Professional Perspective

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In M&A transactions, considerable attention is appropriately paid to what, if any, legal claims will be available post-closing, and against whom such claims can be asserted. Among other things, contractual limitations on legal claims seek to protect affiliates of the seller or target—such as private equity funds and other selling shareholders—who are not themselves parties to the contract or in a position to know the accuracy of the representations and warranties being made.

However, no matter the extent of the contractual limitations, buyers virtually always retain the ability to bring fraudulent inducement claims against defendants who allegedly knew that representations and warranties on which the buyers relied were false. And where a viable fraud claim is pled, innocent affiliates are frequently unable to achieve early dismissal of related unjust enrichment claims against them—thereby frustrating one of the main purposes of many contractual limitations on post-closing litigation.

This article discusses some of the common contractual provisions used to limit post-closing claims, and explains how unjust enrichment claims evade those limits and thus keep innocent selling shareholders exposed to protracted litigation.

Contractual Limitations & Exceptions

Purchase agreements frequently include a host of different provisions that are aimed at contractually limiting a buyer's ability to pursue legal claims post-closing. Such provisions include, but are not limited to:

- **No-Survival Clauses**. By providing that a seller's representations and warranties expire upon closing, “no-survival” provisions generally prevent contractual breach-of-warranty claims. These provisions are frequently paired with clauses dictating the exclusive remedies available to a buyer for breaches of representations and warranties—e.g., indemnification from funds held in escrow within specific limits—absent fraud.

- **Reliance Disclaimers**. By stating that a buyer disclaims reliance on any representations and warranties not expressly set forth in the purchase agreement, reliance disclaimers can effectively limit the universe of statements on which a buyer can plausibly base a claim that it was defrauded to only the express representations and warranties in the written agreement itself.

- **No-Recourse Provisions**. By providing that the terms of an agreement may only be enforced by, and claims based on such terms only pursued against, parties to the written contract, “no-recourse” provisions seek to insulate officers, directors, and affiliates from litigation arising from the transaction. These provisions are often backstopped by express releases of claims.

At their most seller-friendly, these and other provisions could, if applied strictly, preclude buyers from pursuing virtually any post-closing legal claims. But litigation of such claims persists for several reasons.

First, fraud claims are often expressly exempted from certain contractual limitations. In those instances, the parties tend to agree to a specific definition of actionable fraud—by dictating, among other things, whose knowledge counts to make a representation false or misleading, and whether the alleged misstatement must have been made intentionally. The agreements often define “fraud” as narrowly as possible to exclude theories of fraud beyond actual common law fraud, such as “constructive fraud.”

Second, Delaware courts generally decline to dismiss certain specific fraud claims even when the terms of the agreement foreclose their pursuit. In a series of decisions starting with *ABRY Partners V, L.P. v. F&W Acquisition LLC*, 891 A.2d 1032 (Del. Ch. 2006), the Delaware Chancery Court has refused to enforce contractual limitations to prevent fraud claims based on knowingly false misrepresentations contained within a purchase agreement—what courts have come to refer to as “contractual fraud.”

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ABRY Partners involved fraudulent inducement claims arising out of, and aimed at rescinding, a stock purchase agreement pursuant to which one private equity firm sold a portfolio company to entities associated with another private equity firm. Under the terms of the agreement, not only had the portfolio company—and not the private equity seller—made the representations that the buyer claimed were false, but the buyer agreed that indemnification at a capped amount would be its exclusive remedy post-closing.

The court nonetheless declined to dismiss the claim against the seller, holding that "[t]o the extent that the Stock Purchase Agreement purports to limit the Seller's exposure for its own conscious participation in the communication of lies to the Buyer, it is invalid under the public policy of th[e] state." According to the court, if the seller either knowingly made false representations in the agreement or knew that another party's—in that case, its portfolio company's—representations in the agreement were false, the buyer could pursue fraudulent inducement claims in spite of express limits in the contract.

The *ABRY Partners* court emphasized that, to do so, the buyer must prove that the seller acted with "an illicit state of mind" and cannot "escape the contractual limitations on liability by attempting to show [instead] that the Buyer acted in a reckless, grossly negligent, or negligent manner."

Delaware courts have followed *ABRY Partners* in declining to enforce contractual provisions to dismiss fraud claims—for rescission and/or damages—based on written representations allegedly known by the defendants to be false, even when the provisions' language plainly bars such claims. Most recently, in *Online HealthNow, Inc. v. CIP OCL Investments, LLC*, C.A. No. 2020-0654-JRS, 2021 BL 304578 (Del. Ch. Aug. 12, 2021), the Chancery Court considered the extent to which either a no-survival provision or a no-recourse provision could shield defendants from fraud claims based on their alleged knowledge that written representations and warranties made by an affiliated entity were false. Just like in *ABRY Partners*, the Online HealthNow court refused to dismiss the fraud claim, finding that neither provision could insulate parties from liability for intentional fraud.

The upshot of these cases is that no matter the extent of contractual limitations on post-closing claims, fraud claims—against not only the makers of express representations and warranties but their affiliates and shareholders as well—remain viable, provided the buyer can plausibly allege that the defendants knew those representations and warranties were false. And as courts have recognized, that is not a particularly high bar given that all the buyer must do is allege facts making it "reasonably conceivable" that the defendants knew the written representations were false—for instance, because of their alleged involvement in the management of the target company and/or the process pursuant to which the target company is sold.

Insulating Shareholders From Unjust Enrichment Claims

The ever-present potential for fraud claims, however, does more than just prevent parties from contractually insulating allegedly intentional wrongdoers from suit. One lesser-considered consequence of the *ABRY*-inspired doctrine is that it frequently permits unjust enrichment claims to be maintained against even admittedly innocent sellers—i.e., parties who arguably benefitted from the alleged fraud without having participated in it—thereby further undermining the intent of the parties to protect such non-contracting affiliates.

At a high level, unjust enrichment is an equitable claim that accuses the defendant of unjustly benefitting from the wrongful conduct of another to the plaintiff's detriment. Such claims are generally foreclosed by the existence of a comprehensive contract that governs the parties' relationship and rights. While that should prevent unjust enrichment claims in most post-closing M&A litigation, such claims are fairly routine by virtue of an important exception to the doctrine: Where the contract itself allegedly arose from wrongdoing—like fraud—the contract's existence will not preclude unjust enrichment claims against beneficiaries of a transaction.

As a result, if a buyer pleads a viable fraudulent inducement claim against at least one defendant associated with the sale, unjust enrichment claims against others—even those who are not alleged to have been involved in the underlying fraud—are generally permitted to proceed. Unjust enrichment claims are most often pled in the alternative to fraud claims, such that if a defendant accused of fraud is eventually absolved of wrongdoing, it may still be liable for unjustly benefitting from another's wrongdoing. Thus, by excepting certain post-closing fraud claims from restrictive contractual limitations and permitting more such claims to proceed, *ABRY Partners* and its progeny also expose innocent shareholders who received merger consideration to unanticipated post-closing litigation.

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It is not difficult to conceive of contractual provisions that, if applied, would equip innocent shareholders with an argument that tag-along unjust enrichment claims are foreclosed. One way that parties have seemingly attempted to do so is to make clear—for example as part of a fraud carve-out from an exclusive remedy provision or a no-recourse provision—that no party affiliate may be liable for, or as a result of, another party's fraud. An unjust enrichment claim against shareholders who allegedly benefitted from fraudulent misrepresentations made by others would arguably run afoul of such a limitation.

However, the extent to which courts will enforce contractual provisions to dismiss such claims remains an open question. In at least two cases, the Chancery Court has acknowledged the possibility that the terms of a contract would prohibit equitable unjust enrichment claims, but did not reach the issue in either instance. In *Great Hill Equity Partners IV, LP v. SIG Growth Equity Fund I, LLP*, C.A. No. 7906-VCG, 2014 BL 335925 (Del. Ch. Nov. 26, 2014), the purchase agreement at issue limited indemnification claims against shareholders to a specific fund, but the exclusive remedy provision carved out "case[s] of fraud . . . for which no limitations set forth herein shall be applicable."

The Chancery Court queried whether "[b]y limiting indemnification rights to a fund, [] the parties mean[t] to preclude a remedy for unjust enrichment arising from fraud against innocent stockholders." However, the court declined to decide the issue due to inadequate briefing. It instead ruled that "assuming the Plaintiffs can prove that the Moving Defendants profited, and the Plaintiffs were impoverished, as the result of the non-moving Defendants' fraud; and assuming that Plaintiffs are unable to implicate the Moving Defendants in that fraud, unjust enrichment would be invoked."

And in *LVI Group Investments, LLC v. NCM Group Holdings, LLC*, C.A. No. 12067-VCG, 2018 BL 107031 (Del. Ch. Mar. 28, 2018), the exclusive-remedy provision specifically excluded only "claims for fraud against the Person who committed such fraud." But there, the court held that the provision did not defeat the unjust enrichment claim at the pleading stage due to an ambiguity with respect to the defendants' standing to invoke the provision. As in Great Hill, the court ruled that the plaintiff "may be able to show that [certain] Defendants, though not liable for fraud themselves, profited from the fraud committed by the other Defendants" and are therefore liable for unjust enrichment.

When the issue is squarely presented, courts will have to decide whether to strictly enforce the contract as written or abide by the longstanding principle that contracts elicited by wrongdoing do not preclude unjust enrichment claims. Put another way, can an innocent shareholder sued for unjust enrichment rely on a provision in a contract that the plaintiff claims is itself invalid because it was induced by fraud, albeit fraud committed by someone else?

Conclusion

In *ABRY Partners* and subsequent cases, the courts had to decide whether the public policy against fraud outweighed the parties' freedom to contract, and if so, to what extent. In finding that it did with respect to certain types of fraud claims, those courts were motivated by a desire to keep intentional wrongdoers on the hook. But a consequence of those cases—perhaps one that was not anticipated—has been that innocent non-parties are exposed to the burdens of litigation alongside alleged wrongdoers. Such litigation can be especially vexing for innocent non-parties given that the applicable contracts oftentimes expressly eliminate or severely restrict their exposure.

To reduce the risk of such unanticipated litigation, sellers and their counsel should consider specifically addressing unjust enrichment and related claims that are inevitably tacked onto allegations of fraud when negotiating limitations on post-closing claims. Though the legal landscape remains unsettled, it can be safely assumed that the more explicit the contractual prohibition on equitable claims is, the greater the likelihood that sellers' affiliates can avoid the inherent unfairness that such claims pose.

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