

That Pesky Little Thing Called Fraud: An Examination of Buyers' Insistence Upon (and Sellers' Too Ready Acceptance of) Undefined "Fraud Carve-Outs" in Acquisition Agreements

By Glenn D. West*

In those states that have a high regard for the sanctity of contract, a well-crafted waiver of reliance provision can effectively eliminate the specter of a buyer's post-closing fraud claim based upon alleged extra-contractual representations of the seller or its agents. But undefined "fraud carve-outs" continue to find their way into acquisition agreements notwithstanding these otherwise well-crafted waiver of reliance provisions. An undefined fraud carve-out threatens to undermine not only the waiver of reliance provision, but also the contractual cap on indemnification that was otherwise stated to be the exclusive remedy for the representations and warranties that were set forth in the contract. Practitioners continue to exhibit a limited appreciation of the many meanings of the term "fraud" and the extent to which a generalized fraud carve-out can potentially expand the universe of claims and remedies that can be brought outside the remedies specifically bargained-for under the parties' written agreement. Given the frequent insistence upon (and continued acceptance by many of) undefined fraud carve-outs, and recent court decisions that bring the undefined fraud carve-out issue into focus, this article will examine the various (and sometimes surprising) meanings of the term "fraud," and the resulting danger of generalized fraud carve-outs, and will propose some possible responses to the buyer who insists upon including the potentially problematic phrase "except in the case of fraud" as an exception to the exclusive remedy provision of an acquisition agreement.

I. INTRODUCTION

Post-closing fraud claims by a buyer against a seller are "regrettably familiar."¹ Indeed, allegations of fraud can occur whenever a buyer encounters what it contends to be an unanticipated problem with a business it acquired, and either

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1. *Transdigm Inc. v. Alcoa Global Fasteners, Inc.*, C.A. No. 7135-VCP, 2013 WL 2326881, at *1 (Del. Ch. May 29, 2013).

the bargained-for contractual representations and warranties do not cover that particular problem or the bargained-for contractual cap on liability for breach of those contractual representations and warranties proves insufficient.² If the buyer was in fact deliberately lied to by the seller, or facts were deliberately concealed from the buyer by the seller, respecting a matter that was specifically negotiated by the buyer to be represented by the seller as a predicate to the buyer's decision to purchase, such claims are understandable and, more importantly, may be enforceable, without regard to any contractual limits on fraud claims. But, in many states, fraud claims can be premised upon something less than the intentional, personal deceit that is commonly understood to be encompassed by the term fraud.³ And for the seller who instructed its representatives to be completely forthcoming with all relevant information requested by the buyer, and who believed that it had a clear agreement with the buyer as to what the seller was and was not prepared to represent and warrant regarding the business being purchased (and the extent to which the seller was and was not prepared to compensate the buyer in the event any of those bargained-for representations and warranties were inaccurate), the assertion of a claim of fraud by the buyer is a breach of the very bargain the seller believed it had made with the buyer.

In 2009, *The Business Lawyer* published an article that was designed to awaken deal professionals and their counsel to the dangers of these generalized fraud intrusions into the heavily negotiated contractual limitations of liability that are effected through indemnification caps and exclusive remedy provisions.⁴ Specifically, the 2009 *The Business Lawyer* article provided guidance for drafting contractual provisions designed to preserve the integrity of a fully negotiated contractual deal against at least some of the corrupting effects of the ever-elusive "fraud" claim.⁵

Based on the proliferation of published practice notes concerning this subject since the publication of that article,⁶ the message as to the need to disclaim

2. See Carol L. Newman, *New California Supreme Court Decision May Undermine Enforceability of Contracts*, VALLEY LAW. (San Fernando Valley Bar Ass'n, Tarzana, Cal.), Mar. 2013, at 18, 20, available at <http://goo.gl/5b5OLs>; see also *Eurofins Panlabs, Inc. v. Ricerca Biosciences, LLC*, C.A. No. 8431-VCN, 2014 WL 2457515, at *1 (Del. Ch. May 30, 2014) ("A combination of buyer's remorse and 'wishing makes it so' may persuade a frustrated and disappointed buyer that only the seller's misrepresentation could have placed the buyer in its unhappy predicament.").

3. See *infra* Part III.

4. See Glenn D. West & W. Benton Lewis, Jr., *Contractually Avoiding Extra-Contractual Liability—Can Your Contractual Deal Ever Really Be the "Entire" Deal?*, 64 BUS. LAW. 999 (2009).

5. See *id.*

6. See, e.g., Daniel Avery & Nicholas Perricone, *Trends in M&A Provisions: Indemnification as an Exclusive Remedy*, 16 MERGERS & ACQUISITIONS L. REP. (BNA) 1349 (Sept. 19, 2013), available at <http://goo.gl/PGFZ6U>; Wilson Chu & Jessica Pearlman, *Disclaimers of Reliance in Private M&A Deals Chart*, PRAC. L. CO., <http://us.practicallaw.com/2-562-5859> (last updated July 7, 2014); Roxanne L. Houtman & Catherine A. Schmierer, *Walking the Tightrope: Limiting Fraud Claims Based on Extra-Contractual Statements and Omissions*, BUS. L. TODAY (Aug. 2013), <http://www.americanbar.org/publications/blt/2013/08.html>; George Bundy Smith & Thomas J. Hall, *Exceptions to the Enforceability of Contractual Disclaimers of Reliance*, N.Y. L.J. (June 18, 2010), <http://goo.gl/1A1LWw>; Linda R. Stahl, *Beware the Boilerplate in Merger Clauses*, LAW360 (June 28, 2013, 10:09 AM), <http://www.law360.com/articles/453829/beware-the-boilerplate-in-merger-clauses>; Andrew M. Zeitlin & Alison P. Baker, *At Liberty to Lie? The Viability of Fraud Claims After Disclaiming Reliance*,

reliance on extra-contractual representations has been heard and more or less acted upon by many practitioners. Recent case law suggests, however, that the disclaimers of reliance used by many practitioners are not as clear or robust as they could be and, as a result, varied fraud claims have been permitted to proceed in the face of some of these less than fully effective provisions.⁷ But it is not the purpose of this article to re-plow old ground regarding the need for clear disclaimers of reliance.⁸ Rather, the purpose of this article is to address a more troubling issue—that is, the persistent insistence by buyers upon, and the agreement by many sellers to, a generalized fraud carve-out even where the disclaimer of reliance clause is clear that extra-contractual representations should not form the basis of any post-closing claim.

II. DEFINING THE PROBLEM

After listing a number of drafting tips for maximizing the effectiveness of disclaimer of reliance provisions, the 2009 *The Business Lawyer* article warned that draftspersons should avoid generalized fraud carve-outs because they could potentially undermine the effectiveness of the enumerated drafting tips.⁹ But the

20 BUS. TORTS J., Apr. 2013, at 2, available at <http://goo.gl/TURsBD>; see also Robert K. Wise, Andrew J. Szygenda & Thomas F. Lillard, *Of Lies and Disclaimers—Contracting Around Fraud Under Texas Law*, 41 ST. MARY'S L.J. 119 (2009) (containing a thorough examination of Texas law on this subject).

7. See, e.g., *TEK Stainless Piping Prods., Inc. v. Smith*, C.A. No. N13C-03-0175 MMJ CCLD, 2013 WL 5755468, at *3, *4 (Del. Ch. Oct. 14, 2013) (permitting a claim for fraud and finding that language stating “[e]xcept as explicitly set forth herein, no representations, warranties or promises of any kind have been made by Buyer or any third party to induce Seller or Owner to execute this [A]greement” was not an anti-reliance clause that would bar a fraud claim because it “lack[ed] the specific anti-reliance language required” and was “not a clear and unambiguous agreement that the parties are not relying upon any representation or statement of fact not contained within the” agreement); *Alltrista Plastics, LLC v. Rockline Indus., Inc.*, C.A. No. N12C-09-094 JTV, 2013 WL 5210255, at *6 (Del. Ch. Sept. 4, 2013) (permitting a claim for fraud when a supply agreement’s standard “integration clause contain[ed] no explicit anti-reliance language”); *Transdigm Inc. v. Alcoa Global Fasteners, Inc.*, C.A. No. 7135-VCP, 2013 WL 2326881, at *9 (Del. Ch. May 29, 2013) (permitting a fraud claim where the buyer only disclaimed reliance on extra-contractual representations that had been made, not reliance on extra-contractual omissions); *Anvil Holding Corp. v. Iron Acquisition Co.*, C.A. Nos. 7975-VCP, N12C-11-053-DFP [CCLD], 2013 WL 229655, at *9 (Del. Ch. May 17, 2013) (permitting a fraud claim when the agreement “do[es] not clearly state that the parties disclaim reliance upon extra-contractual statements”); *Italian Cowboy Partners, Ltd. v. Prudential Ins. Co. of Am.*, 341 S.W.3d 323, 336 (Tex. 2011) (finding that without a clear and unequivocal intent to disclaim reliance or waive claims for fraudulent inducement by having contract language that does not include the words “rely” or “reliance,” a standard merger clause does not preclude claims for fraudulent inducement); see also Practice Note, *Disclaimers of Reliance in M&A Deals: Judicial Guidance and Market Practice*, PRAC. L. CO. (Oct. 25, 2013), <http://us.practicallaw.com/3-548-4147> (discussing many of these cases).

8. See West & Lewis, *supra* note 4, at 1037–38 (providing a model non-reliance provision that specifically disclaims reliance by the buyer on any extra-contractual representations, disclaims any representations as to the “accuracy or completeness” of any information provided to the buyer by the seller, and disclaims any obligation of the seller to make any disclosures of fact not required to be disclosed pursuant to the specific representations and warranties set forth in the agreement).

9. *Id.* at 1033. This warning was repeated by other practitioners in 2010, in even more alarming language: “The fraud exception to the ‘sole remedy’ provision . . . can result in a host of unintended (and potentially catastrophic) consequences.” Christopher D. Kratovil & D. Joseph Meister, *Weighing the Fraud Exception in Indemnification Provisions*, HEADNOTES (Dallas Bar Ass’n, Dallas, Tex.), Feb. 2010, at 3, available at http://www2.dallasbar.org/documents/HN0210_FINAL.pdf.

article did not suggest that certain types of fraud cannot or should not be an appropriate exception to the otherwise carefully negotiated caps on liability that formed the basis for the contracting parties' written agreement; rather, the message was that the decision to permit any tort or equity based claims outside of the contractually negotiated indemnification should be done knowingly and carefully, within the parties' written agreement, and as a matter of contract. Accordingly, the article suggested that, in lieu of an undefined fraud carve-out, an appropriate area for negotiations was a specific carve-out for deliberate misrepresentations by certain agreed upon persons relating to the bargained-for representations and warranties specifically set forth in the written agreement.¹⁰

The suggestion that the term "fraud" be specifically defined, when used as an exception to an exclusive remedy provision, appears to have been largely ignored by many within the transactional bar.¹¹ Indeed, a recent practice note analyzing "recent case law and market practice on barring fraud claims by disclaiming extra-contractual representations and warranties and reliance in private acquisition agreements" notes a surprising number of publicly reported private company acquisition agreements that contain an undefined fraud carve-out as an exception to the exclusive remedy provision, suggesting that in certain cases the fraud carve-out was even made directly to the disclaimer of reliance provision itself.¹² And the ABA's 2013 *Private Target Mergers & Acquisitions Deal Points Study* similarly suggests that the undefined fraud carve-out persists as a common component of most private target acquisition agreements.¹³ In fact, there appears to be a basic assumption among many practitioners that it is simply inappropriate for a seller to refuse to agree to a generalized fraud carve-out.¹⁴

So, if a generalized fraud carve-out is apparently "market,"¹⁵ why are such carve-outs problematic and why write an article decrying their use? First, an undefined fraud carve-out to an exclusive remedy provision potentially "ren-

10. West & Lewis, *supra* note 4, at 1033.

11. "Ignored" is perhaps unfair. Deal dynamics can definitely require concessions on issues such as these that deal lawyers would prefer not to make. See *infra* note 112. And the conclusion as to how extensive is the use of generalized fraud carve-outs is based on surveys that exclude a significant number of private transactions that are not publicly available for review. See Lisa J. Hedrick, *Finding the Market in Private-Company M&A*, LAW360 (Mar. 3, 2014, 2:38 PM), <http://www.law360.com/mersacquisitions/articles/513619>.

12. Practice Note, *Disclaimers of Reliance in M&A Deals: Judicial Guidance and Market Practice*, PRAC. L. CO. (Oct. 25, 2013), <http://us.practicallaw.com/3-548-4147>.

13. SUBCOMM. ON MKT. TRENDS OF THE BUS. LAW SECTION MERGERS & ACQUISITIONS COMM., 2013 PRIVATE TARGET MERGERS & ACQUISITIONS DEAL POINTS STUDY 104 (2013) (on file with *The Business Lawyer*).

14. See, e.g., Howard T. Spilko, *Key Negotiating Points in Private Acquisition Agreements Comparison Chart*, PRAC. L. CO., <http://us.practicallaw.com/5-422-5017> (last updated July 7, 2014) ("[I]t is difficult for a seller to argue that fraud must be subject to any indemnification limitations."); Avery & Perricone, *supra* note 6, at 3 (noting that "fraud was consistently a very common carve-out" from an exclusive remedy provision based on the authors' review of several ABA studies).

15. Practice Note, *What's Market: Indemnification Provisions in Acquisition Agreements*, PRAC. L. CO. (June 30, 2014), <http://us.practicallaw.com/3-504-8533> ("Exclusive remedy provisions generally exclude claims based on fraud, criminal activity or willful misconduct and claims for equitable relief (such as specific performance)."). Of course, it must be again noted that the determination of market here is based solely upon publicly available sources, which necessarily exclude many private transactions. See *supra* note 11.

ders that provision meaningless” with respect to any allegations of fraud,¹⁶ thereby exposing a seller to lengthy and expensive litigation defending itself against uncapped claims, which may or may not be related to the bargained-for contractual representations and warranties, and which may or may not prove valid.¹⁷ Second, a 2013 Delaware decision noted the ambiguity created with respect to the efficacy of a disclaimer of reliance provision due to the existence of a generalized fraud carve-out—i.e., whether the carve-out related only to fraud claims premised upon the contractual warranties set forth in the written agreement or also to extra-contractual statements or omissions that were otherwise disclaimed.¹⁸ Third, recent cases suggest that the existence of a fraud carve-out renders the survival period and indemnification procedures applicable to the contractual warranties and representations irrelevant to any misrepresentation claim premised upon fraud, even with respect to those contractual warranties and representations.¹⁹ Fourth, undefined fraud is an “elusive and shadowy term,”²⁰ which may not be limited to deliberate lying despite that common conception.²¹ Fifth, an undefined fraud carve-out not only fails to define the term fraud, but also fails to define whose fraud is being carved-out. Sixth, the person alleging the fraud may in fact be the fraudster, who is seeking to extort an unbargained-for post-closing purchase price concession from the seller based upon the mere threat of an undefined fraud claim. And lastly, the courts are not always in the best position to sort out the valid from the invalid claims when it comes to allegations of fraud, particularly when those claims are based on extra-contractual statements.²²

16. *Merrill Lynch & Co. v. Allegheny Energy, Inc.*, No. 02 Civ. 7689 (HB), 2005 WL 832050, at *3 (S.D.N.Y. Apr. 12, 2005); see also *Eurofins Panlabs, Inc. v. Ricerca Biosciences, LLC*, C.A. No. 8431-VCN, 2014 WL 2457515, at *4 n.33 (Del. Ch. May 30, 2014) (“[T]he fraud exception appears to liberate the party asserting fraud from the entirety of the [agreement’s] indemnification provisions.”).

17. *ABRY Partners V, L.P. v. F & W Acquisition LLC*, 891 A.2d 1032, 1062 (Del. Ch. 2006); *West & Lewis*, *supra* note 4, at 1023, 1034–35.

18. *Anvil Holding Corp. v. Iron Acquisition Co.*, C.A. Nos. 7975-VCP, N12C-11-053-DFP [CCLD], 2013 WL 2249655, at *7 n.29 (Del. Ch. May 17, 2013).

19. *ENI Holdings, LLC v. KBR Group Holdings, LLC*, C.A. No. 8075-VCG, 2013 WL 6186326 (Del. Ch. Nov. 27, 2013) (inapplicability of the contractual survival periods to misrepresentation claims premised on fraud, even though the claims were based upon contractual representations rather than extra-contractual representations); *Wyle, Inc. v. ITT Corp.*, No. 653465/2011, 2013 WL 5754086 (N.Y. Sup. Ct. Oct. 21, 2013) (inapplicability of contractual notice requirements to misrepresentation claims premised on fraud, even though the claims were based upon contractual representations rather than extra-contractual representations).

20. *Kinard v. Sims*, 53 S.W.2d 803, 805 (Tex. Civ. App. 1932).

21. See James H. Wallenstein, *Negotiating Non-Recourse Carve-Outs in Light of Recent Court Decisions*, 35TH ANNUAL ADVANCED REAL ESTATE LAW COURSE (Dallas Bar Ass’n, Dallas, Tex.), Mar. 11, 2013, at 20 (on file with *The Business Lawyer*) (“The problem with the terms ‘fraud’ and ‘intentional misrepresentation’ is that they are not, as some may assume, limited to an evil act of gargantuan proportions . . .”).

22. *West & Lewis*, *supra* note 4, at 1017, 1023, 1034–35.

III. THE MANY MEANINGS OF THE TERM FRAUD

The common conception of the term fraud is that it necessarily involves dishonesty, trickery, and deceit on the part of the accused. Indeed, to think in terms of someone being “accused” of fraud—that fraud is essentially theft by deception—is not an uncommon view of the nature of fraud. Thus, the classic dictionary definition of the term fraud is an “intentional pervasion of truth in order to induce another to part with something of value or to surrender a legal right.”²³ But fraud, in fact, is a legal term derived from the common law and courts of equity that is not necessarily limited to the deliberate conveyance of deceptive falsehoods designed to swindle an unsuspecting counterparty. And a fraud carve-out that does not qualify the term “fraud” with the specific type of fraud to which one is intending to refer may well be a carve-out that captures more than the egregious conduct intended to be captured.²⁴

Fraud has many meanings in the law. Indeed, “fraud is a many splendored thing”²⁵ that defies specific definition by the courts,²⁶ and that varies from state to state. Fraud has been described by courts as being “infinite in variety”²⁷ and “taking on protean form at will.”²⁸ Perhaps the best description of the varied meanings of the term fraud is the statement made by one court that “[f]raud is kaleidoscopic.”²⁹ The images of fraud that emerge through the eyehole of this “judicial kaleidoscope” may not be as multifaceted as the patterns that can be seen through a real kaleidoscope, where the cylinder is turned and the colored

23. MERRIAM-WEBSTER'S COLLEGIATE DICTIONARY 498 (11th ed. 2008).

24. See, e.g., *V. John Ella, Common Law Fraud Claims: A Critical Tool for Litigators*, BENCH & B. MINN., Sept. 2006, at 18, 18 n.5, available at <http://www2.mnbar.org/benchandbar/2006/sept06/fraud.htm>. (“To add to the confusion, some courts use the term ‘fraud’ to denote a general category of misrepresentation claims.” (citing *Williams v. Tweed*, 520 N.W.2d 515, 517 (Minn. Ct. App. 1994) (“Three types of misrepresentations fall under [the] broad category of fraud: reckless misrepresentation, negligent misrepresentation, and deceit.”))).

25. A phrase repeatedly used by this author in a series of presentations made with Byron Egan and Patricia Vella.

26. See, e.g., *McClellan v. Cantrell*, 217 F.3d 890, 893 (7th Cir. 2000) (“Fraud is a generic term. . . . No definite and invariable rule can be laid down as a general proposition defining fraud”); Comment, *Deceit and Negligent Misrepresentation in Maryland*, 35 MD. L. REV. 651, 658 n.45 (1976) (“The common law not only gives no definition of fraud, but perhaps wisely asserts as a principle that there shall be no definition of it” (quoting *McAleer v. Horlsey*, 35 Md. 439, 452 (1872))); *Stonemets v. Head*, 154 S.W. 108, 114 (Mo. 1913) (“[D]efinitions of fraud are of set purpose left general and flexible, and thereto courts match their astuteness against the versatile inventions of fraud-doers.”); see generally L.A. SHERIDAN, *FRAUD IN EQUITY: A STUDY IN ENGLISH AND IRISH LAW* (Sir Isaac Pittman & Sons Ltd. 1957) (asserting that fraud has never been defined by the courts); Samuel W. Buell, *What Is Securities Fraud?*, 61 DUKE L.J. 511, 520–40 (2011) (discussing the varied mental states that can constitute fraud, and concluding that “[a] complete understanding of fraud would require a book-length treatment”).

27. *Reddaway v. Banham*, [1896] A.C. 199 (H.L.) 221 (Eng.).

28. *Stonemets*, 154 S.W. at 114, discussed in SHERIDAN, *supra* note 26, at 1.

29. *Id.*; see also Jeremy W. Dickens, Note, *Equitable Subordination and Analogous Theories of Lender Liability: Toward a New Model of “Control,”* 65 TEX. L. REV. 801, 815–16 (1987) (“A word of broad import, fraud implies a type of conduct capable of ‘kaleidoscopic variations’ and consequently not readily translated into definable categories.”).

glass falls into place,³⁰ but they are more varied than many practitioners appear to think. To illustrate that premise, this article will focus on just four possible meanings of the term fraud: common law fraud, equitable fraud, promissory fraud, and unfair dealings fraud. The conduct involved in each of these types of fraud may all be deemed fraudulent under the law, but such conduct may or may not involve the type of dishonest misrepresentation of fact sought to be captured by the use of the phrase “except in the case of fraud.”³¹

A. COMMON LAW FRAUD

Common law fraud in the United States is a tort that is derived from the original English action of deceit.³² In most states, a plaintiff’s successful claim of common law fraud requires proof of each of the following elements:

- (i) the defendant made a representation; (ii) the representation was false; (iii) the defendant acted with scienter (i.e., knew the representation was false or made it recklessly without sufficient knowledge as to whether it was true or false); (iv) the defendant intended that the plaintiff rely on the representation; (v) the plaintiff reasonably or justifiably relied upon the representation; and (vi) the plaintiff suffered injury as a result of the representation.³³

Thus, proof of common law fraud requires not only that a false representation was made by the seller, intending that it be relied upon by the buyer, with the buyer actually and justifiably relying upon that false representation to its detriment, but also that the seller acted with the requisite fraudulent state of mind in conveying that false representation.

While it may be a common belief that the “actual wickedness” that the term fraud connotes is the necessary fraudulent state of mind required to support a common law cause of action premised upon fraud, such has never truly been the case.³⁴ It is true that in the nineteenth century English case of *Derry v. Peek*,³⁵

30. Melanie F.F. Gibbs, *How Kaleidoscopes Work*, HOW STUFF WORKS (Jan. 19, 2012), <http://science.howstuffworks.com/kaleidoscope.htm>. The term “judicial kaleidoscope” is used in at least one reported decision. See *Crosswhite v. United States*, 369 F.2d 989, 992 (Ct. Cl. 1966) (“[A]ll of the circumstances must be blended together to form a judicial kaleidoscope upon which a decision may be patterned.”).

31. This section of necessity may be re-plowing a little old ground from the 2009 *The Business Lawyer* article, but where that is necessary this author is hopeful that the furrows are deeper and straighter. Moreover, this particular area of the law “is a complex object of study, and light dawns only gradually over the whole.” Gregory Klass, *Meaning, Purpose, and Cause in the Law of Deception*, 100 GEO. L.J. 449, 452 (2012).

32. See SHERIDAN, *supra* note 26, at 5; Ella, *supra* note 24, at 18 (“[F]raud has ancient roots as the independent tort of deceit”); Charles E. Fowler, Jr., *The Economic Loss Rule and Its Application to the Tort of Negligent Misrepresentation in Texas*, 18 TEX. WESLEYAN L. REV. 893, 918 (2012) (“The modern actions for fraud and negligent misrepresentation have a common ancestor in the old writ of deceit.”). There really never was a common law tort called “fraud.” See *Armitage v. Nurse*, [1997] EWCA 1279, [1998] Ch. 241, 250 (Eng.) (“The common law knows no generalised tort of fraud.”).

33. West & Lewis, *supra* note 4, at 1013.

34. See O. W. HOLMES, JR., *THE COMMON LAW* 130 (Boston, Little, Brown & Co. 1881).

35. (1889) 14 A.C. 337, 376.

which has been widely cited in the United States,³⁶ it was established by Lord Herschell that proof of “fraud” is a requirement of an action for deceit and that “fraud is proved when it is shewn that a false representation has been made (1) knowingly, or (2) without belief in its truth, or (3) recklessly, careless whether it be true or false.”³⁷ And this concept was reduced by Lord Herschell into a seemingly simple requirement that “[t]o prevent a false statement being fraudulent, there must, I think, be an honest belief in its truth.”³⁸ But the interpretation of this simple guidance that suggested that all fraud was based in moral dishonesty or wickedness plays out quite differently in the modern deal world.

Based on the principles set forth in Lord Herschell’s opinion in *Derry v. Peek*, the *Restatement (Second) of Torts* defines the required state of mind to support a fraudulent misrepresentation claim as follows:

A misrepresentation is fraudulent if the maker (a) knows or believes that the matter is not as he represents it to be, (b) does not have the confidence in the accuracy of his representation that he states or implies, or (c) knows that he does not have the basis for his representation that he states or implies.³⁹

And the *Restatement’s* comment to clause (b) above adds additional color to its definition of fraudulent misrepresentation as follows:

In order that a misrepresentation may be fraudulent it is not necessary that the maker know the matter is not as represented. Indeed, it is not necessary that he should even believe this to be so. It is enough that being conscious that he has neither knowledge nor belief in the existence of the matter he chooses to assert it as a fact. Indeed, since knowledge implies a firm conviction, a misrepresentation of a fact so made as to assert that the maker knows it, is fraudulent if he is conscious that he has merely a belief in its existence and recognizes that there is a chance, more or less great, that the fact may not be as it is represented. This is often expressed by saying that fraud is proved if it is shown that a false representation has been made without belief in its truth or recklessly, careless whether it is true or false.⁴⁰

This is certainly less than the concept of deliberate lying or concealment that is often associated with the term “fraud.”

American courts have always had a broader view of the scienter requirement of *Derry v. Peek* than have the courts of England, reducing the scienter require-

36. See, e.g., *Tex. Tunneling Co. v. City of Chattanooga, Tenn.*, 329 F.2d 402 (6th Cir. 1964); *Hindman v. First Nat’l Bank*, 112 F. 931 (6th Cir. 1902); *Watson v. Jones*, 25 So. 678 (Fla. 1899); *Donnelly v. Balt. Trust & Guar. Co.*, 61 A. 301 (Md. 1905); *Nash v. Minn. Title Ins. & Trust Co.*, 40 N.E. 1039 (Mass. 1895); *Ray Cnty. Sav. Bank v. Hutton*, 123 S.W. 47 (Mo. 1909); *Shackett v. Bickford*, 65 A. 252 (N.H. 1906); *Kountze v. Kennedy*, 41 N.E. 414 (N.Y. 1895); *Tarault v. Seip*, 74 S.E. 3 (N.C. 1912); *Tartera v. Palumbo*, 453 S.W.2d 780 (Tenn. 1970); *Shwab v. Walters*, 251 S.W. 42 (Tenn. 1923). However, some U.S. courts diluted *Derry’s* scienter requirement or simply deferred to prior existing American law with lesser scienter requirements. See *infra* note 41.

37. *Derry*, 14 A.C. at 374.

38. *Id.*

39. RESTATEMENT (SECOND) OF TORTS § 526 (1977).

40. *Id.* § 526 cmt. e.

ment in some cases to a standard that was “little more than negligence.”⁴¹ Indeed, as the law of fraud or deceit developed in the United States, it was made to fill gaps where the law of warranty was insufficient and the law of negligent misrepresentation had not yet been fully recognized as a cause of action.⁴² As a result, a claim of fraud was often the only available remedy when a buyer was induced by a seller’s false statement (regardless of the seller’s state of mind) to enter into a business transaction, and the line between statements being knowingly false and statements which were believed to be true, but not actually known to be true, appears to have become blurred.⁴³ Essentially, fraud could arise in some states whenever a party made a statement that proved false unless at the time he or she made it he or she objectively knew it to be true: “The fraud consists in stating that the party knows the thing to exist, when he does not know it to exist; and if he does not know it to exist, he must ordinarily be deemed to know that he does not.”⁴⁴ And “[a]n unqualified affirmation amounts to an affirmation of one’s own knowledge.”⁴⁵ Thus, according to one court, any time an unqualified statement of fact is made (which is deemed by law to have been made to one’s own knowledge), “[i]t is immaterial whether a statement made as of one’s own knowledge is made innocently or knowingly” for the purpose of establishing fraudulent intent.⁴⁶

The idea of a seller of a business having an honest belief in and being deemed to assert personal knowledge as to the absolute “truth” of every unqualified statement made as part of the representations and warranties of a modern acquisition agreement is a strange one indeed. Can a shareholder have an honest belief in the truth of an unqualified representation being made in a stock purchase agreement with respect to which the stockholder has no actual personal knowledge and which was based solely upon members of management’s knowledge? And is a qualification of a representation “to the knowledge of the seller” an indication that the seller actually has some direct knowledge upon which to base that representation? What about representations required to be made in the modern acquisition agreement with respect to which there is no basis to know whether they are true or false, but which are nonetheless made on an un-

41. JAY M. FEINMAN, PROFESSIONAL LIABILITY TO THIRD PARTIES 63 (2000) (“*Derry v. Peek* was not accepted as wholeheartedly in the United States as it was in the Commonwealth, however; some American courts rejected it outright, while others significantly watered down the requirement of intent to allow actions in which there was little more than negligence.”); see also Robert W. Miller, *Scienter in Deceit and Estoppel*, 6 IND. L.J. 152, 158 (1930); Everett B. Morris, *Liability for Innocent Misrepresentation*, 64 U.S. L. REV. 121, 126 (1930); see generally Fowler V. Harper & Mary Coate McNeely, *A Synthesis of the Law of Misrepresentation*, 22 MINN. L. REV. 939 (1938).

42. See West & Lewis, *supra* note 4, at 1007, 1011–12; see also Francis H. Bohlen, *Misrepresentation as Deceit, Negligence, or Warranty*, 42 HARV. L. REV. 733, 734–35 (1929); Miller, *supra* note 41, at 156–58; Glenn D. West & Kim M. Shah, *Debunking the Myth of the Sandbagging Buyer: When Sellers Ask Buyers to Agree to Anti-Sandbagging Clauses, Who Is Sandbagging Whom?*, M&A LAW. (Thompson/West, New York, N.Y.), Jan. 2007, at 3.

43. See Bohlen, *supra* note 42, at 733–34.

44. *Id.* at 744 (quoting *Chatham Furnace Co. v. Moffatt*, 18 N.E. 168, 169 (Mass. 1888)).

45. *Swanson v. Domning*, 86 N.W.2d 716, 720 (Minn. 1957).

46. *Id.*

qualified basis as a matter of risk allocation? Can some form of negligence on the part of the seller, whether simple or gross, be a sufficient basis to sustain a claim of fraud?

This author does not believe that any seller intends to suggest that he or she has actual, personal knowledge sufficient to assert as true many of the representations and warranties contained in a modern acquisition agreement, never mind many of the statements made in management presentations. But does the existence of an undefined fraud carve-out create an opportunity for a buyer to suggest that the seller did in fact assert such personal knowledge? And given the fact that the representations and warranties in modern acquisition agreements are for the most part contractual risk allocation devices that are not dependent upon what the seller knew or did not know, should the modern U.S. acquisition agreement continue to contain “representations” (as opposed to only warranties) at all?⁴⁷

An early statement of the less than wicked state of mind required to impose liability for common law fraud in the United States is that made by Oliver Wendell Holmes, Jr. in his classic work, *The Common Law*:

The common-law liability for the truth of statements is, therefore, more extensive than the sphere of actual moral fraud. But, again, it is enough in general if a representation is made recklessly, without knowing whether it is true or false. Now what does “recklessly” mean. It does not mean actual personal indifference to the truth of the statement. It means only that the data for the statement were so far insufficient that a prudent man could not have made it without leading to the inference that he was indifferent. That is to say, repeating an analysis which has been gone through with before, it means that the law, applying a general objective standard, determines that, if a man makes his statement on those data, he is liable, whatever was the state

47. This author does not necessarily intend to reopen the debate about whether there is a difference between representations and warranties in the United States, having previously expressed a preference for replacing the entire concept of representations and warranties with the concept of “indemnifiable matters.” See West & Lewis, *supra* note 4, at 1037 n.233. But a recent English case suggests that this debate could be reopened. See *Sycamore Bidco Ltd. v. Breslin*, [2012] EWHC (Ch) 3443, [203], [210]–[211] (Eng.) (holding that contractual warranties clearly designated as such and made part of the negotiated contract were “warranties” only, and not “representations,” and were therefore subject only to the limited contractual remedies set forth in the written agreement, not rescission); see also Neil Mirchandani & Rebecca Huntsman, *Can an Express Warranty Also Be a Representation?*, HOGAN LOVELLS (Jan. 2013), <http://goo.gl/LTfbBj> (noting that the court found that “[i]t would be ‘a strange and uncommercial state of affairs’ for a party to negotiate detailed limitations on liability in relation to Warranties, but for such limitations not to apply to the same statements, were they to be construed as representations”); Claude Serfilippi, *A New York Lawyer in London: Representations and Warranties in Acquisition Agreements—What’s the Big Deal?*, CORP. PRAC. NEWSWIRE (Chadbourne & Parke LLP, New York, N.Y.), Dec. 2012, at 1, 2, available at <http://goo.gl/dOHZsK> (“What most U.S. lawyers might not appreciate, however, is that the distinction in remedies that forms the basis for the solicitor’s objection to include both representations and warranties in an acquisition agreement, is also present under the laws of most U.S. states. Yet, U.S. lawyers routinely include both representations and warranties in an acquisition agreement.”). A nod to Tina Stark and apologies to Ken Adams, who was “gnawing [his] hind leg” the last time this author noted an English case making this distinction. See Ken Adams, *Glenn West Reopens the “Represents and Warrants” Can of Worms*, ADAMS ON CONTRACT DRAFTING (Dec. 30, 2009), <http://www.adamsdrafting.com/glenn-west-reopens-can-of-worms/>. See generally West & Lewis, *supra* note 4, at 1008 n.48 (noting the dispute as to the difference, *vel non*, between representations and warranties in the United States).

of his mind, and although he individually may have been perfectly free from wickedness in making it.⁴⁸

Indeed, if the elements of common law fraud are otherwise present, “it need not be shown that the defendant also had a ‘bad’ motive in doing what he or she did,” because proof of a conscious intent to deceive is not necessarily a separate element of the cause of action for fraud in some states.⁴⁹ Thus, a judge and a jury, looking at the available evidence after the fact, when the representation has in fact been proven false, decide what was the state of the seller’s mind when the representation was made (whether the seller had knowledge of the falsity of the statement itself, or simply had knowledge of the limited information upon which the seller had based its statement) in determining liability for generalized common law fraud. And common law fraud claims are “highly susceptible to the erroneous conclusions of judges and juries.”⁵⁰

In light of the foregoing, one may well ask whether all claims that could be denominated “common law fraud” are truly intended to be carved out by a generalized fraud carve-out or only a specific subset?

B. EQUITABLE FRAUD

It is troubling enough that statements made in the negotiation of, or actually incorporated into the written representations and warranties set forth in, an acquisition agreement can be deemed fraudulent based upon an after-the-fact inquiry into the real-time state of mind of the party who made those statements, particularly when that state of mind can be something less than the deliberate dishonesty that many suppose is required to support a claim of fraud. Even more troubling, however, is the fact that in the field of equity jurisprudence there is a type of fraud that does not require proof of scienter of any kind—i.e., equitable fraud. Indeed, “[t]he elements of scienter, that is, knowledge of the falsity and an intention to obtain an undue advantage therefrom, are not essential if plaintiff seeks to prove that a misrepresentation constituted only equitable fraud.”⁵¹

48. HOLMES, *supra* note 34, at 134–35.

49. Nielsen v. Adams, 388 N.W.2d 840, 846 (Neb. 1986); see also Page Keeton, *Fraud: The Necessity for an Intent to Deceive*, 5 UCLA L. REV. 583, 584 (1958). In apparent recognition of this fact, some practitioners add language to the fraud carve-out to make a “specific intent to deceive” a required element of the fraud being carved out. See, e.g., Stock Purchase Agreement, dated March 2, 2014, by and between CNO Financial Group, Inc. and Wilton Reassurance Company, PRAC. L. CO. § 7.7, at 61 (Mar. 2, 2014), <http://us.practicallaw.com/9-559-8848> (“[N]othing contained in this Article VII (Indemnification) or in Article VIII (Taxes) shall alter or limit the rights and remedies of the parties to pursue a common law claim for fraud with specific intent to deceive.”).

50. West & Lewis, *supra* note 4, at 1034; see also ABRY Partners V, L.P. v. F & W Acquisition LLC, 891 A.2d 1032, 1062 (Del. Ch. 2006) (“Permitting a party to sue for relief that it has contractually promised not to pursue creates the possibility that [sellers] will face erroneous liability (when judges or juries make mistakes) . . .”).

51. Jewish Ctr. of Sussex Cnty. v. Whale, 432 A.2d 521, 524 (N.J. 1981) (citations omitted). And, because the remedy for equitable fraud is rescission not damages, the misrepresentation upon which a claim of equitable fraud is based need not even be “material.” See Emily Sherwin, *Nonmaterial Mis-*

Equitable fraud is based on the simple principle that it is “fraudulent (in the equitable sense) for a defendant to hold a plaintiff to a bargain which has been induced by representations of the defendant which were untrue” regardless of any actual dishonesty on the part of the defendant.⁵² Thus, with only a slight twist of our judicial kaleidoscope, there appears a form of fraud that is devoid of any concept of moral fault. Unlike common law fraud, however, “[i]n an action for equitable fraud, the only relief that may be obtained is equitable relief, such as rescission or reformation of an agreement and not monetary damages.”⁵³

Several recent Delaware cases confirm that the concept of equitable fraud is alive and well in modern jurisprudence.⁵⁴ According to Delaware law, equitable fraud is available only in circumstances where equity jurisdiction is appropriate—i.e., claims involving abuse of fiduciary relationships or where an equitable remedy such as rescission or reformation is being sought.⁵⁵ While the typical buyer/seller relationship in a sophisticated acquisition agreement rarely involves fiduciaries, claims of rescission are frequently made by disappointed buyers when the bargained-for indemnification is considered an insufficient remedy for a post-closing representation and warranty claim. Indeed, it was a claim of rescission that was made by the buyer in *ABRY Partners V, L.P. v. F & W Acquisition LLC*.⁵⁶

As most transactional lawyers are aware, *ABRY* stands for the proposition that Delaware public policy will not permit a court to enforce an exclusive remedy provision to dismiss fraud claims that are based upon the seller’s deliberate lies respecting the contractual representations and warranties set forth in a written acquisition agreement.⁵⁷ But *ABRY* also stands for the proposition that Delaware public policy will permit, and courts will enforce, disclaimer of reliance and exclusive remedy provisions with respect to deliberate lies made outside the specific contractual representations and warranties made within the four corners of an acquisition agreement. Likewise, Delaware will permit an exclusive remedy provision to limit the remedies available for false statements of fact set forth in the specific contractual representations and warranties to the extent that those contractual misrepresentations did not constitute deliberate lies made by the seller itself or by others acting on behalf of the seller and with the seller’s knowledge of the falsity of such representations.⁵⁸ Thus, but for the disclaimer of reli-

representation: *Damages, Rescission, and the Possibility of Efficient Fraud*, 36 *LOU. L.A. L. REV.* 1017, 1018–19 (2003).

52. Edmund Finnane, *Rescission* (Wentworth Selborne Chambers, Sydney, N.S.W., Austl.), Mar. 13, 2008, at 6–7, available at <http://www.13wentworthselbornechambers.com.au/cle/rescission.pdf>; West & Lewis, *supra* note 4, at 1011.

53. *Enright v. Lubow*, 493 A.2d 1288, 1296 (N.J. Super. Ct. App. Div. 1985).

54. See, e.g., *Eurofins Panlabs, Inc. v. Ricerca Biosciences, LLC*, C.A. No. 8431-VCN, 2014 WL 2457515 (Del. Ch. May 30, 2014); *Osrsm Sylvania, Inc. v. Townsend Ventures, LLC*, C.A. No. 8123-VCP, 2013 WL 6199554 (Del. Ch. Nov. 19, 2013); *Grzybowski v. Tracy*, No. 3888-VCG, 2013 WL 4053515 (Del. Ch. Aug. 9, 2013); *In re Wayport, Inc. Litig.*, 76 A.3d 296 (Del. Ch. 2013).

55. *Eurofins*, 2014 WL 2457515, at *18; *Osrsm Sylvania*, 2013 WL 6199554, at *15; *Grzybowski*, 2013 WL 4053515, at *6.

56. 891 A.2d 1032 (Del. Ch. 2006); see West & Lewis, *supra* note 4, at 999–1002 (discussing the *ABRY* decision).

57. *ABRY*, 891 A.2d at 1064; West & Lewis, *supra* note 4, at 1002.

58. *ABRY*, 891 A.2d at 1063–64; West & Lewis, *supra* note 4, at 1000–01.

ance and the exclusive remedy provision that limited the buyer's remedies to the capped indemnification provision, the public policy issue regarding a seller's inability to exclude claims of fraud based upon a seller's deliberate lies respecting the representations and warranties set forth in the written acquisition agreement may have never been reached in the *ABRY* case, as an innocent or negligent misrepresentation either inside or outside the four corners of the written acquisition agreement may have been the basis for equitable relief.⁵⁹

Accordingly, a generalized fraud carve-out could be deemed to include (and thus permit claims based on) equitable, as well as common law, fraud. Is that what the parties intended? And is it clear that claims premised upon misrepresentations of existing fact, whether at common law or in equity, are the extent of a generalized fraud carve-out?

C. PROMISSORY FRAUD

With another twist of our judicial kaleidoscope, the concept of "promissory fraud" appears. Although it has often been said that representations about future performance cannot form the basis of a fraud claim because a fraud claim must be premised upon a misrepresentation concerning an existing fact, many states permit fraud claims based upon allegations that a party to a contract made a promise of future performance that such party never intended to perform.⁶⁰

Promissory fraud is an exception to the longstanding rule of the common law that "[t]he duty to keep a contract at common law means a prediction that you must pay damages if you do not keep it[]—and nothing else."⁶¹ Thus, "the celebrated freedom to make contracts" supposedly includes "a considerable freedom

59. West & Lewis, *supra* note 4, at 1016 n.103 (noting that both "innocent or negligent misrepresentations" suffice under Delaware law to constitute "equitable fraud").

60. Curtis Bridgeman & Karen Sandrick, *Bullshit Promises*, 76 TENN. L. REV. 379, 383 (2009) ("Promissory fraud is currently recognized in some form or other in all fifty states and the District of Columbia."). However, New York's "recognition" of promissory fraud as a cause of action independent of the breach of contract itself is less than clear. See Matthew D. Ingber & Christopher J. Houpt, *Navigating the Shadowy Borderland Between Contract and Tort*, N.Y. L.J., Sept. 13, 2010, at 1, 3, available at <http://goo.gl/s9bZe2> (noting that promissory fraud claims are governed by "a very long and very puzzling line of New York cases. On at least four occasions, New York's Court of Appeals has expressly held that 'a contractual promise made with the undisclosed intention not to perform it constitutes fraud.' At the same time, however, there are numerous Appellate Division cases that state precisely the opposite rule. Notably, federal courts in New York usually follow the Appellate Division rule, not that of the Court of Appeals, and do not recognize promissory fraud."); see also *infra* note 144. The differing approaches to these issues by the Appellate Division and the Court of Appeals "has been explained by the fact that there are fact-specific exceptions to the general principle [that promissory fraud is not a recognized cause of action in New York] and that the New York Court of Appeals has recognized four factual circumstances where the exception applies." *Tobin v. Gluck*, Nos. 07-CV-1605 (MKB), 11-CV-3985 (MKB), 2014 WL 1310347, at *9 (E.D.N.Y. Mar. 28, 2014).

61. Oliver Wendell Holmes, Jr., *The Path of the Law*, 10 HARV. L. REV. 457, 462 (1897), quoted in *E.I. DuPont de Nemours & Co. v. Pressman*, 679 A.2d 436, 445 n.18 (Del. 1996). It has been noted, however, that Oliver Wendell Holmes, Jr., acting in his capacity as a judge, rather than an academic, did in fact support the concept of promissory fraud. See IAN AVRES & GREGORY KLASS, *INSINCERE PROMISES: THE LAW OF MISREPRESENTED INTENT* 5 (Yale Univ. Press 2005).

to breach them as well.⁶² But promissory fraud is considered a form of fraudulent inducement,⁶³ where the existence of a contract is a required element of the cause of action,⁶⁴ but the existence of the contract does not prevent the introduction of extraneous promises made outside the four corners of the written agreement to the extent those promises induced the execution of the written agreement.⁶⁵ Moreover, once those extraneous promises are denominated as fraudulent, the existence of the contract also does not limit the available remedies for nonperformance of those promises to those arising under contract law as opposed to tort law.⁶⁶ And while breach of a promised future performance is not proof of promissory fraud, in some states, a subsequent failure to perform, when coupled with even slight circumstances indicating an intention not to perform at the time the promise was made, is sufficient to prove fraud.⁶⁷

A circumstance that has been deemed in certain cases to be evidence of promissory fraud is the defendant's denial that he or she made the promise of future performance.⁶⁸ Thus, if there is an ambiguity in an agreement, with the defendant claiming that it does not require performance under specified circumstances and the plaintiff claiming that it does, a subsequent finding in favor of the plaintiff as to the contract's meaning can also result in a finding of promissory fraud against the defendant because the defendant has already admitted that he or she never intended to perform in accordance with the plaintiff's claimed interpretation of the contract.⁶⁹

And imagine a circumstance in which a seller states at some point in the negotiation of the sale of his company that he intends to retire to his ranch following the sale of the business. The buyer then requests a non-compete and the seller refuses to agree to anything in writing regarding his future business activities, but reasserts that he is going to the ranch. The buyer closes, without a written non-compete agreement, and several years later the seller starts a competing business. Can the buyer successfully sue the seller for fraud notwithstanding its decision to proceed without a written non-compete? A nineteenth century English case (and remember that the United States inherited its com-

62. E. Allan Farnsworth, *Legal Remedies for Breach of Contract*, 70 COLUM. L. REV. 1145, 1147 (1970), quoted in *E.I. DuPont de Nemours*, 679 A.2d at 445 n.18.

63. See Ian Ayres & Gregory Klass, *New Rules for Promissory Fraud*, 48 ARIZ. L. REV. 957, 962 (2006).

64. See, e.g., *Haase v. Glazner*, 62 S.W.3d 795, 798 (Tex. 2001) ("Fraudulent inducement, however, is a particular species of fraud that arises only in the context of a contract and requires the existence of a contract as part of its proof.")

65. See generally Justin Sweet, *Promissory Fraud and the Parol Evidence Rule*, 49 CALIF. L. REV. 877 (1961) (examining the applicability of the parol evidence rule to a claim of promissory fraud); Eric A. Posner, Essay, *The Parol Evidence Rule, the Plain Meaning Rule, and the Principles of Contractual Interpretation*, 146 U. PA. L. REV. 533 (1998) (examining the rules of contractual interpretation, particularly the parol evidence rule).

66. See Sweet, *supra* note 65, at 900.

67. West & Lewis, *supra* note 4, at 1014.

68. AYRES & KLASS, *supra* note 61, at 55.

69. See, e.g., *H. Enters. Int'l v. Gen. Elec. Capital Corp.*, 833 F. Supp. 1405, 1422 (D. Minn. 1993) (allowing a plaintiff-borrower's claim for promissory fraud to be submitted to the jury where evidence existed that the defendant-lender did not intend to perform based on its interpretation of an ambiguous loan provision), discussed in AYRES & KLASS, *supra* note 61, at 55.

mon law from England) suggests that the answer to this question may well be yes.⁷⁰

When carving out “claims of fraud” from exclusive remedy provisions, are the sophisticated parties involved in most corporate acquisitions intending to open up the possibility of introducing extraneous promises regarding future performance made in the period leading up to the execution of the written agreement, or disagreements as to the meaning of ambiguous provisions in the acquisition agreement, as potentially having been “insincere promises”⁷¹ that thereby constitute fraud? Are parties to a written agreement desirous of placing themselves in a position where a breach of contract claim can be converted into a tort claim through the use of the concept of promissory fraud? While these concepts have their place in protecting the consumer,⁷² do they really belong in the world of corporate acquisition agreements?

D. UNFAIR DEALINGS FRAUD

Even if the seller is somehow comfortable carving out common law fraud, equitable fraud, or promissory fraud from an exclusive remedy provision, a generalized fraud carve-out may not be limited to misrepresentations of fact or intention that have proved to have been false when made. Indeed, fraud can be “presumed or inferred from the circumstances or conditions of the parties’ contracting.”⁷³

Conduct-based fraud can arise anytime one party is deemed to have taken an unfair advantage of the other party in such a manner that the court determines that the resulting bargain is “such as no man in his senses and not under delusion would make on the one hand, and as no honest and fair man would accept on the other: which are unequitable and unconscientious bargains.”⁷⁴ So, with yet another slight twist of our judicial kaleidoscope, there appears the concept of “unfair dealings fraud,” a concept that eliminates the requirement that there has even been any false representation.

An example of a case finding “actual fraud,” without a misrepresentation having been made at all, is the Texas case of *Dick’s Last Resort v. Market/Ross, Ltd.*⁷⁵ *Dick’s* involved the efforts of a landlord to pierce the veil of a corporate tenant to recover damages for breach of a lease agreement from the tenant’s parent companies and an ultimate individual owner.⁷⁶ In Texas, by statute, a veil piercing claim arising from a contractual relationship requires proof of the use of a corporate counterparty for the purpose of perpetrating an “actual fraud” for the “di-

70. *Harrison v. Gardner*, (1817) 56 Eng. Rep. 308, 2 Madd. 198 (Eng.), discussed in SHERIDAN, *supra* note 26, at 45.

71. A term borrowed from the title of the book by Ayres and Klass.

72. See, e.g., AYRES & KLASS *supra* note 61, at 53–54; Bridgeman & Sandrick, *supra* note 60, at 387–94; see also Oren Bar-Gill & Kevin Davis, *Empty Promises*, 84 S. CAL. L. REV. 1 (2010).

73. *Earl of Chesterfield v. Janssen*, (1751) 28 Eng. Rep. 82, 101, (1750) 2 Ves. Sen. 125, 157 (Eng.).

74. *Id.* at 100.

75. 273 S.W.3d 905 (Tex. App. 2008); see also Glenn D. West & Stacie L. Cargill, *Corporations*, 62 SMU L. REV. 1057, 1066–73 (2009) (criticizing the *Dick’s* case).

76. *Dick’s*, 273 S.W.3d at 908.

rect personal benefit” of the person sought to be charged with the corporate counterparty’s contractual obligations.⁷⁷

In essence, the landlord’s claim was that the tenant had deliberately set up a new entity that had no assets in order to enter into a lease renewal specifically for the purpose of shielding the parent companies from liability so that the parent companies would preserve flexibility to breach the lease in the future.⁷⁸ The tenant’s ultimate individual owner admitted that he indeed had done exactly that.⁷⁹ But the evidence was that there had never been any representation made to the landlord as to the financial wherewithal of the new corporate tenant, the new corporate tenant had fully performed for six of the ten years of the renewal term, the landlord never even inquired or did any diligence as to the financial soundness of the new tenant, and the existing tenant had expressly made its willingness to enter into the extended lease term conditioned upon the landlord’s acceptance of the new corporate tenant as the sole entity liable on the lease.⁸⁰ Thus, the parent companies and their ultimate individual owner defended against the piercing claim by saying that “actual fraud” was simply a shorthand expression for common law fraud—i.e., the type of fraud that requires a misrepresentation and reliance, neither of which had been alleged by the landlord.⁸¹

But the *Dick’s* court held that “actual fraud” was not the same as common law fraud (with the elements of a false representation and reliance), but instead could be premised simply upon a finding of “conduct involving either dishonesty of purpose or intent to deceive”⁸²—in this case, the use of a shell company as the new tenant in a lease renewal with a sophisticated lessor. With this finding of actual fraud by the jury, the new corporate tenant’s obligations under the lease were imposed upon the parent companies and their ultimate individual owner.⁸³

While the doctrine of unfair dealings-based fraud may be appropriate to protect consumers from unscrupulous vendors who misrepresent the terms of so-called standard form contracts,⁸⁴ do they really belong in a transaction between sophisticated parties who have bargained for the written agreement, negotiated at length, to be the extent of their respective obligations?⁸⁵ And are sophisticated parties truly intending to carve out this type of fraud through a generalized fraud carve-out?

77. TEX. BUS. ORGS. CODE ANN. § 21.223(b) (West, Westlaw through Third Called Sess. of the 83d Legis.).

78. *Dick’s*, 273 S.W.3d at 911; West & Cargill, *supra* note 75, at 1066, 1069.

79. *Dick’s*, 273 S.W.3d at 911.

80. *Id.* at 911–12; West & Cargill, *supra* note 75, at 1067, 1069. There was also a claim that the tenant had breached a subleasing prohibition that obligated the tenant to pay a fee for any subleasing. *See id.* at 1069 n.72.

81. *Dick’s*, 273 S.W.3d at 909–10.

82. *Id.* at 909.

83. *Id.* at 912–13; West & Cargill, *supra* note 75, at 1070.

84. *See generally* Russell Korobkin, *The Borat Problem in Negotiation: Fraud, Assent, and the Behavioral Law and Economics of Standard Form Contracts*, 101 CALIF. L. REV. 51 (2013); West & Lewis, *supra* note 4, at 1034.

85. *See* West & Lewis, *supra* note 4, at 1034.

IV. SO WHAT DOES AN UNDEFINED FRAUD CARVE-OUT POTENTIALLY CARVE OUT?

Notwithstanding the many images of fraud that can be viewed through our judicial kaleidoscope, anecdotal evidence suggests that when transactional lawyers agree to a generalized fraud carve-out to an exclusive remedy provision, they are intending to preserve only their right to bring claims for “common law fraud.”⁸⁶ But is language that simply carves out “claims of fraud” limited to claims based upon common law fraud, or can “claims of fraud” encompass some of the other concepts of fraud that do not necessarily require a false representation, scienter, and reliance? A 2009 English case provides one potential answer to that question.

In *Cavell USA, Inc. v. Seaton Insurance Co.*,⁸⁷ the English Court of Appeal held that a fraud carve-out in a settlement agreement that released all legal and equitable claims against a party, “save” for claims “in the case of fraud,” was not limited to claims arising from the common law tort of deceit.⁸⁸ Instead, recognizing that “the concept of fraud is notoriously difficult to define,” and impossible to confine in equity, the court found that “the concept of ‘fraud’ is wider than the concept of the tort of deceit where a fraudulent misrepresentation (or equivalent) is required.”⁸⁹ While not precedent in the United States, the opinion was thoughtfully written and traced the historical reluctance of the common law and equity to define fraud or limit its application to the strict legal proof of the tort of deceit based on a fraudulent representation. As a result, this case suggests that a generalized fraud carve-out can have a meaning beyond the common law tort of fraud.

But even if the fraud carve-out is limited to claims of common law fraud only, is that carve-out intended to allow claims to proceed based upon any extra-contractual misrepresentations or only misrepresentations based upon the actual contractual representations and warranties bargained-for in the written acquisition agreement? Recent Delaware cases, like the holding in the English case of *Cavell USA*, suggest that a generalized fraud carve-out carries with it a potentially broad meaning that could undermine the disclaimer of reliance provision that was otherwise negotiated with respect to all purported extra-contractual representations.

In *Airborne Health, Inc. v. Squid Soap, LP*,⁹⁰ the Delaware Court of Chancery noted that “[w]hen drafters specifically preserve the right to assert fraud claims, they must say so if they intend to limit that right to claims based on written representations in the contract.”⁹¹ Similarly, in *Anvil Holdings Corp. v. Iron Acquisition Co.*,⁹² the Delaware Court of Chancery noted in dicta that the existence of a

86. See, e.g., Kratovil & Meister, *supra* note 9, at 3.

87. [2009] EWCA (Civ) 1363 (Eng.).

88. *Id.* at [29].

89. *Id.* at [15], [29]; see Jessica Schuehle-Lewis, Crispin Daly & Mark Griffiths, *Cavell USA Inc. and Another v. Seaton Insurance Company and Another: Interpretation of the Term “Fraud” Within an Agreement by the Court of Appeal*, 7 INT’L CORP. RESCUE 419 (2010), available at <http://www.chase cambria.com/site/journal/icr.php?vol=8&issue=6>.

90. 984 A.2d 126 (Del. Ch. 2009).

91. *Id.* at 141.

92. C.A. Nos. 7975-VCP, N12C-11-053-DFP [CCLD], 2013 WL 2249655 (Del. Ch. May 17, 2013).

generalized fraud carve-out casts doubt upon the efficacy of an otherwise clear waiver of reliance clause.⁹³ The waiver of reliance provision in *Anvil* was actually broadly written.⁹⁴ But, based in part upon the existence of a generalized fraud carve-out, the court nevertheless noted that “it appears reasonably conceivable that the Purchase Agreement does not preclude the Buyer’s fraud claim to the extent that claim is based on misrepresentations or omissions by the Individual Defendants during meetings leading up to the closing of the Transaction.”⁹⁵

Moreover, there are collateral effects to the generic exclusion of fraud, even if “fraud” means only common law fraud related to the express written representations and warranties as set forth in the acquisition agreement. In *ENI Holdings, LLC v. KBR Group Holdings, LLC*,⁹⁶ the Delaware Court of Chancery held that an express fraud carve-out from the exclusive remedy provision of an acquisition agreement precluded the dismissal of a fraud-based claim arising from the agreement’s express contractual representations and warranties, even though that claim had been brought outside the contractual survival period.⁹⁷ So a fraud carve-out may allow a buyer to make fraud claims based on the contractual representations and warranties after the expiration of the contractual survival periods set forth in the indemnification provisions of the acquisition agreement. Is that what the parties truly intended?

It would appear, therefore, that carving out undefined “fraud” from an exclusive remedy provision may be excluding more than just the conscious communication of deliberate lies by the seller to the buyer respecting the bargained-for factual predicates to the deal.⁹⁸ Instead, a generalized fraud carve-out could permit assertion of common law fraud (with its potentially less than actually dishonest state of mind requirement), equitable fraud (which could involve any misstatements of fact regardless of fault), promissory fraud (which may allow a breach of contract claim to be converted into a fraud claim and, in some circumstances, to potentially allow the introduction of alleged extra-contractual promises of future performance that were not made part of the final negotiated agreement), and unfair dealings-based fraud (which potentially opens up second guessing about the

93. *Id.* at *7 n.29.

94. *Id.* Notwithstanding the broad language in the provision, the court declined to consider whether it precluded the buyer’s fraud claim because the defendant-seller failed to plead the applicability of the disclaimer of reliance clause during briefing on the motion to dismiss. *Id.* at *7. Hence the court deemed the argument waived for the pending motion to dismiss and simply noted the argument in a footnote. *Id.* at *7 n.29.

95. *Id.* at *7 n.29. This author believes that a generalized fraud carve-out from an exclusive remedy provision should not, in fact, lessen the value and effect of a properly drafted disclaimer of reliance provision. If the parties have permitted fraud claims notwithstanding the exclusive remedy provision, the disclaimer of reliance should still have its intended effect of negating the element of reliance with respect to those representations as to which reliance was disclaimed. But the *Anvil* dictum raises some concern.

96. C.A. No. 8075-VCG, 2013 WL 6186326 (Del. Ch. Nov. 27, 2013).

97. *Id.* at *17; see also *Wyle, Inc. v. ITT Corp.*, No. 653465/2011, 2013 WL 5754086, at *5, *6 (N.Y. Sup. Ct. Oct. 21, 2013) (permitting a buyer to assert fraud claims based on the express contractual representations and warranties even though those same claims were not sustainable under the contract because the time period for asserting such claims had expired).

98. *ABRY Partners V, L.P. v. F & W Acquisition LLC*, 891 A.2d 1032, 1064 (Del. Ch. 2006).

overall fairness of the deal that was made). Are all these various forms of fraud what the parties intended to carve out through a clause that simply states: “except in the case of fraud”? And, even if the fraud carve-out is in fact limited to common law fraud, are the parties truly intending to extend the survival period for claims based on the contractually bargained-for representations and warranties if the buyer simply re-pleads its claim as one arising in tort rather than contract?

V. WHOSE FRAUD IS BEING CARVED OUT ANYWAY?

In *ABRY Partners V, L.P. v. F & W Acquisition LLC*,⁹⁹ then Vice Chancellor Strine¹⁰⁰ distinguished not only between the various types of misrepresentations that can give rise to a claim of fraud, but also between a fraud involving the “Seller itself” and one involving members of the management team of the portfolio company that was the subject of the stock purchase agreement.¹⁰¹ According to then Vice Chancellor Strine, only a fraud involving the “conscious participation in the communication of lies” by the “Seller itself” and with respect to the representations and warranties specifically set forth in the stock purchase agreement constituted the type of fraud which, as a matter of public policy, could not be excluded by virtue of an exclusive remedy provision.¹⁰² A fraud perpetrated by the seller itself includes, of course, contractual representations made by the company in the acquisition agreement that are known by the seller to have been false when made.¹⁰³ But then Vice Chancellor Strine thought there was nothing immoral about allocating the risk of lies being told by the management of the target company, without the seller’s knowledge, in such a way that the seller was not exposed to an extra-contractual fraud claim based upon its management team’s misrepresentations.¹⁰⁴

In the absence of such a contractual allocation of risk, the common law has long held that a principal is liable for the fraud of his or her agent committed

99. *Id.*

100. Leo E. Strine, Jr. is now the Chief Justice of the Delaware Supreme Court.

101. *ABRY*, 891 A.2d at 1063–64; West & Lewis, *supra* note 4, at 1002.

102. *ABRY*, 891 A.2d at 1064; West & Lewis, *supra* note 4, at 1001–02.

103. *ABRY*, 891 A.2d at 1063; West & Lewis, *supra* note 4, at 1001–02; *see also* DDJ Mgmt., LLC v. Rhone Grp. L.L.C., 931 N.E.2d 87 (N.Y. 2010); Glenn D. West & Natalie A. Smeltzer, *Protecting the Integrity of the Entity-Specific Contract: The “No Recourse Against Others” Clause—Missing or Ineffective Boilerplate?*, 67 BUS. LAW. 39, 53–54 (2011) (discussing DDJ).

104. *ABRY*, 891 A.2d at 1063; West & Lewis, *supra* note 4, at 1001–02. In the English case of *HIH Casualty & General Insurance Ltd. v. Chase Manhattan Bank*, [2003] UKHL 6, [2003] 1 All E.R. 349 (appeal taken from Eng.), Lord Bingham suggested that the same distinction may apply in England. According to Lord Bingham, while one could not disclaim liability for one’s own fraud, one could disclaim liability for the fraud of one’s agents as long as such disclaimer was done in the clearest of language in the contract. *Id.* at [16]; *see also* Kevin Davis, *Licensing Lies: Merger Clauses, the Parol Evidence Rule and Pre-Contractual Misrepresentations*, 33 VAL. U. L. REV. 485, 508 (1999) (“From a moral perspective it is critical to distinguish between the primary responsibility of an agent who has made a false or negligent misrepresentation and the vicarious responsibility of the enterprise on whose behalf he acted.”); West & Lewis, *supra* note 4, at 1022 n.149 (noting the distinction in the treatment of contract clauses disclaiming liability for one’s own fraud and those clauses that disclaim liability for an agent’s fraud).

in the scope of that agent's actual or apparent authority.¹⁰⁵ And the agent is always personally liable for any fraud in which he or she participates, even if the fraud was committed solely for the benefit of the principal.¹⁰⁶ Of course, these common law concepts were developed before the creation of the various limited liability entities that the law deems to have separate personhood from the individuals who manage and own them.¹⁰⁷

A corporation or other limited liability entity is a non-sentient legal person and must act through human agents.¹⁰⁸ It is the human officers or managers of these entities who are deemed the agents and the entities themselves that are deemed the principals.¹⁰⁹ Thus, a corporate officer who is deemed to have committed a fraud in negotiating an acquisition agreement on behalf of his or her corporate principal is not only personally liable for the resulting damage claim, but so too is the corporate principal. And the corporate principal can be liable for its agent's fraud even if the fraud benefited the agent.¹¹⁰ If members of management of a company being sold are listed as "knowledge parties" for the purposes of the representations and warranties being given by the selling shareholders, and there is an undefined fraud carve-out in the stock purchase agreement, are the selling shareholders creating the possibility that the buyer will attempt to im-

105. *E.g.*, *Citibank, N.A. v. Nyland (CF8) Ltd.*, 878 F.2d 620, 624 (2d Cir. 1989) (finding that it is an "established rule that a principal is liable to third parties for the acts of an agent operating within the scope of his real or apparent authority"); *Johnson v. Schultz*, 691 S.E.2d 701, 704 (N.C. 2010) (finding a principal liable for damages "resulting from the fraud of his agent committed during the existence of the agency and within the scope of the agent's actual or apparent authority from the principal"); *see, e.g.*, *Fidelity & Guar. Ins. Underwriters, Inc. v. Jasam Realty Corp.*, 540 F.3d 133, 140 (2d Cir. 2008) (finding it is a "well-established principle that an agent's frauds or misrepresentations are imputed to the principal if made within the scope of the agent's authority"); *see also Kolbe & Kolbe Millwork Co. v. Manson Ins. Agency, Inc.*, 983 F. Supp. 2d 1035 (W.D. Wis. 2013); *see generally* Steven N. Bulloch, *Fraud Liability Under Agency Principles: A New Approach*, 27 WM. & MARY L. REV. 301 (1986); Paula J. Dalley, *A Theory of Agency Law*, 72 U. PITT. L. REV. 495 (2011); Deborah A. DeMott, *When Is a Principal Charged with an Agent's Knowledge?*, 13 DUKE J. COMP. & INT'L L. 291 (2003); Note, *Liability of Principal for the Unauthorized Fraud of His Agent*, 3 NEWARK L. REV. 75 (1938); James C. Porter, *Liability of Principal for Fraud of Agent Committed for the Agent's Benefit*, 8 WASH. U. L. REV. 180 (1923).

106. West & Lewis, *supra* note 4, at 1017; Glenn D. West, *Protecting the Deal Professional from Personal Liability for Contract-Related Claims*, PRIVATE EQUITY ALERT (Weil, Gotshal & Manges, LLP, New York, N.Y.), Mar. 2006, at 5–7, available at <http://goo.gl/nQzQGS>; *see, e.g.*, *Miller v. Keyser*, 90 S.W.3d 712, 717 (Tex. 2002) (noting the "longstanding rule that a corporate agent is personally liable for his own fraudulent or tortious acts"); *see also* Jonathan Bellamy, *Commercial Fraud: Civil Liability* (39 Essex Street, London, Eng., U.K.), July 2008, at 7, available at <http://goo.gl/HQbqKS> ("No one can escape liability for his fraud by saying 'I wish to make it clear that I am committing this fraud on behalf of someone else and I am not to be personally liable.'" (quoting *Standard Chartered Bank v. Pak. Nat'l Shipping Corp.*, [2002] UKHL 43, [22], [2003] 1 A.C. 959 (on appeal from Eng.))).

107. *See* West & Smeltzer, *supra* note 103, at 41–44 (discussing the history of limited liability entities).

108. *See* *Yeary v. State*, 711 S.E.2d 694, 697 (Ga. 2011); *In re Merrill Lynch Trust Co. FSB*, 235 S.W.3d 185, 189 (Tex. 2007); *see also* *Standard Oil Co. of Tex. v. United States*, 307 F.2d 120, 127 (5th Cir. 1962) ("[W]hile it was perhaps long in coming, it is now almost ancient law that despite these conceptual, logical difficulties, a corporation acting through human agents has the legal capacity to do wrong as well as right.").

109. *See* *Diederich v. Wis. Wood Prods., Inc.*, 19 N.W.2d 268, 270–71 (Wis. 1945).

110. *See* Annotation, *Liability of Corporation for Fraud of Officer for His Own Benefit but Within His Apparent Authority*, 45 A.L.R. 615 (1926); Porter, *supra* note 105, at 188–89.

pute a fraud committed by any such members of management to the selling shareholders?¹¹¹

VI. THE CURRENT MARKET RATIONALE FOR, AND PROPOSED SOLUTIONS TO, THE GENERALIZED FRAUD CARVE-OUT

A surprising number of agreements negotiated by the most sophisticated counsel in the transactional bar contain ambiguous terms simply because the use of such terms is considered market.¹¹² Why it should be deemed market to have an undefined fraud carve-out to an exclusive remedy provision, when it is now also market to disclaim all extra-contractual representations made outside the four corners of the agreement, is a mystery, at least in the United States. But a comparison of the practice in England, with that of the United States, may shed some light on this phenomenon.

A. ENGLISH MARKET PRACTICE REGARDING FRAUD CARVE-OUTS

Like in the United States, undefined fraud carve-outs are also market in England.¹¹³ Unlike in the United States, where a fraud carve-out has developed as a market ask for a buyer (and sellers have apparently demonstrated a significant willingness to accede to that ask), in England, the absence of a generalized fraud carve-out has been viewed as potentially rendering ineffective, under the Unfair Contract Terms Act,¹¹⁴ a provision that otherwise validly disclaims liability for negligent or innocent misrepresentations.¹¹⁵ Thus, a fraud carve-out has generally been volunteered by sellers based upon a 1996 case, *Thomas Witter Ltd. v. TBP Industries Ltd.*¹¹⁶

In *Thomas Witter*, the court stated that a provision whereby the buyer disclaimed reliance upon any representation other than those contained in the written agreement would be invalid under the Unfair Contract Terms Act because the provision purported to exclude liability for any type of pre-contractual misrepresentation, including those that were fraudulently made.¹¹⁷ According to the

111. In the case of the management of a company being sold by selling shareholders, it is important to note that the management of the company being sold are agents of that company, not of the selling stockholders. But avoiding these arguments being made is always better if possible.

112. See Glenn D. West & Sara G. Duran, *Reassessing the "Consequences" of Consequential Damage Waivers in Acquisition Agreements*, 63 BUS. LAW. 777, 780 n.10, 805, 807 (2008). This is not necessarily because deal lawyers do not understand that they are doing this; many times deal dynamics simply do not permit the correction of these ambiguities. See *supra* note 11. But there are other less appealing theories explaining the "herd" mentality of many within the transactional bar, as well as the resulting tendency of many transactional lawyers to become document processors rather than contract draftspersons. See MITU GULATI & ROBERT E. SCOTT, *THE THREE AND A HALF MINUTE TRANSACTION: BOILERPLATE AND THE LIMITS OF CONTRACT DESIGN* 39–40, 93–96, 149–50 (2013).

113. See *infra* notes 123–25 and accompanying text.

114. 1977, c. 50, § 8 (U.K.).

115. See Abbie Goldstone, *Effective Exclusion Clauses: Ensuring They Work—Excluding and Limiting Liability*, MONDAQ (Sept. 14, 2009), <http://goo.gl/MdLjBk>.

116. [1996] 2 All E.R. 575 (Ch.) (Eng.).

117. *Id.* at 598.

court, it would be inappropriate to imply an exception for fraudulent misrepresentations from a disclaimer provision that did not explicitly provide for such exclusion.¹¹⁸ Therefore, it was suggested that a broad disclaimer provision without an express fraud exception would be invalid, even as to claims involving negligent or innocent misrepresentations, which could have otherwise been validly disclaimed.¹¹⁹ As stated by Mr. Justice Jacob: “It is not for the law to fudge a way for an exclusion clause to be valid. If a party wants to exclude liability for certain sorts of misrepresentations, it must spell those sorts out clearly.”¹²⁰

English commentators have noted, however, that *Thomas Witter* has not subsequently been followed by the English courts and that an express carve-out for fraud is now not necessary.¹²¹ It appears that subsequent case law has effectively held that unless a disclaimer clause expressly includes fraudulent misrepresentations, it will not be deemed to do so simply by virtue of broad language concerning non-reliance upon all pre-contractual representations.¹²² In light of these subsequent case law developments, and the holding of *Cavell USA* suggesting that an express fraud carve-out includes more than just truly fraudulent misrepresentations, one would think that our English colleagues would begin to change market practice and cease the use of generalized fraud carve-outs. But old habits die hard. While some English commentators suggest that the practice of specifically carving out fraud should be discontinued,¹²³ others have suggested continued caution.¹²⁴ But the existence of a generalized fraud carve-out after *Cavell USA* can no longer be viewed as a meaningless concession in England because the term “fraud” has a meaning beyond mere fraudulent misrepresentation as an element of the tort of deceit.¹²⁵ Market practice is nevertheless slow to change in both England and the United States.

118. *Id.*

119. *Id.*

120. *Id.*

121. See Practice Note, *Contracts: Entire Agreement Clauses*, PRAC. L. CO., <http://goo.gl/AYbOE3> (last updated July 7, 2014); Goldstone, *supra* note 115; *Entire Agreement Clauses: Ensure Careful Drafting*, LEWIS SILKIN (May 6, 2011), <http://goo.gl/HZjZ5r>; JOHN CARTWRIGHT, MISREPRESENTATION, MISTAKE AND NON-DISCLOSURE 491–92 (3d ed. 2012).

122. See *HIH Cas. & Gen. Ins. Ltd. v. Chase Manhattan Bank*, [2003] UKHL 6, [16] (appeal taken from Eng.); *Foodco UK LLP v. Henry Boots Devs. Ltd.*, [2010] EWHC (Ch) 358, [166]–[167] (Eng.); Matheson, *Pre-contract Misrepresentations: Are “Entire Agreement” Clauses Effective?* LEXOLOGY (Dec. 8, 2010), <http://goo.gl/Ezfdcb>.

123. See, e.g., Practice Note, *Contracts: Entire Agreement Clauses*, PRAC. L. CO., <http://goo.gl/oWJrz7> (last updated July 7, 2014) (“However, by the time *HIH Casualty* was heard, the habit of inserting an express carve-out for fraud and fraudulent misrepresentation had taken hold and entire agreement clauses now normally contain one. We suggest the clause is omitted.”).

124. See, e.g., Christopher Luck, Practice Note, *Asset Purchase Agreement: Commentary*, PRAC. L. CO., <http://goo.gl/guKm9T> (last updated July 7, 2014) (“Nonetheless, it remains prudent for an entire agreement clause . . . to be drafted on the basis that liability for fraud is not excluded.”).

125. See CARTWRIGHT, *supra* note 121, at 493 (discussing the use of fraud carve-outs in England and noting that “[t]he precise scope of such a clause depends on the language used, but if it refers generally to ‘fraud’ it is unlikely to leave intact only claims in the tort of deceit, but may well also allow other claims where fraud has been established, such as rescission of the contract on the basis of a fraudulent misrepresentation, or claims in equity for a party’s dishonest abuse of his fiduciary position”).

B. U.S. MARKET PRACTICE REGARDING FRAUD CARVE-OUTS

In the United States, there is no general equivalent to the Unfair Contract Terms Act that would have potentially invalidated for all purposes (even as to innocent and negligent misrepresentations) a non-reliance clause that purported to disclaim all extra-contractual misrepresentations, even those that were determined to have been fraudulent.¹²⁶ Like England, however, there are states where public policy does in fact override an effort by contracting parties to disclaim reliance upon fraudulent misrepresentations of fact that were alleged to have been made as an inducement to the counterparty to enter into the contract.¹²⁷ Prior to the 2009 *The Business Lawyer* article, when this author would informally survey transactional lawyers as to the efficacy of disclaimers of reliance, even in states without such a strict public policy prohibition (Delaware, Texas, and New York primarily), the overwhelming sentiment was that “you can always bring a claim for fraud no matter what the contract says.” That assumption may have led many to agree to a fraud carve-out on an “it’s just sleeves off my vest” approach because of the belief that a fraud carve-out is read into the contract in any event.¹²⁸ But practitioners should now know that, under many states’ law governing large corporate transactions in the United States, it is simply not the case that you can always bring a claim for fraudulent misrepresentation notwithstanding carefully crafted disclaimers of reliance and exclusive remedy provisions.¹²⁹ Is the fraud carve-out, therefore, just an effort by some buyers to contractually get back to the place that was previously assumed, i.e., “you can always bring a claim for fraud no matter what the contract says”? If so, why are sellers agreeing to this? Why denominate the exact extent of the bargained-for representations and warranties in the first place if a party can instead claim reliance upon extra-contractual statements that were made in management presentations and discussions, but not incorporated into the carefully negotiated written representations and warranties that formed the basis of the parties’ written agreement? And even as to those representations and warranties that were incorporated into the written acquisition agreement, “why spend all of the time and effort negotiating detailed indemnification provisions if a buyer can avoid them based on the legal characterization it decides to place on the claim?”¹³⁰ Is the explanation for this practice essentially the same as in England—i.e., old habits die hard?

A recent practice note illustrates, but does not necessarily explain the rationale for, the apparent disconnect between the purpose of the exclusive remedy provision and the ubiquitous, undefined fraud carve-out commonly associated with existing U.S. market practice.¹³¹ First, the authors note that, in U.S. acquisition

126. *But see* CAL. CIV. CODE § 1668 (West, Westlaw current with urgency legislation through Ch. 25, also including Chs. 27, 39, 41, and 47 of 2014 Reg. Sess., Res. Ch. 1 of 2013–2014 2d Exc. Sess., and all propositions on the 6/3/2014 ballot).

127. West & Lewis, *supra* note 4, at 1024–25; Chu & Pearlman, *supra* note 6.

128. See Gregory V. Gooding, *Yes, Virginia, You Really Can Waive Fraud Claims*, PRIVATE EQUITY REP. (Debevoise & Plimpton LLP, New York, N.Y.), Spring 2012, at 17, available at <http://goo.gl/7AGXGB>.

129. See West & Lewis, *supra* note 4, at 1023–28. But this is not true in all states. *See id.* at 1024–25; Chu & Pearlman, *supra* note 6.

130. Avery & Perricone, *supra* note 6, at 2.

131. *Id.*

agreements, the provisions governing indemnification “generally specify in detail the rights of the parties with respect to how claims are dealt with, including . . . timing, process, payment of claims, and limitations on liability.”¹³² And “[a]n [exclusive remedy] provision is intended to prevent a plaintiff from circumventing these carefully negotiated limitations by providing that the right of indemnification constitutes the only post-closing recourse available to either party and precludes the parties from seeking claims outside of the specifically negotiated indemnification terms.”¹³³ But then the authors note that, based on a review of four years of ABA *Private Target M&A Deal Points Studies*, exclusive remedy provisions are also subject to “commonly negotiated carve-outs, usually fairly narrow in scope.”¹³⁴ And what is the most common of these supposedly “narrow in scope” carve-outs? Undefined fraud, of course, is the most common carve-out.¹³⁵ However, the authors do identify what they refer to as a “surprising” “trend to increasingly define the term ‘fraud.’”¹³⁶ But the identified “definitions” of the term “fraud” were largely limited to the use of a descriptive adjective in front of the word fraud, such as “actual” or “intentional.”¹³⁷

C. COMPARING U.S. VERSUS ENGLISH MARKET PRACTICE CONCERNING THE USE OF CONTRACTUAL REPRESENTATIONS AND WARRANTIES

It is always important when discussing fraud carve-outs in the U.S. market to keep in mind the distinction between fraud claims based upon extra-contractual representations and fraud claims based upon the representations and warranties set forth in the acquisition agreement itself. While it is against public policy to disclaim liability for fraudulent pre-contractual misrepresentations in England, a seller can apparently avoid incurring tort liability for any contractual statements regarding a purchased business made in an acquisition agreement if the seller carefully denominates those statements as warranties rather than representations. Indeed, a recent English case refused to allow carefully crafted contractual warranties in an acquisition agreement to be converted into tort-based representations that could circumvent the contractually limited remedies available for breach of those warranties.¹³⁸ In contrast, at least in Delaware, liability for deliberate misrepresentations based on the contractual representations and warranties specifically set forth in a written agreement is the only type of misrepresentation-related liability that an exclusive remedy provision (and a related non-reliance provision) cannot avoid.¹³⁹

The distinction between contractual warranties and contractual representations does not appear to mean much in the United States given that, unlike

132. *Id.* at 2.

133. *Id.*

134. *Id.*

135. *Id.* at 3.

136. *Id.* at 4.

137. *Id.* at 3.

138. *Sycamore Bidco Ltd. v. Breslin*, [2012] EWHC (Ch) 3443, [203], [209]–[211] (Eng.).

139. *See supra* notes 57–58 and accompanying text.

in England, “it is common market practice for a seller to make both representations and warranties” in an acquisition agreement.¹⁴⁰ But a recent practice note comparing New York versus English practice on this subject suggests that the exclusive remedy provision of a standard New York acquisition agreement provides for the same result under a New York-style agreement that includes both representations and warranties as does an English-style agreement that only provides for warranties.¹⁴¹ The reason for this conclusion is that the exclusive remedy provisions of most New York acquisition agreements broadly exclude “all other rights, claims and causes of action that they might have against the other party, except pursuant to the indemnification provisions set forth in the indemnification article.”¹⁴² And this exclusion of other available remedies necessarily includes the remedy of rescission that is the primary benefit of bringing a claim as one based on a misrepresentation rather than merely a breach of warranty in both England and the United States.¹⁴³ But then, to further illustrate, but still not explain the rationale for, the disconnect between the undefined fraud carve-out and the purpose of the exclusive remedy provision in the United States, the author simply notes that a generalized fraud carve-out could potentially moot the benefit of this exclusion of the remedy of rescission.¹⁴⁴

140. Serfilippi, *supra* note 47, at 1; see *supra* note 47 for a discussion of the need to potentially reopen the debate as to whether U.S. lawyers should reconsider whether there is in fact a difference in the United States between only “warranting” and “representing and warranting” certain information regarding a business being purchased by a buyer. Without a representation having been made at all, a common law fraud claim would appear to lack an essential element of the cause of action. But recognizing the difficulties of changing the existing market practice of including both representations and warranties in U.S. acquisition agreements, the 2009 *The Business Lawyer* article attacked this issue by suggesting the inclusion of a provision to make clear that the representations and warranties are not actually intended to assert truth, but only to provide risk allocation. See West & Lewis, *supra* note 4, at 1037; see also Ken Adams, *My Exchange with Glenn West on Using “States” Instead of “Represents and Warrants,”* ADAMS ON CONTRACT DRAFTING (June 6, 2012), <http://www.adamsdrafting.com/my-exchange-with-glenn-west-on-using-states-instead-of-r-and-w/>.

141. Serfilippi, *supra* note 47.

142. *Id.* at 3; see also Jonathan B. Stone, *Differences Between English and US M&A Risk Allocation*, LAW360 (Mar. 6, 2014, 3:38 PM), <http://goo.gl/1B5Xs8> (“Most sellers under English law share purchase agreements will intentionally refrain from using the term ‘representation’ to limit the buyer’s ability to bring tortious, rather than contractual, claims, in particular, to rescind the contract. New York law generally does not recognize such a distinction and, in any event, most New York law-governed sale and purchase agreements will expressly exclude tortious remedies.”).

143. See Serfilippi, *supra* note 47, at 3; Stone, *supra* note 142.

144. See Serfilippi, *supra* note 47, at 4. Still another practice note suggests that New York is more like England than Delaware when it comes to premising fraud claims on contractually bargained-for representations and warranties rather than extra-contractual representations. See Daniel E. Wolf & Matthew Solum, *Delaware vs. New York Governing Law—Six of One, Half Dozen of Other?*, KIRKLAND M&A UPDATE (Kirkland & Ellis LLP, New York, N.Y.), Dec. 17, 2013, at 2, available at http://www.kirkland.com/siteFiles/Publications/MAUpdate_121713.pdf (“There are cases in New York, however, that suggest that fraud claims can only be based on conduct and statements outside of the contract, and not on contractual representations. Therefore, even with the fraud exception, a buyer’s recovery may be limited by the contractual cap even when the contractual representation was knowingly false (i.e., fraudulent).”). This author believes that the New York cases on this subject are confusing at best and suggest a failure at times to distinguish between the various types of fraud claims. See West & Lewis, *supra* note 4, at 1014 n.97. While it is true that there are New York cases that state that a fraud claim must be premised on misrepresentations that are “collateral or extraneous to the contract,” *Bridgestone/Firestone, Inc. v. Recovery Credit Servs., Inc.*, 98 F.3d 13, 20 (2d Cir.

So where does this leave us? While it is apparently “still a minority approach” in the U.S. market, there is a clear “trend to increasingly define fraud with some specificity when including it as an exception to an [exclusive remedy] provision.”¹⁴⁵ And defining fraud by adding a descriptive adjective is certainly a step in the right direction, but it does not necessarily address all of the concerns previously noted in this article. So, if we are stuck with a market reality of a fraud carve-out to the exclusive remedy provision in the United States, how should the term “fraud” be defined so that it properly captures only the egregious form of fraudulent misrepresentation and then only with respect to the representations and warranties specifically bargained for in the written agreement?

D. ENCOURAGING A NEW APPROACH IN U.S. MARKET PRACTICE: SPECIFIC VERSUS GENERAL FRAUD CARVE-OUTS

A good start in crafting an appropriate definition of fraud that is specific rather than general is a provision from the acquisition agreement governing Miller Energy Resources, Inc.’s 2013 purchase of certain assets of Armstrong Cook Inlet, LLC.¹⁴⁶

1996), this requirement has been interpreted by some cases to simply mean that New York does not recognize a claim based on mere promissory fraud. *See, e.g.,* Merrill Lynch & Co. v. Allegheny Energy, Inc., 500 F.3d 171, 184 (2d Cir. 2007) (“New York distinguishes between a promissory statement of what will be done in the future that gives rise only to a breach of contract cause of action and a misrepresentation of a present fact that gives rise to a separate cause of action for fraudulent inducement. . . . That the alleged misrepresentations would represent, if proven, a breach of the contractual warranties as well does not alter the result. A plaintiff may elect to sue in fraud on the basis of misrepresentations that breach express warranties. Such cause of action enjoys a longstanding pedigree in New York.”); Koch Indus., Inc. v. Aktiengesellschaft, 727 F. Supp. 2d 199, 214 (S.D.N.Y. 2010) (“[U]nder New York law, alleged misrepresentations are collateral or extraneous to the contract if they ‘involve misstatements and omissions of present facts,’ rather than ‘contractual promises regarding prospective performance.’”). Still others suggest that you in fact cannot premise a fraud claim simply based on the warranties set forth in the contract unless you can allege that the warranties merely restate previous representations made outside the contract. *See, e.g.,* MBIA Ins. Corp. v. Credit Suisse Sec. (USA) LLC, 927 N.Y.S.2d 517, 531 (Sup. Ct. 2011) (“Nonetheless, to the extent that MBIA alleges that it relied on contractual representations and warranties in the Insurance Agreement and PSA, the fraud claim duplicates the breach of contract claims and must be dismissed. To sustain a claim for fraudulently inducing a party to contract, the plaintiff must allege a representation that is collateral to the contract, not simply a breach of a contractual warranty, and damages that are not recoverable in an action for breach of contract.”); Gotham Boxing, Inc. v. Finkel, No. 601479-2007, 2008 WL 104155, at *10 (N.Y. Sup. Ct. Jan. 8, 2008) (“To be sure, the distinction is a fine one. It seems to turn on whether the complaint alleges a particular statement, omission, or other conduct by the defendant, in addition to the text or statements that form the basis of the alleged contract. . . . [I]t does not seem to matter that the alleged fraudulent representation is virtually identical to the promise contained in the contract as long as it is made at a different time and place.”). *But see* First Bank of Ams. v. Motor Car Funding, Inc., 690 N.Y.S.2d 17, 21 (App. Div. 1999) (“A warranty is not a promise of performance, but a statement of present fact. Accordingly, a fraud claim can be based on a breach of contractual warranties notwithstanding the existence of a breach of contract claim.”). Reconciling these cases is difficult and appears to constitute an area that would require an article all of its own. *See* Leo K. Barnes, Jr., *Simultaneously Viable Causes of Action for Breach of Contract and Fraud*, SUFFOLK LAW. (Suffolk Cnty. Bar Ass’n, Suffolk, N.Y.), Mar. 2009, at 8, 27, available at http://scba.org/suffolk_lawyer/tsl309.pdf (discussing many of these cases).

145. Avery & Perricone, *supra* note 6, at 3.

146. Purchase and Sale Agreement, dated November 22, 2013, among Cook Inlet Energy, LLC and Armstrong Cook Inlet, LLC, GMT Exploration Company, LLC, Dale Resources Alaska, LLC, Jonah Gas

Section 11.3 of this acquisition agreement contains a fairly standard exclusive remedy provision mandating indemnification pursuant to Article 11 of the agreement as “the sole and exclusive remedy of each Party under, arising out of or relating to this Agreement, and the transactions contemplated hereby, whether based in contract, tort, strict liability, statute, common law or otherwise.”¹⁴⁷ Like many acquisition agreements, however, this agreement also contains a fraud carve-out. But the difference in this agreement is that it is not a generalized fraud carve-out. Instead, the fraud carve-out in this agreement reads as follows:

Notwithstanding the foregoing, nothing in this ARTICLE 11 is intended to limit the rights of the Parties with respect [to] intentional or willful misrepresentation of material facts which constitute common law fraud under applicable laws.¹⁴⁸

The benefit of this more specific language is that it specifies the scienter requirement (“intentional or willful misrepresentation”), specifies the requirement that the misrepresentation must be of “material facts,” and maintains the requirement that the resulting intentional or willful¹⁴⁹ misrepresentation of material facts must still constitute “common law fraud,” which appears intended to preserve the requirement that the buyer still has to prove all the other elements of common law fraud, including the buyer’s justifiable reliance. But the clause does not limit this more specific common law fraud carve-out to the contractual rather than extra-contractual representations, nor does it specify whose intentional or willful misrepresentations can be charged to the seller.

A recent example of a more specific fraud carve-out that defines fraud so that it only captures deliberate lies made by a seller through the contractual representations is the one set forth in the exclusive remedy provision of the acquisition agreement governing Cementos Argos S.A.’s acquisition of certain assets of

Company, LLC, and Nerd Gas Company LLC, PRAC. L. CO. (Nov. 22, 2013), <http://us.practicallaw.com/8-550-8947>.

147. *Id.* § 11.3, at 44.

148. *Id.* Still another approach is to mitigate the risk of fraud claims being based on any form of scienter less than actual dishonesty by excluding fraud based on any form of negligence. *See, e.g.*, Membership Interest Purchase Agreement, dated May 1, 2014, by and among William C. Cocks, Jr., et al., as Sellers, J. Cody Bates as a Sable II Member, and Ferrellgas, L.P., as Purchaser, PRAC. L. CO. annex A, at 43 (May 1, 2014), <http://us.practicallaw.com/8-567-5106> (“‘Fraud’ means actual fraud and does not include constructive fraud or negligent misrepresentation or omission.”); Agreement and Plan of Merger, dated May 27, 2014, by and among The Spectranetics Corporation, SAA Merger Sub, Inc., Angioscore Inc., and the Securityholders’ Representative, PRAC. L. CO. § 8.1(e)(ii), at 65 (May 27, 2014), <http://us.practicallaw.com/4-570-1145> (“For purposes of this Article VIII, references to the term ‘fraud’ do not include negligent misrepresentation.”).

149. The term “willful” is somewhat ambiguous itself. *See Johnson & Johnson v. Guidant Corp.*, 525 F. Supp. 2d 336, 349–53 (S.D.N.Y. 2007). Expressing frustration with “willful’s” ambiguous definition, distinguished jurist Judge Learned Hand stated: “It’s an awful word! It is one of the most troublesome words in a statute that I know. If I were to have the index purged, ‘wilful’ would lead all the rest in spite of its being at the end of the alphabet.” *Id.* at 349 n.9; *see also* Don Bivens, *Comments on Proposed Civil Rule Amendments*, REGULATIONS.GOV (Feb. 3, 2014), <http://goo.gl/TGH3hC>. Another approach is to define fraud as only including intentional and knowing misrepresentations by a person. *See, e.g.*, Membership Interest Purchase Agreement, dated June 10, 2014, by and among Stamps.com Inc., Auctane LLC and the Members of Auctane LLC, PRAC. L. CO. §§ 1.1(nn), 7.2(g), at 5, 52 (June 10, 2014), <http://us.practicallaw.com/4-572-5189>.

Vulcan Materials Company.¹⁵⁰ In that agreement the fraud carve-out reads as follows:

[N]othing herein shall operate to limit the common law liability of any Seller to Purchasers for fraud in the event such Seller is finally determined by a court of competent jurisdiction to have willfully and knowingly committed fraud against any Purchaser, with the specific intent to deceive and mislead any Purchaser, regarding the representations and warranties made herein or in any schedule, exhibit or certificate delivered pursuant hereto.¹⁵¹

Again, the scienter standard for fraud in this clause requires deliberate dishonesty, with intent to deceive. Moreover, the specifically defined fraud carve-out in this clause only relates to the representations and warranties made in the agreement or in a document delivered pursuant to the agreement, and each seller is only responsible for its own fraud.

Finally, the Stock Purchase Agreement governing Leonard Green & Partners, L.P.'s acquisition of the stock of Lucky Brand Dungarees, Inc. from Fifth & Pacific Companies, Inc. contains a defined term for "Fraud," for the purposes of the fraud carve-out, as follows:

"Fraud" means, with respect to a Party, an actual and intentional fraud with respect to the making of the representations and warranties pursuant to Article IV or Article V (as applicable), provided, that such actual and intentional fraud of such Party shall only be deemed to exist if any of the individuals included on Section 1.1(vv) of the Seller Disclosure Letter (in the case of the Seller) or Buyer Disclosure Letter (in the case of the Buyer) had actual knowledge (as opposed to imputed or constructive knowledge) that the representations and warranties made by such Party pursuant to, in the case of the Seller, Article IV as qualified by the Seller Disclosure Letter, or, in the case of the Buyer, Article V as qualified by the Buyer Disclosure Letter, were actually breached when made, with the express intention that the other Party rely thereon to its detriment.¹⁵²

150. Asset Purchase Agreement, dated January 23, 2014, by and among Florida Rock Industries, Inc., Florida Cement, Inc., Argos Cement LLC, Argos Ready Mix LLC, and, solely for purposes of Section 12.18, Vulcan Materials Company and Cementos Argos S.A., PRAC. L. CO. (Jan. 23, 2014), <http://us.practicallaw.com/7-555-7066>.

151. *Id.* § 8.6, at 55; *see also* Stock Purchase Agreement, dated April 5, 2014, by and among The Laclede Group, Inc., Energen Corp., and Alabama Gas Corp., PRAC. L. CO. §§ 9.06(a)(v), 9.07(a)(v), at 54, 56 (Apr. 5, 2014), <http://us.practicallaw.com/1-565-5885> (providing a fraud carve-out "with respect to circumstances in which Seller is finally determined by a court of competent jurisdiction to have willfully and knowingly committed fraud against Purchaser with specific intent to deceive and mislead Purchaser regarding the representations and warranties expressly set forth in Article II and Article III of this Agreement"); Agreement and Plan of Merger, dated May 9, 2014, by and among Akorn, Inc., Akorn Enters. II, Inc., VPI Holdings Corp. and Tailwind Mgmt. LP, PRAC. L. CO. § 9.13, at 74–75 (May 9, 2014), <http://us.practicallaw.com/0-568-3228> (limiting the fraud carve-out to "intentional fraud with respect to any representation and warranty of the Company set forth in Article IV," capping the liability of any shareholder for such intentional fraud to the actual proceeds received from the transaction by such shareholder, and specifically waiving all other forms of fraud "whether intentional, reckless, negligent, constructive or otherwise").

152. Stock Purchase Agreement, dated December 10, 2013, by and between LBD Acquisition Company, LLC ("Buyer") and Fifth & Pacific Companies, Inc. ("Seller"), regarding the purchase and sale of the capital stock of Lucky Brand Dungarees, Inc., PRAC. L. CO. § 1.1(II), at 5 (Dec. 10,

This definition captures the intentional scienter requirement, the fact that the fraud has to relate only to the representations and warranties made in the agreement itself, the determination of whose fraud matters, the specific type of knowledge that constitutes fraud, and the requirement that there be a specific intention to harm the other party.

Of course, there are obvious other points that could be the subject of further negotiation respecting this definition of fraud. For example, this definition charges the seller with fraud committed by the named individuals rather than providing that the named individuals are liable for their own fraud only;¹⁵³ and this definition still leaves open the possibility of bringing a claim of fraud outside the survival periods, without complying with the indemnification procedures and without the benefit of any limitations on recoverable losses that may have otherwise been bargained for as part of the indemnification provision.¹⁵⁴

2013), <http://us.practicallaw.com/4-552-0885>; See Summary, *Leonard Green & Partners, L.P. Acquisition of Stock of Lucky Brand Dungarees, Inc.*, PRAC. L. CO. (Dec. 10, 2013), <http://goo.gl/exJTss>.

153. An example of an agreement limiting the fraud carve-out to the individuals actually committing the fraud rather than the seller parties generally can be found in Agreement and Plan of Merger, dated February 12, 2014, by and among Victory Electronic Cigarettes Corporation, VCIG LLC, FIN Electronic Cigarette Corporation, Inc., and Elliot B. Maisel, as Representative, PRAC. L. CO. § 7.1(d)(iv), at 31 (Feb. 12, 2014), <http://us.practicallaw.com/1-558-8985> (“For purposes of clarity, the commission of actual fraud by a Shareholder shall not affect the application of the limitations set forth in this Article VII to any other Shareholder that has not also committed actual fraud with respect to the claim in question”); see also Stock Purchase Agreement, dated April 28, 2014, by and among Clarcor Inc., Clean Seller, LLC, Stanadyne Holdings, Inc. and Stanadyne Corp., PRAC. L. CO. § 8.06, at 51 (Apr. 28, 2014), <http://us.practicallaw.com/4-567-1025> (fraud carve-out limited to “any claim of intentional fraud asserted against the Person who committed such fraud”); Amended and Restated Agreement and Plan of Merger, dated February 2, 2014, by and among Myriad Genetics, Inc., Myriad Crescendo, Inc., Crescendo Bioscience, Inc., and MDV IX, L.P., as Representative, PRAC. L. CO. § 10.2(b)(ii), at 92 (Feb. 2, 2014), <http://us.practicallaw.com/5-557-1935> (fraud carve-out limited to “Claims against a Person for such Person’s own actual fraud with intent to deceive or intentional misrepresentation”). Obviously the issue regarding whose fraud is chargeable to the sellers is even more critical if the subject matter of the fraud is not limited to the representations and warranties set forth in the agreement but also includes extra-contractual representations. After all, the company’s officers included in the knowledge parties list may well end up working for the buyer. And it may be that the knowledge party list for the purpose of the contractual remedies may need to be different than the knowledge party list for whose knowledge counts for the purpose of a defined fraud finding chargeable to the seller.

154. The suggested fraud carve-out to the model exclusive remedy provision in the 2009 *The Business Lawyer* article, however, did make an effort to preserve indemnification as the sole remedy even in the event of a defined fraud, but with a cap equal to the purchase price. See West & Lewis, *supra* note 4, at 1038. This is certainly preferable, as it maintains the contract as the source of all applicable remedies. See also Stock Purchase Agreement, dated February 6, 2014, by and among Illinois Tool Works Inc., ITW IPG Investments LLC, ITW Alpha S.A.R.L., ITW LLC & Co. KG, ITW Signode Holding GmbH, and Vault Bermuda Holding Co. Ltd., PRAC. L. CO. § 9.06, at 108 (Feb. 6, 2014), <http://us.practicallaw.com/3-558-4665> (“After the Closing, other than as set forth in Section 2.06 or Section 11.09, the sole and exclusive remedy for any and all claims, Damages or other matters arising under, out of, or related to this Agreement or the transactions contemplated hereby, including in the case of fraud, shall be the rights of indemnification set forth in Section 6.05 and this Article IX only, and no Person will have any other entitlement, remedy or recourse, whether in contract, tort, strict liability, equitable remedy or otherwise, it being agreed that all of such other remedies, entitlements and recourse are expressly waived and released by the Parties to the fullest extent permitted by Law.” (emphasis added)). Another means of achieving this result is to make the defined fraud carve-out an exception to the indemnification caps, but not an exception to the exclusive remedy provision that declares contractual indemnification to be the sole and exclusive remedy for any claim

But given that only a claim of “Fraud” (as defined above) is carved out, rather than “any claim based on fraud,” then, depending on the deal dynamics, perhaps these potential deficiencies are something worth letting slide. The point is not that this definition of fraud is perfect, but that it begins to limit the many splendors of fraud to something concrete and understandable in the context of a sophisticated acquisition agreement.

There remains, of course, the argument that once you agree to eliminate all claims of extra-contractual fraud, why should you then agree to allow fraud claims to be premised on the contractually bargained-for representations and warranties that are subject to specifically bargained-for contractual remedies at all?¹⁵⁵ But the market, at least in the United States, seems to be decidedly favoring those that persist in insisting upon some form of fraud carve-out.¹⁵⁶

VII. CONCLUSION

What the term fraud denotes in the law is potentially more far reaching than that which it connotes. Fraud is an ancient term that comes to us shrouded in myth and legend. It is like that beast reported to be dwelling in the cave just on the other side of the swamp outside the village walls. It purportedly breaths fire, has wings, is massive, and is something to be feared and loathed, but until we go into the cave and drag him out (if he is actually there at all) we cannot “count his teeth and claws, and see just what is his strength.”¹⁵⁷ And perhaps there is not just one creature that dwells in that cave, but several that have been mythically arranged into a composite, only one or more of which are actually to be feared, loathed, and per-

(and specifically waives any right of rescission). See, e.g., Asset Sale Agreement, dated April 2, 2014, between StoneMor Operating LLC, et al., as Buyer, and S.E. Funeral Homes of Florida, LLC, et al., as Seller, PRAC. L. CO. §§ 8.3(b)(i)(B), 8.11, at 55, 61 (Apr. 2, 2014), <http://us.practicallaw.com/2-565-8765>.

155. See *supra* note 130 and accompanying text.

156. A buyer, of course, will view a deliberate and knowing failure to disclose information that is required to make the bargained-for representations and warranties in the agreement accurate at signing as fundamentally different than a breach occurring in any other circumstance. While the purchased business will be just as impacted by the non-disclosed information regardless of the state of mind of the seller, the buyer will argue that the risk allocation that resulted in the capped liability presupposes that the seller has not deliberately concealed information that was part of the bargained-for representation and warranty package, because that withheld information may have impacted the negotiation of the caps and deductibles in the first instance. Hence, a specific, rather than general, fraud carve-out should meet the justifiable expectations of both the seller and the buyer. And, it is worth mentioning that if a buyer is insisting upon any kind of fraud carve-out, the buyer should then agree to an anti-sandbagging provision in favor of the seller (limited to the same extent as the defined fraud carve-out in favor of the buyer) for the same reasons that the buyer is arguing for a fraud carve-out—i.e., the seller would not have agreed to the bargained-for representation and warranty package if it had known that the buyer knew information that the seller did not concerning certain of those representations and warranties. See West & Lewis, *supra* note 4, at 1032; West & Shah, *supra* note 42, at 3–4.

157. Holmes, *supra* note 61, at 469. The Holmesian “dragon” is a metaphor for the common law and the need to carefully examine and adapt its precepts to changing conditions, rather than blindly follow it for “no better reason . . . than that so it was laid down in the time of Henry IV.” *Id.*; see Sanford Levinson & J.M. Balkin, *Law, Music, and Other Performing Arts*, 139 U. PA. L. REV. 1597, 1647–51 (1991).

haps killed, with the others being nothing more than harmless lizards whose collective “shadows” in the firelight only made them seem like a dragon.¹⁵⁸

As noted in a 2008 *The Business Lawyer* article about the use of the term “consequential damages,” “many of the most sophisticated and ‘heavily counseled’ acquisition agreements contain ‘glaringly ambiguous terms that lead to avoidable litigation.’”¹⁵⁹ “Fraud” is a term very much like the term “consequential damages.” Practitioners believe they know what both these terms mean, but they may, in fact, be basing that belief on those terms’ connotations, not their legal definitions. The term “fraud” carries with it a connotation that makes it extremely difficult for seller’s counsel to resist when buyer’s counsel insists on the inclusion of the seemingly straightforward phrase “except in the case of fraud” at the end of the exclusive remedy provision of an acquisition agreement. After all, who wants to be perceived as suggesting that his or her client would actually commit fraud, as that term is commonly, but not necessarily legally, understood? And clients rarely “get” this issue or have patience for it because they have no intention of acting other than honestly. But the purpose of this article has been to “get the dragon out of his cave on to the plain and in the daylight”¹⁶⁰ and demonstrate why simply acting honestly will not necessarily preclude the possibility of certain types of fraud claims. If this article has succeeded in that purpose, then perhaps future discussions with clients and opposing counsel regarding the need for better definition as to exactly what is meant by the phrase “except in the case of fraud” will be easier.

To have set out to identify as problematic an apparently common market practice of including undefined fraud carve-outs to exclusive remedy provisions, this author is “not so naïve as to believe that this [a]rticle will suddenly change existing deal practice and result in more deliberate and thoughtful negotiation regarding [fraud carve-outs].”¹⁶¹ That does not appear to have been the case for consequential damage waivers despite identifying the term “consequential damages” as being “shockingly ambiguous” in a 2008 *The Business Lawyer* article.¹⁶² But this author hopes that the previously identified “minority trend” to clearly define fraud for the purpose of an exclusive remedy provision will become a dominant market practice for negotiated fraud carve-outs because “[a] properly drafted contract should clearly and unequivocally define the limits of the parties’ obligations in words that are well understood.”¹⁶³ Only time will tell if that hope will be realized.

158. See Ker Than, *Top Ten Beasts and Dragons: How Reality Made Myth*, LIVE SCI. (Mar. 1, 2011, 3:30 AM), <http://www.livescience.com/11320-top-10-beasts-dragons-reality-myth.html>. The use of the term “shadows” is a reference to Plato’s “Allegory of the Cave.” Plato, *Allegory of the Cave*, in *THE REPUBLIC OF PLATO* 193 (Allan Bloom ed. & trans., Basic Books 1991) (c. 360 B.C.E.).

159. West & Duran, *supra* note 112, at 780 n.10 (citing *Johnson & Johnson v. Guidant Corp.*, 525 F. Supp. 2d 336, 353 (S.D.N.Y. 2007)). See *supra* note 112 for possible explanations for this phenomenon.

160. Holmes, *supra* note 61, at 469. As Holmes noted, moreover, “to get [the dragon] out is only the first step. The next is either to kill him, or to tame him and make him a useful animal.” *Id.*

161. West & Duran, *supra* note 112, at 805.

162. *Id.* at 780.

163. *Id.* at 807.

