc.
  - Committee and advisors did the best they could, but could not cure controller's conduct
  - Court found that Company's 40% stockholder and de facto controller, together with its president, COO and GC, were jointly and severally liable for more than **$148 million in damages** on a $1.2 billion deal
  - Cautionary tale
    - **MOREOVER, a question remained in the minds of practitioners whether this new framework would permit pleading-stage (i.e., pre-discovery) dismissals**

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Appraisal Rights: The Current Lay of the Land

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Appraisal Rights: The Current Lay of the Land

Question: Is the appraisal calculus changing?

Answer: Maybe.

Why: DFC Global v. Muirfield

- After a string of decisions hewing to deal price as a proxy for "fair value," Chancery Court has recently issued two appraisal awards substantially in excess of deal price.
  - *DFC Global*: Court determined fair value to be 7.4% above merger price where deal was negotiated amid regulatory uncertainty and price was based in part on PE buyer's internal rate of return analysis.
    - Delaware Supreme Court reversed and remanded, strongly endorsing reliance on deal price as an indicator of fair value where transaction was negotiated at arm's-length pursuant to a robust and competitive sale process.
  - *In re Appraisal of Dell*: In controller take-private, Court pegged fair value at approximately 30% above the deal price.
    - Currently on appeal to the Delaware Supreme Court.

Appraisal Rights: The Current Lay of the Land

Appraisal Rights Under 8 *Del. C.* §262

Surge in appraisal actions in Delaware since 2012

- In 2016, 62 appraisal actions filed in Delaware Chancery (representing $1.9 billion in aggregate merger consideration) versus 16 actions in 2012 (representing $129 million in aggregate merger consideration).
- Several driving forces:
  - Favorable case law regarding appraisal eligibility
  - Statutory interest rate on carried appraisal investment that is favorable to historically low interest rates
  - Available funding sources: cottage industry of arbitration arbitrageurs and hedge funds who purchase stock upon announcement of merger with the intent of exercising appraisal rights as an investment strategy
  - Recent Delaware case law limiting availability of damages claims in traditional fiduciary duty deal litigation
  - Lucrative judgments and settlements for appraisal plaintiffs
- 2015 amendments to DGCL Section 262 (i) limiting appraisal to cases with significant dollar amounts at stake and (ii) allowing companies to avoid statutory interest accumulation by pre-paying merger consideration have not demonstrably stemmed the tide to date.

Appraisal Rights: The Current Lay of the Land

- **Departure From Deal Price as a Proxy For "Fair Value" Under Appraisal Statute**
  - In recent years, several Court of Chancery decisions relied on the negotiated deal price as the best indicator of fair value for appraisal purposes, such that plaintiffs received no premium (beyond interest).
    - *See, e.g., In re Appraisal of Ancestry.com, Inc.*; *LongPath Cap., LLC v. Ramtron Int'l Corp.*; *Merlin P'rs LP v. AutoInfo, Inc.*; *Merion Cap. V. Lender Processing Servs. Inc.*
    - These cases generally involved arm's-length, third-party transactions that were free of potential or actual conflicts of interest and subject to robust auction processes with competition among multiple bidders.
  - Several 2016 appraisal decisions halted that trend – departing from the negotiated deal price and issuing substantially higher fair value determinations.

Appraisal Rights: The Current Lay of the Land

- **Departure From Deal Price as a Proxy For "Fair Value" Under Appraisal Statute (Cont.)**
  - *In re: Appraisal of Dell Inc*. Management-led buyout; Court applied its own DCF analysis and concluded that fair value was $17.62 per share, more than 28% higher than the $13.75 deal price.
  - *ISN Software Corp*. Cash merger involving privately-held company; Court applied DCF analysis to find fair value more than 2.5 times higher on a per share basis than deal price, reasoning that (a) company's shares were not publicly traded, (b) historical sales of stock are not reliable indicators of fair value, and (c) no comparable company valuation existed.
  - *Farmers & Merchants Bancorp Inc*. Conflicted controller transaction that involved no auction or solicitation of third-party bids; Court applied a discounted net income analysis and concluded that fair value was 11% higher than deal price.

Appraisal Rights: The Current Lay of the Land

"Fair Value": A Preference (If Not a Presumption) for the Merger Price in Fully-Shopped Deals

- ***In re DFC Global Corp*. v. *Muirfield Value P'ners, L.P*. (Del. Aug. 1, 2017)**
  - Court of Chancery (Chancellor Bouchard) applied its own DCF analysis and concluded that "fair value" was 7.47% ***higher*** than the merger price.
  - Departed from merger price because the deal, while widely shopped (the process "appeared to be robust"), was negotiated during a period of significant regulatory uncertainty in which management repeatedly revised its projections downward and the deal price was based in part on the PE buyer's internal rate of return analysis.
  - Delaware Supreme Court reversed.
    - While rejecting argument that exclusive or presumptive weight should be given to the deal price, and confirming the Court of Chancery's statutory discretion to take into account all relevant factors, Court essentially found, based on economic principles, that, ***in the absence of external influences such as a controlling stockholder***, the price achieved in a robust, unconflicted sale process is the best evidence of fair value and any relative weighting of competing valuation methodologies must be grounded in the record.

Appraisal Rights: The Current Lay of the Land

Role of the Deal Price in MBOs, Controlling Stockholder Take-Privates and Other "Interested" Transactions

- ***In re Appraisal of Dell, Inc.*, C.A. No. 9322-VCL (Del. Ch. May 31, 2016)**
  - MBO context
  - Court of Chancery (VC Laster) applied its own DCF analysis and concluded that "fair value" was $17.62 per share, approximately ***30% higher than the $13.75 deal price***
    - LBO pricing model focused on PE buyer's short-term internal rate of return
    - Post-signing "go shop" of limited utility given size and complexity of company
  - Currently on appeal to the Delaware Supreme Court
  - Will the Court extend *DFC*?

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Appraisal Rights: The Current Lay of the Land

When Is the Court Most Likely to Depart from the Deal Price?

- Actual or potential conflicts of interest in the transaction;
- Process favors a particular bidder (*i.e.*, controller transactions, MBOs);
- Lack of competitive bidding process involving mix of bidder types (*i.e.*, strategic as well as financial);
- Significant management involvement (*i.e.*, MBOs);
- LBOs – valuations are generally based on IRR and not intrinsic valuation of company

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Appraisal Rights: The Current Lay of the Land

Practice Points

Implications for Private Company M&A

- Appraisal Conditions or Blow Clauses. Consider closing condition requiring that no more than a certain percentage of target shares (often 5-15%) shall have sought appraisal.
- Indemnification. Consider indemnification coverage for appraisal claims from target company or participating stockholders who are signatories to the merger agreement.
- Drag-Along Provisions/Waivers. Consider condition that seller enforce contractual drag-along rights or waivers of appraisal rights to compel stockholder's participation in deal.
  - Ability of company to enforce stockholder's contractual waiver of appraisal rights to preclude statutory right to appraisal remains uncertain after *Halpin v. Riverstone Nat'l* (Del. Ch. Feb. 26, 2015).
- Process. Memorialize emphasis on intrinsic valuation, robust auction/market check and competition among bidders to enhance reliability of deal price as fair value proxy.
- Pre-Payment Option. In leveraged transactions, lenders may require buyer to pre-pay merger consideration to stockholders perfecting appraisal rights to cut off interest accumulation.

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Reliance Disclaimers & the Fraud Carve-Out

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Reliance Disclaimers & the Fraud Carve-Out

Question: Can the parties contractually agree to waive fraud claims based on statements within the agreement?

Answer: No

Why: For public policy reasons, Delaware law does not allow parties to contractually preclude claims against a party for statements *made by that party* within the *four corners of the contract* itself that the party *knew* were false.

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Reliance Disclaimers & the Fraud Carve-Out

Question: Can the parties contractually agree to waive fraud claims based on statements outside of the agreement?

Answer: Yes.

How: An effective non-reliance provision.

- In Delaware, not enough to have "entire agreement" and "no other representations" provisions.
- Seller also needs an affirmative "non-reliance" statement from Buyer disclaiming reliance on extra-contractual statements.

Abry Partners V, L.P. v. F & W Acq., LLC, 891 A.2d 1032 (Del. Ch. 2006). Under Delaware law, parties can preclude post-closing fraud claims based on extra-contractual statements through an effective non-reliance provision.

- A representation from the perspective of the disclaiming party that it has relied solely upon the representations and warranties in the agreement itself and/or has not relied on any other statement or omission beyond what is included in the agreement. *FdG Logistics LLC v. A&R Logistics Holdings, Inc.*, 131 A.3d 842, 860 (Del. Ch. 2016)

Reliance Disclaimers & the Fraud Carve-Out

Question: What if the parties agree to preserve claims for fraud based on statements outside of the agreement?

Answer: Carve-out fraud from non-reliance provision.

Why: JCM Innovation Corp. v. FL Acquisition Holdings, Inc., No. N15C-10-255 (Del. Super. Sept. 30, 2016).

- Court allowed fraud claims to proceed based on statements made during diligence, notwithstanding a non-reliance provision acknowledging that the seller had made no representations outside of the agreement and expressly disclaiming reliance on "***projections, estimates and other forecasts.***"
- Notably, however, the agreement included a fraud carve-out not just to the exclusive remedies provision, but to ***the operative non-reliance provision itself***.

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Reliance Disclaimers & the Fraud Carve-Out

Carving Out Fraud

***JCM* Exclusive Remedy Provision:**

- "From and after the Closing, … the sole and exclusive remedy for any breach or failure to be true and correct, or alleged breach or failure to be true and correct, of any representation or warranty or any covenant or agreement in this Agreement (other than for claims arising from fraud), shall be indemnification in accordance with this ARTICLE IX and, as applicable, ARTICLE VIII. The parties have voluntarily agreed to define their rights, liabilities and obligations respecting the subject matter of this Agreement exclusively in contract ***(other than for fraud)*** pursuant to the terms and provisions of this Agreement and their sole and exclusive remedies regarding the subject matter of this Agreement ***other than for fraud)*** shall be remedies available at law or in equity for breach of contract only (as such remedies may be limited by the express terms of this Agreement). Notwithstanding anything to the contrary in this Section 9.9, ***the Parties shall retain (a) remedies that cannot be waived as a matter of Law*** and (b) any equitable relief to which any Party shall be entitled under this Agreement or ***(c) to seek any remedy related to fraud***."

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Reliance Disclaimers & the Fraud Carve-Out

Carving Out Fraud

***JCM* Anti-Reliance Clause:**

- "Purchaser's investigation of Seller, the Company and its Subsidiaries, Purchaser and its Representatives have received from Seller and its Subsidiaries (individually or through its Representatives) certain projections, estimates and other forecasts and certain business plan information (collectively, "Projections"). Purchaser acknowledges that there are uncertainties inherent in attempting to make such Projections, that it is familiar with such uncertainties, that it is making its own evaluation of the adequacy and accuracy of all Projections so furnished to it and any use of, or reliance by, it on such Projections shall be at its sole risk, and without limiting any other provisions herein, that it shall have no claim against anyone with respect thereto; ***provided, that the foregoing shall not be interpreted to waive any rights that Purchaser has with respect to recovery*** for breaches of express representations and warranties made by Seller or the Company in ARTICLE III of this Agreement or ***for any intentional misconduct by Seller, the Company, its Subsidiaries, or any person authorized to act on behalf of Seller, the Company or its Subsidiaries***."

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Reliance Disclaimers & the Fraud Carve-Out

Defining Fraud

- Definitions of fraud can vary from state-to-state if left undefined; Buyer can benefit, as in some states it can include so-called “negligent misrepresentation.”
- Seller-driven trend is towards defining “fraud” in order to avoid these types of claims; for example, limiting any “fraud” carve-out to deliberate lying with respect to the reps and warranties in the purchase agreement.

Reliance Disclaimers & the Fraud Carve-Out

Practice Points

- Reliance Disclaimers
  - Clearly evidence that *plaintiff* has contractually promised that it did not rely on statements outside of the agreement
  - Do not rely on boilerplate integration clause merely stating that the written contract represents the entirety of the parties' agreement
  - Include statements to evidence that plaintiff is a sophisticated party
- Defining Fraud
  - Limit the carve-out to scienter-based, intentional fraud

    Example - "Fraud" means "a claim for common law fraud with a specific intent to deceive or with reckless disregard as to the accuracy or inaccuracy of [a statement made]; provided that, at the time such [statement was made], (a) such [statement] was inaccurate, (b) the Party making such [statement] had 'knowledge' of the inaccuracy of such [statement] or the Party made such [statement] with reckless disregard as to the accuracy of such [statement] and (c) the other Party acted in reliance on such inaccurate [statement] and suffered any Loss as a result of such [statement].
  - Limit to statements made by the specific seller

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Thank You

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