Delaware Supreme Court Ruling Suggests Potential Buyers in M&A Deals Likely Have Limited Recourse Against Sellers Prior to Signing Agreement

The Delaware Supreme Court recently reminded potential buyers in M&A transactions that they likely will have very limited, if any, remedies or recourse against the seller in connection with the potential transaction until an agreement is signed. In RAA Management, LLC v. Savage Sports Holding, Inc., the Delaware Supreme Court upheld a superior court ruling dismissing a claim by RAA (a private equity firm) seeking due diligence and negotiation costs that RAA incurred while pursuing an acquisition of Savage prior to learning late in the due diligence period of certain significant liabilities that Savage failed to disclose earlier in the process. The dismissal was upheld based on the non-disclosure agreement between the parties that included broad, though relatively standard, non-reliance and waiver clauses.

Background

When RAA first expressed interest in purchasing Savage, the parties entered into a non-disclosure agreement prior to RAA obtaining confidential documents and information from Savage to initiate due diligence. The non-disclosure agreement (NDA) stated that Savage was not “making any representation or warranty, express or implied, as to the accuracy or completeness of ... any ... information” it provided to RAA during due diligence. Additionally, the non-disclosure agreement stated that “[o]nly those representations or warranties that are made ... in the [s]ale [a]greement when, as and if it is executed, and subject to such limitations and restrictions as may be specified [in] such a [s]ale [a]greement, shall have any legal effect.”

Upon executing the non-disclosure agreement, RAA conducted preliminary due diligence on Savage. A few months later, the parties entered into a letter of intent, after which RAA conducted further due diligence. During such further diligence, now several months after signing the NDA and commencing the diligence process, RAA learned of three significant liabilities of Savage, any one of which, according to RAA, “would have caused RAA to have never attempted to acquire Savage.” Additionally, according to RAA, Savage was aware of these liabilities long before they were finally disclosed to RAA and made affirmative statements to RAA during the earlier stages of the diligence process that no such liabilities existed. In light of this new information, RAA terminated negotiations before a final sale agreement was entered and brought suit against Savage in the Delaware Superior Court, demanding payment for “sunken due diligence costs’ of $1.2 million.”

The Superior Court dismissed RAA’s suit for failure to state a claim. RAA appealed, arguing, among other things, that the non-reliance and waiver clauses of the non-disclosure agreement were not intended to bar claims based on “willful falsehoods” and that the “peculiar knowledge” of
Savage with respect to the liabilities removed RAA’s claims from the scope of the non-reliance provisions under New York law.

Delaware Supreme Court Opinion

In affirming the dismissal, the Delaware Supreme Court emphasized the intent and language of the non-disclosure agreement and the context in which it was entered into—namely, between two sophisticated parties negotiating a sophisticated M&A deal. The court noted that the intent of the non-disclosure agreement was clear: it was “designed to require ... [waiver of] any deficiencies in due diligence as basis for suit, unless that deficiency constituted a breach of representation or warranty in the resulting merger agreement.” Furthermore, the court found the language to be unambiguous and “virtually identical” to non-disclosure language enforced in other instances.

The court cited several previous cases for the proposition that express disclaimers should be enforced, even in the context of potential fraud or intentional misrepresentation. The court relied on policy considerations, along with the weight of the precedent, in reaching its conclusion. In summarizing its analysis, the court wrote:

The efficient operation of capital markets is dependent upon the uniform interpretation and application of the same language in contracts or other documents. The non-reliance and waiver clauses in the NDA preclude the fraud claims asserted by RAA against Savage. Under New York and Delaware law, the reasonable commercial expectations of the parties, as set forth in the non-reliance disclaimer clauses in Paragraph 7 and the waiver provisions in Paragraph 8 of the NDA, must be enforced.²

Takeaways from RAA Management

Given the court’s straightforward and unambiguous decision in the face of arguably egregious facts, much can be learned from this opinion. Buyers should be aware that they will likely have limited, if any, recourse against the seller for sunken costs or any other losses incurred by the buyer in connection with the transaction if a definitive agreement is not signed, unless they are able to negotiate explicit exceptions or modifications to standard non-reliance and waiver clauses that are ordinarily included in NDAs signed in connection with M&A deals (which may not be possible depending on the deal dynamics and the parties’ relative leverage) or otherwise negotiate expense reimbursement or other protections in case the deal is not consummated for various reasons. Buyers should recognize that this is true even if the reason for the failed deal is less-than-fulsome, or even fraudulent, disclosures by the seller in the due diligence process. In light of this reality, buyers should enter into the due diligence process with full knowledge of this potential risk and consider whether it is possible, under the circumstances, to delay relatively expensive aspects of the due diligence review (e.g., outside consultants) until later in the due diligence process when a deal is more certain.

On the other side, sellers should ensure that their NDAs contain standard non-reliance and waiver clauses of the type at issue in RAA Management and resist making any changes to these clauses. Given the clear statements in RAA Management that standard non-reliance and waiver clauses generally result in no potential liability for sellers, any deviation from standard language may be interpreted as meaning the parties meant something different, thereby potentially exposing sellers to unclear results.

² Mayer Brown | Delaware Supreme Court Ruling Suggests Potential Buyers in M&A Deals Likely Have Limited Recourse Against Sellers Prior to Signing Agreement
As the court in *RAA Management* explained, sellers have a distinct interest in ensuring that buyers have no ability to bring claims against them based on alleged misstatements or omissions in the due diligence process out fear that any failed deal could be the source of an action for expense reimbursement based on such theories, however warranted. Therefore, in most instances, sellers would be well-served by sticking with standard disclaimers in this context.

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*For more information about RAA Management or any other matter raised in this Legal Update, please contact any of the following lawyers.*

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*The authors wish to thank summer associate Stephanie Mills for her assistance with this Legal Update.

### Endnotes


2. Though the case was heard by the Supreme Court of Delaware, it was actually decided under New York law. The Supreme Court stated, however, that had the case been decided under Delaware law the outcome would have been the same.