

# Tips For Drafting Contractual Nonreliance Clauses

By **Amy Park and Niels Melius** (February 13, 2018)

Contractual nonreliance provisions, sometimes called “big boy” letters, have received their fair share of attention. And rightly so. A properly drafted nonreliance provision can be a powerful tool in defeating an adversary’s claim of reliance on extracontractual representations. While much of the discussion about nonreliance provisions has focused on the precision with which they should be drafted, little attention has been paid to the effect forum selection and choice-of-law issues have on such provisions. The choice of where to litigate and which law will govern can significantly impact, if not conclusively determine, the outcome of any dispute involving a nonreliance provision. Practitioners should be as deliberate in choosing their law and forum as they are in drafting their nonreliance terms.



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## Background

Contractual nonreliance clauses are just as their name suggests — assertions that the contracting parties are not relying on anything other than the representations and disclosures in the contract. Nonreliance provisions are frequently included in agreements governing the purchase and sale of investment vehicles, such as partnership or subpartnership interests, or other ownership interests in privately held companies. In that context, nonreliance clauses typically state that: (a) the buyer has made its investment decision based on its own knowledge and independent investigation, without regard to anything the seller has said or not said; (b) the seller may possess material, nonpublic information that has not been disclosed; and (c) the buyer has relied only on the specific representations contained in the parties’ definitive agreement and expressly disclaims reliance on representations not explicitly contained in that agreement.



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In the investment context in particular, nonreliance provisions are often referred to as “big boy” letters because they say, in essence, that the buyer made the investment decision based on its own diligence and is aware of the risk that there may be material information that the seller did not share. Whether referred to as “big boy” provisions or something more appropriately gender-neutral, nonreliance clauses are an important tool parties can use to defeat claims of reasonable reliance on extracontractual statements or information.

While courts regularly encounter contractual disclaimers of reliance, their treatment varies widely. Parties entering into contracts with nonreliance provisions would be wise to consider carefully the forum they select for, and the law that will govern, the resolution of any dispute.

## The Law in Three Common Jurisdictions: Delaware, New York and California

Delaware courts view contractual nonreliance provisions favorably. Although Delaware courts will not enforce murky or even standard integration clauses that lack explicit anti-reliance language, they will enforce provisions agreed to by sophisticated parties that clearly

disclaim reliance on extracontractual representations — even at the pleadings stage. The decision in *FdG Logistics LLC v. A&R Logistics Holdings Inc.*[1] is particularly instructive because it illustrates what will — and will not — be effective in disclaiming reliance on extracontractual information. The Delaware Court of Chancery held that a nonreliance clause did not preclude a buyer’s common law fraud claim. The agreement merely contained a disclaimer by the seller of what it was and was not representing and warranting to the buyer, but did not contain a clear clause from the buyer’s point of view specifically disclaiming reliance on extracontractual representations. The latter is critical.

Delaware federal courts sitting in diversity and adjudicating common law fraud claims have applied Delaware state law concerning nonreliance provisions. Several recent decisions have applied *FdG Logistics* in dismissing fraud claims where the nonreliance language was clear, or denying motions to dismiss or motions for summary judgment where it was not.

In suits alleging federal securities fraud claims, Delaware federal courts follow the rule articulated by the Third Circuit Court of Appeals in *AES Corp. v. Dow Chem. Co.*[2] There, the Third Circuit split with some of its sister circuits, holding that a nonreliance clause may not be enforced to bar a Section 10(b) claim on a motion to dismiss. Notably, the court remarked that declining to enforce a nonreliance clause at the pleadings stage does not render it useless — the clause may nonetheless “establish an absence of reliance and, when unrebutted, may even provide a basis for summary judgment in the defendant’s favor.”

New York law on nonreliance provisions is similar to that of Delaware. While boilerplate disclaimers and standard integration clauses generally will not defeat a fraud claim, specific nonreliance provisions generally will, even at the pleadings stage. However, unlike Delaware, New York recognizes a “peculiar knowledge” exception to nonreliance provisions. Under that exception, a specific disclaimer of reliance can be insufficient to bar a fraud claim where the facts allegedly misrepresented are peculiarly within the defendant’s knowledge. On its face, the exception would appear to render New York an inhospitable forum and choice of law for parties defending fraud claims involving nonreliance provisions. But while the exception can undermine the enforcement of nonreliance provisions in certain contexts, New York state and federal courts applying New York law have held that the “peculiar knowledge” exception does not apply to nonreliance provisions between sophisticated parties that specifically state the buyer is aware the seller has material information beyond the buyer’s ability to discover. Case law regarding the “peculiar knowledge” exception is still evolving and is highly fact-specific.

Second Circuit law is consistent with New York state law. Nonreliance provisions can be used to bar federal securities fraud and common law fraud claims, even at the pleadings stage.

California law stands in stark contrast to the laws of Delaware and New York. In California, it is against public policy to contract away liability for fraud, and several cases have held that parties may not defeat a fraud claim, even by a contractual stipulation, such as a nonreliance clause. As a result, California courts generally are disinclined to enforce nonreliance provisions at the pleadings stage, although the provisions still may be relevant at summary judgment or trial in determining whether a plaintiff reasonably relied on extracontractual statements.

California federal law concerning nonreliance provisions is sparse and appears to be in tension with California state law in at least one respect. In *Applied Elastomerics Inc. v. Z-Man Fishing Products*,[3] a California district court acknowledged that specific nonreliance language may preclude a showing of reasonable reliance on extracontractual statements as

a matter of law.

### **Best Practices for Drafting Nonreliance Provisions**

Given courts' disparate treatment of nonreliance provisions, practitioners should be thoughtful in drafting the disclaimer language, as well as choosing the law that will govern and selecting the forum for litigating any disputes arising out of or relating to the agreements.

#### ***Be Strategic With Choice of Law and Forum***

Consider selecting Delaware or New York law, which generally view contractual nonreliance provisions with equal favor when they are agreed to after negotiation by sophisticated parties with relatively equal bargaining power. California is rather inhospitable to nonreliance provisions.

When it comes to forum, be mindful of the Third Circuit's differing view from Delaware state courts on the enforceability of nonreliance clauses at the pleadings stage. Choosing a Delaware federal forum could yield undesired results in the event of a lawsuit asserting state common law fraud and federal securities fraud claims. A Delaware federal court would apply Third Circuit law to the federal securities fraud claim and Delaware state law to the common law fraud claim, which could produce a counterintuitive result: A properly drafted nonreliance clause likely would bar the common law fraud claim at the motion-to-dismiss stage, but it would not bar the federal securities fraud claim at that stage.

As a result, it may be beneficial to select a New York forum for resolving contract-related disputes, where a carefully worded nonreliance agreement that avoids the pitfalls of the "peculiar knowledge" exception may be enforced as an absolute bar to federal securities fraud and common law fraud claims at the motion-to-dismiss stage. Or, if circumstances permit, one might consider selecting New York as the forum for dispute resolution and Delaware law as the choice of law.

#### ***Use Precise Disclaimer Language and Include an Express Integration Clause***

Although Delaware and New York law do not require specific language, disclaimers of reliance must be unambiguous. The agreement explicitly should state that the buyer (a) had the opportunity to conduct its own due diligence; (b) relied exclusively on its own diligence and sources of information (subject to any specific warranties, which should be designated as exclusive of any others); and (c) disclaims reliance on any representations not expressly made in the agreement. The agreement also should include an integration clause that states that the contract constitutes the entire agreement between the parties and supersedes all prior agreements or representations, whether oral or written.

#### ***Make Your Disclaimers Bilateral***

While most agreements include an express disclaimer by the seller that it is representing or warranting anything beyond what is expressly stated, nonreliance disputes most often concern the sufficiency of the buyer's disclaimer of reliance. As a best practice, make your express disclaimer language bilateral — have the seller expressly disclaim any representations and warranties not expressly stated in the agreement, and have the buyer expressly disclaim reliance on any representations, warranties, statements or information not set forth within the agreement.

### ***Clearly Identify Any Information Withheld***

To the extent possible, your agreement should specify the categories of information the seller did not provide to the buyer and as to which the seller is not making any warranty (e.g., earnings projections and financial statements). Courts generally will enforce nonreliance language that identifies the specific information on which a party has relied and which forecloses reliance on other specified information.

### ***Expressly State the Desire to Proceed Despite Informational Asymmetry***

If applicable, your agreement should contain a statement that there is material information beyond the buyer's ability to discover, of which the seller is aware, and an acknowledgement by the buyer that, notwithstanding this informational asymmetry, the buyer wishes to proceed. Including a specific reference to the existence of information that is beyond the buyer's ability to discover makes the nature of the transaction clear: The specificity will allow a court to impute a knowing assumption of risk to the buyer for choosing to proceed in the face of incomplete information. Courts are loathe to rewrite detailed, bargained-for contractual provisions that clearly have allocated risks between sophisticated parties.

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[1] 131 A.3d 842, 860 (Del. Ch. 2016)

[2] 325 F.3d 174, 180 (3d Cir. 2003)

[3] No. 06-cv-2469, 2006 WL 3251732, at \*6 (N.D. Cal. Nov. 8, 2006)