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Private Equity Alert

NDAs Can Shield Sellers from Liabilities Arising During Pre-Contracting Diligence

By Samuel Peca

A recent decision by the Delaware Supreme Court serves as a reminder to buyers and sellers of the important role non-disclosure agreements can play in fixing the limits of potential liability for sellers during the pre-contracting, diligence phase of a transaction. Claims of misrepresentation can arise not only after an agreement is signed and consummated, but even when the negotiations break down and an agreement is never executed. Buyers can incur significant costs pursuing an acquisition of a business; if negotiations fall apart before a definitive agreement is reached and the buyer believes the seller made misrepresentations during the process that mislead the buyer into continuing to incur such costs, the buyer may seek to recoup these expenses from the seller. On May 18, 2012, the Court held in *RAA Management, LLC v. Savage Sports Holdings, Inc.* that a properly worded disclaimer of reliance clause can defeat any such claims by a buyer, even claims based on intentionally fraudulent misstatements allegedly made by the seller during the pre-contracting phase of the transaction.

RAA Management and Savage Sports entered into a non-disclosure agreement as part of RAA's exploration of a possible purchase of Savage Sports. The non-disclosure agreement included a broad non-reliance provision that disclaimed "any" representation or warranty as to the accuracy of the evaluation material and disclaimed "any" liability resulting from the use of such material, except as might be set forth in a definitive agreement. The non-disclosure agreement also included a broad waiver of claims by which RAA waived "any" claims in connection with the transaction unless a definitive agreement was entered into.

Negotiations broke down during the due diligence process, and RAA sued Savage Sports, alleging that Savage Sports knowingly made material fraudulent misrepresentations and omissions during the due diligence process. RAA alleged that as a result of its reliance on Savage Sports' representations, RAA spent $1.2 million on due diligence and negotiation expenses that RAA would not have spent had Savage Sports made accurate and complete disclosures earlier on in the process. RAA demanded Savage Sports be held liable to RAA for the $1.2 million in expenses.

The Court held that even if Savage Sports did knowingly make material fraudulent misrepresentations and omissions, the disclaimer of reliance clause in the non-disclosure agreement barred RAA's

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claim. The Court explained that not only did the plain language of the non-reliance provision bar the claim, but prior case law, public policy and the efficient functioning of the M&A markets are all in favor of allowing sophisticated M&A actors to allocate risk by disclaiming reliance on representations made *outside* a final agreement.

In drafting disclaimers of reliance in non-disclosure agreements, sellers of businesses should insist upon broad disclaimers of reliance and waivers of claims. After all, not all claims of misrepresentation are valid. In Delaware (among other states) these provisions will assist a seller in defeating a claim of fraudulent misrepresentation by a potential buyer. Buyers, on the other hand, have generally always assumed the risk that they would spend significant costs diligencing a target only to discover that all was not what it seemed. Unless a buyer has sufficient leverage to negotiate an expense reimbursement agreement as part of the diligence process, this case makes clear that a properly worded disclaimer of reliance slams the door on there being any "but they told me" exception to that assumed risk.

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