Will Anti-Reliance Provisions Preclude Extra-Contractual Fraud Claims? Answers Differ in Delaware, New York, and California

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Merger agreements and other complex contracts often contain "anti-reliance" provisions reciting that the representations in the agreement are the sole representations on which the parties relied in entering into the contract. The law regarding the interpretation and enforceability of such clauses—whether in a merger agreement, a settlement agreement, or other commercial contract—varies by jurisdiction, and continues to develop. On November 24, 2015, the Delaware Court of Chancery in *Prairie Capital III, L.P. v. Double E Holding Corp.*[1] held that, as a matter of Delaware law, there are no "magic words" to disclaim reliance on extrinsic representations. While a standard integration clause (reciting that the contract is the sole agreement between the parties and replaces any prior agreements) is insufficient to limit the parties' obligations to promises within the agreement, the Court of Chancery reaffirmed that where a party expressly represented that it had relied *only* on information within the contract, that party could not later state a fraud claim relating to *other*, extrinsic promises.

Delaware's anti-reliance law is similar to that of New York, but stands in contrast to the law in California, which disfavors allowing even sophisticated parties represented by counsel to contract away liability for fraud. In all jurisdictions, anti-reliance clauses that are clear and specific have a greater chance of being enforced than do more vague or general statements.

Background: Claims of Fraudulent Inducement Based on Representations Made Outside of a Contract

Fraud claims based on extra-contractual statements arise in numerous contexts, such as mergers and acquisitions (including regarding earn-outs), commercial contracts, securities purchase agreements,[2] and settlement agreements resolving litigation. Such claims may be brought in lieu of, or in addition to, claims for breach of contract. Fraud claims can carry reputational and other risks for the defendant, including potentially damages in excess of what would be available in suits for breach of contract.

Courts across the country differ in their interpretation and enforcement of integration clauses and "anti-reliance" (or "no-reliance") language in agreements. A typical integration clause states that the contract

[1] C.A. No. 10127, 2015 WL 7461807, at *8 (Del. Ch. Nov. 24, 2015) (Laster, V.C.).

[2] Transactions involving the purchase or sale of securities may also implicate fraud claims under Section 10(b) of the Securities Exchange Act of 1934 and other provisions. While Section 29(a) of the Exchange Act provides that "[a]ny condition, stipulation, or provision binding any person to waive compliance with any provision" of the federal securities laws "shall be void," the federal circuits have differing interpretations of the applicable law regarding anti-reliance language. If you have any questions about this subject, please contact any of the undersigned or your regular Davis Polk contact.

constitutes the entire agreement between the parties and that it supersedes all prior agreements or representations, whether oral or written. Anti-reliance provisions are more specific, typically stating that the parties are (a) relying only on written representations expressly set forth in the agreement, and/or (b) disclaiming reliance on representations not explicitly contained in that agreement.

Delaware's Stance on Integration Clauses and Anti-Reliance Language

Delaware public policy favors the enforcement of contractual language disclaiming reliance on representations made outside of a final agreement.[3] Despite this policy, Delaware courts repeatedly have held that standard integration clauses alone do not contain "anti-reliance" language sufficient to bar extra-contractual fraud claims.[4] For example, in *Kronenberg v. Katz*, the court held that the following integration clause did not disclaim reliance on extrinsic representations:

> This Agreement . . . constitutes the entire agreement and understanding of the parties hereto with respect to the subject matter hereof and supersedes all prior or contemporaneous agreements, understandings, inducements, or conditions, oral or written, express or implied.[5]

In another decision, *Airborne Health v. Squid Soap*, the court additionally noted that the presence of an "Exclusive Remedy" provision preserving the parties' rights to pursue fraud claims—a provision that did not expressly limit such preserved claims to those involving representations *within* the contract—further supported the conclusion that the integration clause did not operate as an anti-reliance provision.[6]

Under Delaware law, in order for a party to disclaim reliance on extra-contractual representations, an agreement must contain language that, when read cohesively, can "add up to a clear anti-reliance clause."[7] In other words, Delaware courts will enforce anti-reliance language that identifies the "specific information on which a party has relied and which foreclose[s] reliance on other information."

The *Prairie Capital* case involved the sale of a portfolio company from one private equity sponsor to another. The transaction was governed by a stock purchase agreement containing both a standard integration clause and an "Exclusive Representations" clause, the latter of which stated:

> In making its determination to proceed with the Transaction, the Buyer has relied on . . . the representations and warranties of the [Sellers] expressly and specifically set forth in this Agreement, including the Schedules. Such representations and warranties by the [Sellers] constitute the sole and exclusive representations and warranties of the [Sellers] 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 [the portfolio company]) are specifically disclaimed by the [Sellers].

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[3] *RAA Mgmt., LLC v. Savage Sports Hldgs., Inc.*, 45 A.3d 107, 118-19 (Del. 2012); *see also Abry Partners V, L.P. v. F & W Acq. LLC,* 891 A.2d 1032, at 1058-59 (Del. Ch. 2006) (noting that failing to enforce explicit anti-reliance clauses would "excuse a lie made by one contracting party in writing").

[4] *See, e.g.*, *Airborne Health, Inc. v. Squid Soap, LP*, 984 A.2d 126,141 (Del. Ch. 2009) ("This is a standard integration clause . . . [n]othing in this provision resembles anti-reliance language."); *Kronenberg v. Katz*, 872 A.2d 568, 593 (Del. Ch. 2004) (Strine, V.C.) ("The presence of a standard integration clause alone, which does not contain explicit anti-reliance representations and which is not accompanied by other contractual provisions demonstrating with clarity that the plaintiff had agreed that it was not relying on facts outside the contract, will not suffice to bar fraud claims.").

[5] *Kronenberg*, 872 A.2d at 587.

[6] *Airborne Health,* , 984 A.2d at 141.

[7] *Prairie Capital III*, 2015 WL 7461807, at *8; *see also Abry Partners*, 891 A.2d at 1059.

The buyer nonetheless initiated litigation that included fraud claims against the sellers based on alleged promises made outside of the stock purchase agreement.[8]

The court found that although the Exclusive Representations Clause was "framed positively"—i.e., the clause stated that the buyer relied *solely* on representations within the stock purchase agreement, not that the buyer did *not* rely on extrinsic representations—the language, together with the integration clause, "add[ed] up to a clear anti-reliance clause."[9] The court also concluded that parties can disclaim reliance by "multiple means" so long as there is "sufficient clarity [of] the universe of information on which the contracting parties relied." This finding is consistent with prior Delaware cases holding that a party cannot promise that it is not relying on representations outside of an agreement and then assert a fraudulent inducement claim based on extrinsic representations.

New York's Similar Approach to Integration Clauses and Anti-Reliance Language

New York generally recognizes the same policy reasons as Delaware for enforcing anti-reliance language.[10] Similar to Delaware courts, New York courts have found that "a general, boilerplate disclaimer of a party's representations cannot defeat a claim for fraud."[11] Moreover, a standard integration clause stating that a written instrument embodies the whole agreement, or that no representations have been made, will not bar a fraud claim. New York courts instead require specific anti-reliance provisions.

A New York court will typically enforce a disclaimer that "tracks the substance" of the alleged misrepresentation, under the policy that a party cannot reasonably rely on misrepresentations that have been explicitly disclaimed.[12] For example, in *Danann Realty Corp.*, the court found that the plaintiff purchaser of a building could not assert that it was relying on oral representations made by the seller outside of a contract in which the plaintiff had specifically agreed in writing not to rely on such representations.[13] The court found that the following language barred the plaintiff purchaser's claim:

> The Seller has not made and does not make any representations as to the . . . expenses, operation or any other matter or thing affecting or related to the aforesaid premises, except as herein specifically set forth, and the Purchaser hereby expressly acknowledges that no such representations have been made . . . . It is understood and agreed that . . . this contract . . . is entered into after full investigation, neither party relying upon any statement or representation, not embodied in this contract, made by the other.

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[8] The buyer also asserted a fraud claim against the seller based on allegedly misleading representations made *within* the four corners of the contract. Such claims were not at issue in the motion to dismiss. It bears emphasizing that anti-reliance clauses have no bearing on such claims.

[9] *Prairie Capital III*, 2015 WL 7461807, at *8.

[10] *See RAA Mgmt., LLC*, 45 A.3d at 117-18 (applying New York law); *see also Warner Theatre Assocs. Ltd. P'ship v. Metro. Life Ins. Co.*, 149 F.3d 134, 137 (2d Cir. 1998) (noting that allowing a fraud claim despite a non-reliance disclaimer "might greatly lessen the useful role disclaimers play in negotiation agreements").

[11] *JM Vidal, Inc. v. Texdis USA, Inc.*, 764 F. Supp. 2d 599, 623 (S.D.N.Y. 2011); *see also Danann Realty Corp. v. Harris*, 5 N.Y.2d 317, 320 (1959).

[12] *Harbinger Capital Partners Master Fund I, Ltd. v. Wachovia Capital Markets, LLC*, 27 Misc. 3d 1236(A) at *5, 910 N.Y.S.2d 762 (Sup. Ct. May 10, 2010); *Plaza PH2001 LLC v. Plaza Res. Owners LP*, 914 N.Y.S.2d 26, 26 (2010) (disclaimer of extra-contractual representations undermined allegations of reliance on contrary oral representations).

[13] *Danann Realty Corp.*, 5 N.Y.2d at 320.

Even broader anti-reliance language can be found in *In re IBP, Inc. Shareholders Litigation*,[14] where a confidentiality agreement accompanying a merger agreement provided that the seller would have no liability for extrinsic representations or for any *omissions* that it may have made:

> We [the acquirer] understand and agree that none of the [seller], its advisors or any of their . . . representatives (i) have made or make any representation or warranty, expressed or implied, as to the accuracy or completeness of the Evaluation Material or (ii) shall have any liability whatsoever to us or our Representatives relating to or resulting from the use of the Evaluation Material or any errors therein or omissions therefrom, except in the case of (i) and (ii), to the extent provided in any definitive agreement relating to a Transaction.

The court found that this language defeated fraud claims based on extrinsic representations and alleged omissions of material fact in the final transaction documentation.[15]

It is important to note that New York law also recognizes a "peculiar knowledge" exception to anti-reliance provisions. If the defendant has unique knowledge of an allegedly misrepresented fact, even a specific contractual disclaimer will not defeat a plaintiff's contention that it reasonably relied on the misrepresentation.[16] The exception is designed to address circumstances under which a party would face sufficiently high costs, extraordinary effort, or great difficulty in determining the truth or falsity of an oral misrepresentation (for example, where the information is not easily verifiable, such as a latent property defect).[17] It does not apply where the other party has the means available to him of learning the truth by the exercise of ordinary intelligence.[18] Factors relevant to whether the exception may apply include (1) the plaintiff's level of sophistication, (2) the plaintiff's access to information underlying the defendant's alleged misrepresentation, and (3) whether the plaintiff took reasonable steps to protect itself against fraud (such as seeking written assurances that certain facts are true).[19]

California's Alternative Approach

In contrast to Delaware and New York law, it is against public policy in California for a contract to exempt, directly or indirectly, a party from responsibility for its own willful or negligent fraud.[20] California state courts have found that integration clauses do not bar fraudulent inducement claims as a matter of law.[21] Several California cases also have held that a party cannot avoid a finding of fraud by "any stipulation" in a contract, including a specific anti-reliance clause.[22]

Integration clauses and anti-reliance language may still be relevant in California, however, as "a factor . . . to consider" with other evidence in determining whether a plaintiff reasonably relied on extra-contractual

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[14] 789 A.2d 14, 32 (Del. Ch. 2001) (applying New York law).

[15] *Id.* at 73.

[16] *Danann Realty Corp.*, 5 N.Y.2d at 322; *see also Warner Theatre Assocs.*, 149 F.3d at 136.

[17] *See, e.g.*, *Schooley v. Mannion*, 659 N.Y.S.2d 374, 375 (1997) (noting that representation about insulation within the property was "not easily verified without destructive testing"); *DIMON Inc. v. Folium, Inc.*, 48 F. Supp. 2d 359, 368 (S.D.N.Y. 1999).

[18] *See ACA Fin. Guar. Corp. v. Goldman, Sachs & Co.*, 25 N.Y.3d 1043, 1044 (2015).

[19] *Id.* at 1045, 1048; *DIMON Inc.*, 48 F. Supp. 2d at 368-69.

[20] Cal. Civ. Code § 1668; *see also Manderville v. PCG & S Grp., Inc.*, 146 Cal. App. 4th 1486, 1501-02 (2007).

[21] *See, e.g.*, *Hinesley v. Oakshade Town Ctr.*, 135 Cal. App. 4th 289, 301 (2005).

[22] *See McClain v. Octagon Plaza, LLC*, 159 Cal. App. 4th 784 (2008) (noting that "[s]uch a stipulation or waiver will be ignored" because fraud renders the whole agreement voidable) (citation omitted); *Ron Greenspan Volkswagen, Inc. v. Ford Motor Land Dev. Corp.*, 32 Cal. App. 4th 985, 992-94 & n.7 (1995).

statements.[23] As in New York and Delaware, fraudulent inducement claims in California require a finding of reasonable or justifiable reliance.[24] Thus, while the existence of an anti-reliance clause may not allow a defendant to get a fraud claim based on extrinsic promises dismissed as a matter of law, the defendant may be able to use the anti-reliance clause at trial as evidence showing that the plaintiff's alleged reliance on such promises was not reasonable.

In addition, some federal courts in California recently have undertaken a different approach. While acknowledging that a general integration clause does not make reliance on oral statements automatically unreasonable, these cases have found that *specific* written language that directly contradicts alleged extrinsic oral statements does preclude a showing of reasonable reliance.[25] If this approach were to take root in California jurisprudence, it would allow contracting parties to draft enforceable anti-reliance provisions, but may require a greater degree of specificity than is currently required in Delaware or New York.

Considerations Regarding Choice of Law Provisions in Delaware, New York, and California

As courts in Delaware, New York, and California may not enforce similar anti-reliance language identically, choice of law provisions may have a significant impact if a dispute is litigated. Unfortunately, just as courts differ over the enforceability of anti-reliance language, courts also differ about whether to respect parties' decisions about the law that will govern their agreements:

- Delaware courts will respect contractual choice of law provisions so long as the identified state has a "material relationship" to the transaction. Where Delaware law is selected by the parties, Delaware courts will apply it so long as the parties are subject to Delaware jurisdiction and may be served with legal process.[26]
- New York courts, when deciding between the conflicting laws of two states, will apply the law of the jurisdiction with the "most relation" to the fraud, i.e., where the underlying fraud originated and was executed.[27] Where contracting parties select New York law to govern their agreement, New York courts, by statute, must enforce that choice whether or not the agreement bears a reasonable relation to the State.[28]
- California courts generally will enforce a choice of law provision if there is a "substantial relationship" between the chosen state and the parties or the transaction.[29] For this purpose, the fact that a corporation is incorporated in Delaware is sufficient to justify use of a Delaware choice of law provision in a contract. However, there are situations in which a California court will nonetheless refuse to apply another state's laws: where California has a "materially greater"

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[23] *Hinesley*, 135 Cal. App. 4th at 302 (also considering plaintiff's conduct); *see also McClain*, 159 Cal. App. 4th at 797 & n.3.

[24] *See Warner Theatre Assocs.*, 149 F.3d at 136; *Hinesley*, 135 Cal. App. 4th at 294; *Abry Partners*, 891 A.2d at 1050.

[25] *Applied Elastomerics, Inc. v. Z-Man Fishing Prods.*, No. C 06-2469CW, 2006 WL 3251732, at *6 (N.D. Cal. Nov. 8, 2006) ("Reliance on representations that contradict clear and unambiguous terms of an agreement is unjustified as a matter of law."); *Omni Home Fin., Inc. v. Hartford Life and Annuity Ins. Co.*, No. 06cv0921IEG(JMA), 2008 WL 1925248, at *5 (S.D. Cal. Apr. 29, 2008), *case dismissed*, 367 F. App'x 792 (9th Cir. 2010).

[26] *Abry Partners*, 891 A.2d at 1046; *see also* 6 Del. C. § 2708 (applying to agreements of at least $100,000).

[27] *See Pension Comm. of Univ. of Montreal Pension Plan v. Banc of Am. Sec., LLC*, 446 F. Supp. 2d 163, 194-95 (S.D.N.Y. 2006).

[28] *See* N.Y. Gen. Oblig. Law § 5-1401 (applying to agreements of at least $250,000 and excluding certain types of contracts); *Lehman Bros. Commercial Corp. v. Minmetals Int'l Non-Ferrous Metals Trading Co*., 179 F. Supp. 2d 118, 136 (S.D.N.Y. 2000).

[29] *See Nedlloyd Lines B.V. v. Superior Court*, 3 Cal. 4th 459, 466-67 (1992).

interest in applying its own law *and* the chosen law would contravene California's fundamental public policy.[30]

The practical takeaway? If you are seeking to preclude fraud claims based on matters outside of a contract, then: (i) draft anti-reliance language as explicitly and specifically as possible; (ii) where the parties have a nexus to Delaware or to New York, consider selecting either state's law (and avoid selecting California law) to govern the agreement; and (iii) consider identifying a state other than California as the exclusive forum for dispute resolution.

If you have any questions regarding the matters covered in this publication, please contact any of the lawyers listed below or your regular Davis Polk contact.

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[30] *See, e.g.*, *Abat v. Chase Bank USA, N.A.*, 738 F. Supp. 2d 1093, 1095 (C.D. Cal. 2010). A detailed analysis of choice of law issues in California is beyond the scope of this memorandum, but it is important to understand that a California court's willingness to enforce a choice of law provision in a contract (a) specifying another state's laws and (b) involving an anti-reliance provision is likely to depend on the specific facts and circumstances in a given case.