

Are hints disclosures? Delaware Supreme Court revives M&A fraud claim despite buyer's red flags

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The Delaware Supreme Court's recent opinion in *Paragon Metals v. Smith*¹ is a pointed reminder for M&A dealmakers: hints, partial disclosures, or due diligence "red flags" may not neutralize false contractual representations when the seller is actively concealing the truth.

Willful blindness requires more than missed red flags; the buyer must subjectively believe there is a high probability of the truth and then take deliberate steps to avoid learning it.

The case involved a CEO's strategy to conceal damaging information about the target company while still attempting to avoid a fraud claim by providing enough hints about the situation to arguably put the buyer on inquiry notice about the issues.

In reversing a trial court opinion, the Delaware Supreme Court held that the buyer could justifiably rely on the CEO's representations despite imperfect due diligence because the CEO concealed critical customer-loss information and responded untruthfully when pressed.

For M&A practitioners, the opinion sharpens several recurring issues, including when flawed due diligence becomes willful blindness, what standard of proof applies to Delaware fraud claims, how broadly a forward-looking "no material adverse effect" representation may reach, and what anti-reliance language can — and cannot — do.

Background

The transaction

The day after a private equity sponsor closed its \$100 million acquisition of an automobile parts manufacturer, it learned that two of the target company's largest customers intended to materially reduce their future purchases.

The revenue impact was severe enough that the buyer later defaulted on the acquisition financing and injected an additional \$37 million into the company to avoid bankruptcy.

The purchase agreement contained two seller and CEO representations that became central to the fraud claim:

- *No material adverse effect (MAE)*: No fact, event or circumstance had occurred or arisen that had or would reasonably be expected to have a material adverse effect on the company; and
- *Customers and suppliers*: The company had not received notice from key customers, and neither the company nor the CEO had any knowledge that any key customers would stop, decrease the rate of, or change the terms with respect to buying products from the company.

The agreement also included a typical anti-reliance provision, by which the buyer acknowledged that it had "conducted to its satisfaction an independent investigation" and had relied on both that investigation and the representations and warranties expressly made in the purchase agreement.

The litigation

The buyer sued the CEO for common law fraud, claiming that he gave false "no MAE" and customer/supplier representations.

After a five-day trial, the Delaware Superior Court entered judgment for the CEO; although it found that the CEO's representations were false and that he intended to defraud the buyer, it held that the buyer could not show justifiable reliance because the buyer had made itself willfully blind to the truth.²

More specifically, the trial court held that:

- The CEO acted with intent to defraud. Before closing, two key customers told him about intended purchase reductions, and the record included evidence that he withheld a customer letter, pushed to remove volume-reduction details from an amended customer contract, paid a \$300,000 rebate to the customer through a foreign affiliate to keep the payment off the company's books, destroyed his company-issued phone,

and failed to update financial projections that had become inaccurate.

- Even so, the trial court held that the buyer had not justifiably relied on the CEO's representations. In the trial court's view, the buyer knew or should have known about the purchase reductions because due diligence and customer meeting preparation materials revealed red flags that the buyer failed to pursue.

On appeal, the Delaware Supreme Court reversed on justifiable reliance and remanded for damages, holding the buyer's imperfect due diligence did not defeat reliance where the CEO's concealment efforts helped keep the truth from the buyer.

Key takeaways

The Court's analysis yields four key lessons for M&A deal teams.

- Fraud claims are subject to the preponderance of the evidence standard — not a heightened clear and convincing evidence standard. The CEO argued that a "clear and convincing" evidentiary standard applies to fraud claims because fraud allegations carry moral stigma and can rest on circumstantial evidence. The Court rejected that argument and confirmed that ordinary civil preponderance remains the standard for Delaware fraud claims, noting³ that Delaware's heightened pleading requirements already help screen out meritless claims.
- Events that threaten acquisition financing may help establish a material adverse effect. Proving an MAE remains difficult under Delaware law, so the trial court's MAE finding is noteworthy.⁴ The "no MAE" representation was forward looking, and the trial court found it false because extensive changes to the target's business with two major customers made it reasonably likely that the company would default on its acquisition financing and face bankruptcy. The Delaware Supreme Court affirmed that falsity finding because the CEO did not challenge the trial court's conclusion. Although the MAE issue was not the focus of the appeal, the case is still a useful warning for sellers. A forward-looking "no MAE" representation may require consideration not only of the company as operated pre-closing, but also of how known adverse developments may affect the post-closing company in light of the buyer's financing and capital structure. The record also cautions against overreading the holding: the trial court noted that the buyer attributed the financing default to multiple factors, including COVID and a General Motors strike, so the customer reductions alone may not have been the full story. The practical point is that sellers should assess forward-looking MAE representations against the real-world consequences of known adverse developments and disclose facts that could trigger those consequences.
- A buyer cannot be willfully blind, but a seller's fraud is not excused by imperfect due diligence. The buyer had to prove justifiable reliance even though its due diligence revealed warning signs. The trial court concluded that the buyer failed that test because it had enough information to ask sharper follow-up questions and failed to do so, making itself willfully blind to the falsity of the CEO's representations. The Delaware Supreme Court disagreed. It acknowledged that reasonable reliance can be difficult to assess, but emphasized that Delaware law does not allow contracts to insulate a party from damages or rescission for fraudulent conduct. Willful blindness requires more than missed red flags; the buyer must subjectively believe there is a high probability of the truth and then take deliberate steps to avoid learning it. Here, the record did not show that the buyer deliberately avoided the truth. The buyer asked questions, the CEO concealed information or answered untruthfully, and the buyer therefore could justifiably rely on the CEO's contractual representations. For sellers, the message is blunt: oblique references and "clues" in due diligence materials are not a substitute for accurate contractual disclosures. A seller facing negative developments should not assume it can preserve a fraud defense by saying just enough to create a later argument that the buyer was on inquiry notice. Such a strategy is risky because the seller still must overcome a high bar to show that the buyer deliberately avoided the truth.
- A typical anti-reliance clause is not a back-door due diligence covenant or conclusive proof. The agreement's anti-reliance provision said the buyer had conducted to its satisfaction an independent investigation and relied on that investigation and the CEO's contract representations. The trial court treated that language as imposing an obligation to conduct reasonable due diligence. The Delaware Supreme Court disagreed, holding that the provision served the limited purpose of waiving extra-contractual fraud claims and, at most, referred to an investigation that satisfied the buyer's own subjective standard. Because the agreement did not hold the buyer accountable for failing to conduct reasonable or effective due diligence, the buyer's imperfect due diligence did not, as a contractual matter, bar reliance on the CEO's contractual representations. The Court also rejected the buyer's effort to use the same anti-reliance language as conclusive proof of justifiable reliance. Consistent with *Johnson & Johnson v. Fortis Advisors*,⁵ the Court treated the provision as one-sided language with a limited scope, designed to protect the seller from extra-contractual claims, not as a shortcut for proving reliance on contractual representations. Taken together, these holdings reinforce that justifiable reliance is a fact-intensive inquiry. Contractual recitals and anti-reliance provisions remain important, but they are unlikely to conclusively establish that a party did — or did not — justifiably rely on contractual representations or conduct sufficient due diligence.

Practical guidance

For sellers and target management:

Disclose adverse developments directly in disclosure schedules. The CEO in this case provided references to customer issues in emails, due diligence materials, and even a stricken line in draft documents. But because the specific adverse information was not disclosed on the schedules qualifying the representations, the representations were still held to be false.

For sellers, the message is blunt: oblique references and “clues” in due diligence materials are not a substitute for accurate contractual disclosures.

If a seller has knowledge of facts that would contradict a representation, those facts should be expressly disclosed on the applicable schedule, regardless of what the buyer might have learned independently.

Answer due diligence questions truthfully. The Court found that when the buyer asked about a stricken reference to a “letter from [a customer]” about decreased purchases, the CEO falsely represented that the purchase volume would be net-neutral, when he knew it would not. That misrepresentation undermined any argument that the buyer should have discovered the truth on its own.

Consider how adverse developments may compound under the target’s post-closing capital structure. A forward-looking “no MAE” representation may be breached if the seller knows of facts that, when combined with the buyer’s expected financing arrangements, could trigger a financing default or bankruptcy risk.

Sellers should assess not just how known adverse developments affect the company in isolation, but how they might cascade through the buyer’s post-closing financial arrangements.

Concealment activity is powerful evidence of scienter. The record included evidence that the CEO withheld a customer letter, pushed to remove volume-reduction details from an amended contract, routed a rebate payment through a foreign affiliate, and destroyed his company-issued phone. Even if each action had an innocuous explanation in isolation, the pattern painted a picture of intent to defraud.

For buyers and investors:

Follow up on red flags with specific questions and document the responses. The buyer in this case prepared questions about anticipated volume decreases and even flagged a reference to a customer cancellation letter,

but the lead negotiator did not ask those questions in customer meetings.

The trial court found this to be evidence of willful blindness, and the Supreme Court only reversed because the CEO concealed information and answered untruthfully when pressed. Had the CEO answered truthfully, the buyer’s failure to follow up may well have defeated its fraud claim.

Read and digest all due diligence communications.

The CEO sent the buyer an email that specifically referenced the customer cancellation letter and summarized its contents. The buyer’s failure to read that email was noted by the trial court, but the Supreme Court ultimately held this did not defeat reliance because the CEO stated in the same email that he would discuss the items later.

Do not rely on anti-reliance clauses to establish justifiable reliance.

The buyer attempted to use the agreement’s acknowledgment that it had “relied on” the seller’s representations as conclusive proof of justifiable reliance. The Court rejected this interpretation, holding that the one-sided anti-reliance provision was designed to protect the seller from extra-contractual claims, not to serve as a shortcut for proving reliance on contractual representations.

Sellers cannot assume that partial disclosures, hints in due diligence materials, or oblique references will insulate them from fraud liability if their representations turn out to be false.

Incorporate known due diligence findings into valuation models and closing conditions. The buyer failed to update its deal model to reflect the softening market conditions and declining volume projections that were disclosed during due diligence.

While the buyer ultimately prevailed on appeal, the case is a reminder that buyers can strengthen their position by maintaining a clear audit trail of how diligence findings are incorporated into deal economics and risk allocation.

Conclusion

Paragon Metals reinforces that M&A fraud claims turn on the specific facts of the transaction and the conduct of the parties.

Sellers cannot assume that partial disclosures, hints in due diligence materials, or oblique references will insulate them from fraud liability if their representations turn out to be false.

Buyers, for their part, must conduct meaningful due diligence and follow up on red flags — not because they can rely solely on due diligence to defeat a fraud claim, but because a court

may find that failing to ask obvious questions when warning signs appear constitutes willful blindness.

The case is a reminder that contractual provisions can allocate some risks, but they cannot fully immunize either party from the consequences of dishonesty or deliberate ignorance.

Notes:

¹ *Paragon Metals Holdings LLC v. Smith*, ___ A.3d ___, No. 385, 2025, (Del. July 1, 2026), <https://bit.ly/3TsTOoO>.

² *Paragon Metal Holdings LLC v. Smith*, C.A. No. N21C-12-090 SKR CCLD (Del. Super. August 13, 2025), <https://bit.ly/4xlRHSG>.

³ *Sofregen Medical Inc. v. Allergan Sales, LLC*, C.A. No. N20C-03-319 EMD CCLD (Del. Super. September 26, 2024), <https://bit.ly/3TGAWTe>, ("While in

some jurisdictions fraud must be shown by clear and convincing evidence, the burden of proof in a fraud case in Delaware is by a preponderance of the evidence."), affirmed 349 A.3d 1148, No. 28, 2025 (Del. 2025), <https://bit.ly/3TCgMd3>.

⁴ "A contractual material adverse effect ('MAE') is like a Delaware tornado — frequently alleged but rarely shown to exist." *ChyronHego Corporation v. Wight*, C.A. No. 2017-0548-SG (Del. Ch. July 31, 2018), <https://bit.ly/4ySfqLj>; "Buyers seeking to enforce a MAE clause ... face a heavy burden to prove an adverse change in the target's business that is consequential to the company's long-term earnings power over a commercially reasonable period." *Project Boat Holdings, LLC v. Bass Pro Group, LLC*, C.A. No. 12606-VCS (Del. Ch. May 29, 2019, revised June 4, 2019), <https://bit.ly/3ROnKv2>, (cleaned up).

⁵ *Johnson & Johnson v. Fortis Advisors LLC*, 352 A.3d 229, No. 490, 2024 (Del. 2026), <https://bit.ly/4fMDKWb>, (holding that an anti-reliance provision is to be understood within the scope of its terms and that a one-way provision cannot be read expansively to provide mutual benefit).

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