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Anti-Reliance Clauses and Fraud in Stock Purchase Agreements: Not Quite a Silver Bullet

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Delaware Courts recently held that buyers and sellers cannot rely on contractual limitations (*e.g.*, indemnification limitations, like survival clauses) that are obtained as a result of fraud. Full disclosure and precise drafting can mitigate this risk.

Representations and warranties are often a hotly negotiated aspect of mergers and acquisitions transactions. Parties frequently negotiate additional provisions in an effort to limit the scope of a seller's liability for those representations and warranties and to limit the manner in which a buyer can assert claims relating to a recently closed transaction. A common type of liability-limiting provision is an "anti-reliance clause" through which buyers disclaim any reliance on certain statements made by sellers and their representatives leading up to the consummation of a transaction. Another common liability-limiting provision is a "survival clause" which contractually modifies and shortens the applicable statute of limitations on claims arising out of the transaction documents. A third liability-limiting mechanism is a "non-recourse clause" which limits the scope and amount of a buyer's potential recovery for claims arising out of the transaction documents. However a recent Delaware Chancery Court decision, *Online Healthnow, Inc et. al., v. CIP OCL Investments, LLC et. al.,* (August 12, 2021), recognizes that courts will not always enforce these provisions– particularly where allegedly fraudulent statements were made within the transaction documents. The court stated: "the strong American tradition of freedom of contracts…must give way to Delaware's venerable public policy against fraud, rooted fundamentally in the

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societal consensus that lying is wrong." The guidance provided by the court in *Online Healthnow* is useful for parties negotiating transactions and evaluating potential claims.

Online Healthnow involved multiple buyer parties and seller parties, which are referred to here as "Buyer," "Target Company," "Seller," and "Consultant" for the sake of brevity. In the summer of 2018, Seller decided to put Target Company on the market and retained Consultant to act as its financial advisor in any sale transaction. Seller solicited bids from various potential purchasers—including Buyer—and worked with Consultant to determine what information to share with each potential purchaser. Seller and Consultant decided that different potential purchasers (including Buyer) would have access to different sets of information for their due diligence.

After Buyer completed its due diligence, Buyer and Seller entered into a stock purchase agreement on August 20, 2018. In the stock purchase agreement, Seller represented that Target Company's tax returns had been duly filed and were true, complete, and correct in all material respects, and further represented that Seller had no undisclosed liabilities. Buyer, for its part, represented that it had been provided with adequate access to Target Company's records and that it did not rely on any representations, warranties, or information made by or obtained from Seller, Target Company, or anyone else, except for the representations and warranties specifically set forth in the stock purchase agreement. The parties engaged in a no recourse public company style transaction with all representations and warranties terminating upon the closing of the transaction, and that any claims arising from those representations and warranties were extinguished when the deal closed.

Shortly after the transaction closed, Buyer learned that Seller had not disclosed substantial information relating to sales and use tax applicability for sales of Target Company's software. Buyer also learned that Seller and its Consultant had shared information with other potential purchasers – but not Buyer – that showed the Target Company had not been properly collecting and/or remitting significant amounts in sales and use taxes for several preceding years. (It was estimated that the resulting tax liability likely exceeded $8 million.).

Upon learning of the potential tax liability, Buyer filed suit in the Delaware Chancery Court, claiming that Seller had fraudulently induced Buyer into consummating the transaction by misrepresenting the financial condition of Target Company in the stock purchase agreement's representations and warranties. Seller moved to dismiss the lawsuit on the basis that: 1) the operative representations and warranties had been extinguished when the deal closed; and 2) that provisions within the Stock Purchase Agreement barred Buyer's fraud claim.

The court rejected Seller's arguments. The court observed that a seller can generally limit its exposure to a post-closing fraud claim by bargaining for limits on: (1) "what" information the buyer is relying upon, (2) "when" the buyer may bring a claim, (3) "who" among the sellers may be held liable and "who" among the buyers may pursue a claim, and (4) "how much" the buyer may recover if it proves its claim. But the court made it clear that a seller cannot invoke the provisions of a contract obtained as a result of fraud. First, the court found that the "survival clause" could not effectively cause the statute of limitations on fraud claims relating to the representations and warranties in the stock purchase agreement to expire on the day of closing. A purchaser must have some reasonable period of time to discover the possible misrepresentations and bring suit on them. Second, the court found that the stock purchase agreement's non-recourse provision, which limited the Seller's liability for claims arising out of the stock purchase agreement, could not limit Seller's liability for fraudulent statements made by the buyer within the stock purchase agreement.

Put another way, a seller cannot make false statements in a contract in order to obtain a buyer's signature, and then rely upon that very contract to avoid the consequences of those false statements. The court held that Buyer's fraud claims survived the motion to dismiss because Seller could not use anti-reliance provisions and other provisions within the stock purchase agreement to avoid liability.

Delaware law strongly favors parties' freedom of contract and often will not stand in the way of sophisticated parties who wish to limit or allocate liability by way of contract; however, *Online Healthnow* demonstrates that there are limits to that freedom under Delaware law. While parties may agree to shift the risk of loss between them for misrepresentations the seller is not aware of, and may generally agree to limit the type, time, and magnitude of post-closing claims (including fraud claims), a seller may not misrepresent facts in a contract in order to obtain a buyer's signature, and then rely upon the terms of that contract to avoid the consequences of its fraud.