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CORPORATE ALERT

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Recent Delaware Decisions: Disclaimers of Reliance in Acquisition Agreements; Stockholder & Director Demands for Books and Records under DGCL Section 220

Disclaimers of Reliance in Acquisition Agreements

Delaware courts have recently considered several cases relating to "reliance disclaimers" in acquisition agreements. A disclaimer of reliance is a statement made in a purchase or merger agreement by a party to the agreement (typically the buyer) to the effect that the disclaiming party has not relied on any statements or representations made by or on behalf of the non-disclaiming parties (typically the seller, or its stockholders), other than those set forth in the agreement. A properly drafted disclaimer will preclude the disclaiming party from bringing claims for fraud against the other parties in connection with any extra-contractual statements made by or on behalf of such other parties.[1] However, Delaware courts have consistently held that such disclaimers will only be valid to preclude fraud claims if drafted from the point of view of the disclaiming party.

Since the representations and warranties in an acquisition agreement are carefully negotiated as part of the overall transaction, sellers often try to include language in the agreement that the representations and warranties expressly made by the seller in the agreement are the exclusive representations and warranties of the seller, and that the buyer may not rely on any other statements made by or on behalf of the seller. However, recent Delaware case law makes clear that a statement by a seller that it has made no representations and warranties other than those set forth in the acquisition agreement will not, on its own, be sufficient to preclude aggrieved buyers from bringing fraud claims for such extra-contractual statements. For such a disclaimer to be enforceable, acquisition agreements should also include an affirmative statement by the buyer that it relied only on the representations and warranties of the seller as set forth in the

[1] In order to prove a fraud claim, an aggrieved party must be able to show, in part, that it "justifiably relied" on statements made by the party that it is accusing of fraud. If the parties include a properly drafted and enforceable "disclaimer of reliance" in the acquisition agreement, it can preclude the disclaiming party from bringing fraud claims against the other parties based on any extra-contractual statements made by or on behalf of such other parties, as the aggrieved party would not be able satisfy the "justifiable reliance" element of a fraud claim.

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agreement, and that it did not rely on any other information, statements, representations or warranties of the seller in entering into the agreement.

Several recent Delaware cases illustrate the importance of a properly drafted disclaimer. In *FdG Logistics LLC v. A&R Logistics Holdings, Inc*., the Delaware Court of Chancery refused to dismiss fraud claims being asserted by the buyer against the selling stockholders on the basis of extra-contractual statements allegedly made by such stockholders because the reliance disclaimer in the merger agreement did not include any affirmative expression by the buyer (1) stating specifically what the buyer was relying on when it decided to enter the merger agreement or (2) that the buyer was not relying on any representations made outside of the merger agreement. This affirmed the Court's previous holding in *Abry Partners V, L.P. v. F & W Acquisition LLC* that Delaware contract law "will not insulate a party from liability for its counterparty's reliance on fraudulent statements made outside of an agreement absent a clear statement by that counterparty—that is, the one who is seeking to rely on extra-contractual statements—disclaiming such reliance." In other words, if the buyer is the party seeking to rely on extra-contractual statements made by or on behalf of the seller, the seller's disclaimer of any such statements (rather than the buyer's disclaimer) is not enough to preclude a buyer's fraud claim in connection with such statements.

The Court also referred back to and contrasted its holding in *FdG* with its holding in *Prairie Capital III, L.P. v. Double E Holdings Corp*. In that case, the Court dismissed fraud claims asserted by a buyer based on the seller's alleged extra-contractual representations because the Court found, critically, that the provisions at issue, were, in fact "an affirmative expression by the aggrieved buyer that it had relied only on the representations and warranties in the purchase agreement."

The Court's rationale for such decisions is the state's strong public policy interest against fraud. As the Court explained in *FdG*, it "will not bar a contracting party from asserting claims for fraud based on representations outside the four corners of the agreement unless that contracting party unambiguously disclaims reliance on such statements. The language to disclaim such reliance may vary […] but the disclaimer must come from the point of view of the aggrieved party (or all parties to the contract) to ensure the preclusion of fraud claims for extra-contractual statements under *Abry* and its progeny." Therefore, the parties to acquisition agreements should take care to ensure that the disclaimer language used in the acquisition agreement is carefully drafted to both reflect their intent and be enforced by the courts.

Demands for Books and Records

The Delaware Court of Chancery[2] has also recently addressed several issues with respect to Section 220 of the Delaware General Corporate Law ("DGCL"), which provides directors and, to a more limited extent, stockholders of a Delaware corporation with rights to inspect the corporation's books and records. Specifically, the Court has considered what materials constitute "books and records" of an entity (particularly with respect to electronic records), and when it is appropriate to permit discovery of such materials in connection with a Section 220 demand.

DGCL Section 220 provides that a stockholder of a Delaware corporation has a right to inspect that corporation's books and records "for a proper purpose." The Court has previously interpreted the term "proper purpose" to mean a purpose reasonably related to the requesting party's interest as a stockholder, and not a "mere curiosity" or a "fishing expedition". The Court has specifically included the following purposes, among others, as

[2] Section 220 vests the Chancery Court with exclusive jurisdiction to determine whether stockholders and directors are entitled to the inspections sought thereunder.

"proper" for such a demand: investigating allegedly improper transactions or mismanagement of the company, ascertaining the value of the holder's stock, clarifying unexplained discrepancies in financial statements, investigating the possibility of improper transfers of assets out of the corporation, inquiring into the independence, good faith and due care of a special committees, and communicating with other stockholders about a tender offer.

In *Amalgamated Bank v. Yahoo! Inc.,* the Court recently determined that electronic documents, including those in directors' and officers' personal email accounts, are within the scope of "books and records" under Section 220 if such electronic documents are essential to fulfilling a stockholder's proper purpose in requesting them. As a general rule, in order to discourage nuisance suits, the Court will not permit wide-ranging discovery of the type customary in other civil litigation in response to a Section 220 demand. If a stockholder alleges improper behavior or wrongdoing by the corporation's directors or officers as its purpose in requesting the corporation's books and records, the stockholder must also be able to show a "credible basis" that wrongdoing has occurred before the corporation can be required to produce responsive records. In any event, the scope of the books and records that the stockholder seeks to inspect may not be broader than what is "necessary and essential to accomplish the stated, proper purpose". Plaintiff stockholder Amalgamated Bank instituted a Section 220 demand action against Yahoo claiming wrongdoing in connection with the CEO's and the board's termination of Yahoo's chief operating officer, and seeking access to certain records, including emails in the personal accounts of Yahoo's officers and directors. Specifically, Amalgamated claimed that Yahoo's termination of its COO without cause entitled him to a compensation package that Amalgamated believed he would not have received had he been terminated for cause. The Court determined that the stockholders had met the "credible basis" test to establish potential wrongdoing in connection with this termination, and therefore the stockholders had a proper purpose to request such books and records. The Court ordered Yahoo to provide access to the personal emails of Yahoo's officers and directors to the extent such accounts were used to conduct business. In doing so, the Court stated "[n]ot surprisingly, Delaware precedents have ordered the production of electronic documents and emails in Section 220 actions. […] If [Yahoo's CEO] chose to use a personal email account to conduct Yahoo business, she must produce responsive documents. […] A corporate record retains its character regardless of the medium used to create it."

It is easier for a director of a Delaware corporation to access corporate records. Section 220 also gives directors of a Delaware corporation the right to examine its books and records "for a purpose reasonably related to the director's position as a director", and states that "the burden of proof shall be upon the corporation to establish that the inspection such director seeks is for an improper purpose." These information rights have been described by the Court as "virtually unfettered" so long as the director's purpose is proper, which makes sense in light of the significant responsibilities and fiduciary obligations of directors to the corporation that they serve and its stockholders. However, in *Chammas v. NavLink, Inc.*, the Court recently took a more limited view as to what items properly constitute the books and records of a corporation. In *Chammas*, two directors instituted a Section 220 demand because they felt that they were being excluded from portions of the business before the board of directors. Specifically, the plaintiff directors requested various communications, meeting minutes and draft documents between non-plaintiff directors, management and outside counsel. The Court found that a director's request for communications among corporate directors or officers must: "(1) state a proper purpose, (2) encompass communications constituting books and records of the corporation, i.e., those that affect the corporation's rights, duties, and obligations, and (3) be sufficiently tailored to direct the court to the specific books and records relevant to the director's proper purpose." In contrast to the Court's holding in *Amalgamated*, the Court was unwilling to require that directors disclose all electronic communications between them, as the Court determined that not all communications among directors are necessarily "books and records" of a corporation, even if stored on its

computer servers. The Court stated that "[a]lthough communications containing official corporate documents or other communications, such as acceptance of offers to enter into binding agreements or waivers of legal liabilities, may fall within Section 220's purview, mere conversations, especially in the absence of alleged mismanagement or wrongdoing […] do not rise to the level of corporate records." Therefore, the Court granted the plaintiff directors access to all communications containing draft meeting minutes and documents relating to a material customer contract, which it noted were properly considered the books and records of the company. However, it did not grant the directors access to all communications between directors concerning such meeting minutes or the contract. Similar to *Amalgamated*, this case makes clear that the Court will be interested in the substance, rather than the location, of requested electronic communications. Taken together, these cases also serve as a helpful reminder to officers and directors to keep their personal and business email accounts segregated to decrease the likelihood of commingling personal and business records.

The Court has also recently analogized the inspection rights of stockholders and directors of a corporation under DGCL Section 220 to those of members and managers of an LLC under Section 18-305(a) of the Delaware Limited Liability Company Act. Specifically, in *RED Capital Investment L.P. v. RED Parent LLC*, an individual member and manager of a limited liability company requested certain financial information of a company's wholly-owned subsidiaries under Section 18-305(a) of the Delaware Limited Liability Company Act. Section 18-305(a) sets forth certain categories of information that members and managers are entitled to receive in the absence of limitations set forth in a limited liability company agreement, provided such member or manager can state "a purpose reasonably related to the position."

The Court held that "[t]his language is tantamount to that used in [Section 220] with respect to director requests for corporate information. As such, LLC managers should be afforded similar 'unfettered' access to company books and records, absent restrictions in an applicable LLC agreement. With this context, the Court is unwilling to deprive an LLC holding company's manager of books and records of the company's wholly-owned operating entities – such information is 'reasonably related' to a manager's position as such, and falls within the scope of Section 18-305(a)." This case is also a helpful reminder that statutes will often fill in the gaps if a limited liability company agreement is silent on a particular issue. It is therefore advisable to review such agreements with counsel from time to time in light of changes to laws to ensure that the rights and responsibilities of the members or managers of a limited liability company are in line with the intent and expectations of the parties.

These cases illustrate that directors, officers, stockholders, members and managers of Delaware entities should be mindful of the extent of their rights to access business records and communications under Section 220, which may be limited if a request for such records and communications is not specifically tailored to an appropriate inquiry. These cases should also remind members of these constituencies that Delaware courts may permit other parties to access their personal documents and emails if they contain or relate to business records.

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