M&A NOTES

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Two recent Federal Court Decisions raise serious questions regarding the enforceability of certain important "boiler plate" provisions in the typical confidentiality agreements used in the proposed sale of the stock of a company and in merger agreements.

Both cases concern variations on a clause which provided that: "We [the proposed buyer] acknowledge that neither you [proposed seller], nor seller's investment banker . . . make any express or implied representation or warranty as to the accuracy or completeness of the Information being provided, and we agree that no such person will have any liability relating to the Information or for any errors therein or omissions therefrom. We further agree that we are not entitled to rely on the accuracy or completeness of the Information and that we will be entitled to rely solely on any representations and warranties as may be made to us in any definitive agreement with respect to the Transaction, subject to such limitations and restrictions as may be contained therein."

In both cases, the Offering Memorandum (which was part of the "Information") included projections. Each offering memorandum also included a statement to the effect that "[o]nly those particular representations and warranties which may be made to a purchaser in a definitive agreement, when, as, and if executed, and subject to such limitations and restrictions as may be specified in such definitive agreement, shall have any legal effect."

The two decisions (*AES Corp. v. Dow Chemical Co.*, 325 F.3d 174 (3d Cir. 2003) and *Citibank v. Itochu International, Inc.*, 2003 WL 1797847 (S.D.N.Y. April 4, 2003)) both involve an obscure provision of the securities laws — Section 29(a) of the Securities Exchange Act of 1934. Section 29(a) provides that: "[A]ny condition, stipulation, or provision binding any person to waive compliance with any provision of this chapter or of any rule or regulation thereunder, or of any rule of an exchange required thereby shall be void." 29 U.S.C. § 77cc(a). That provision has long been applied to strike down some clauses which, read literally, do not speak to waiving compliance with the federal securities laws at all, but which have the practical effect of limiting the ability of parties to bring securities fraud claims. To bring a securities fraud claim, a plaintiff must allege that it reasonably relied on the representation it alleges to have been fraudulent. In the first federal appellate decision to address the issue, the First Circuit held void a contractual provision in which a buyer in a securities transaction acknowledged he was not relying on any representation by the seller. (For ease of reference, we will refer to all such clauses, including those that are narrower than the one at issue in the First Circuit case, as "no other representation clauses.") *See Rogen v. Ilikon Corp.*, 361 F.2d 260 (1st Cir. 1966). As the First Circuit discussed the clause before it:

> This is not, in its terms, a "condition, stipulation or provision binding . . ." (plaintiff) to waive compliance with the Securities Act of 1934, as set forth in Section 29(a) of the Act. But on analysis, we see no fundamental difference between saying, for example, "I waive any rights I may have because of your representations or obligations to make full disclosure" and "I am not relying on your representations or obligations to make full disclosure."

Id. at 268 (citation and footnote omitted).

"No other representation" clauses are common in M&A transactions. They are a standard element of the confidentiality agreements that investment banking firms require prospective buyers to sign in order to obtain offering memoranda and other information. Accordingly, the enforceability of these clauses is an important issue.

In 1996, the Second Circuit held that Section 29(a) should *not* be applied to strike down a "no other representation" clause in a sale contract. Kirkland & Ellis represented the prevailing party in that case. *See Harsco v. Segui*, 91 F.3d 337 (2d Cir. 1996). The Second Circuit decision did not reject the First Circuit *Rogen* decision, but held that Section 29(a) was inapplicable to the contract before it. The *Harsco* opinion emphasized that the no other representation clause at issue was narrower than in *Rogen* and that the contract at issue included a customized list (set out in fourteen pages of

single-spaced text) specifying exactly what representations the seller was and was not making. As the Second Circuit explained:

> Harsco bought Section 2.04's fourteen pages of representations. Unlike a contractual provision which prohibits a party from suing at all, the contract here reflects in detail why Harsco bought MultiServ — in essence, Harsco bought the representations and, according to [the no other representation clauses], nothing else.

Id. at 344.

Unfortunately, the Third Circuit has now created a split of the Federal Courts of Appeals by rejecting the Second Circuit's reasoning in *Harsco*. Thus, the Third Circuit has now decided:

> [I]f a party commits itself never to claim that it relied on representations of the other party to its contract, it purports anticipatorily to waive any future claim based on the fraudulent misrepresentations of that party. The same is true if the commitment is more limited, *e.g.*, a promise not to claim reliance on any representation not set forth in the agreement. The scope of the anticipatory waiver is more limited, but it is nevertheless an anticipatory waiver of potential future claims under Rule 10b-5.

AES Corp. v. Dow Chemical Co., 325 F.3d 174, 180 (3d Cir. 2003). The difference between the Third Circuit's approach and the Second Circuit decision in *Harsco* is not just academic. In *Harsco*, the Second Circuit affirmed a District Court decision dismissing (without discovery or trial) all of the federal securities claims in the case. In contrast, in *AES Corp.*, the Third Circuit reversed a District Court decision that had granted the defendant summary judgment dismissing all of the plaintiff's federal securities claims.

The second of the two recent decisions comes out of the Southern District of New York, where *Harsco* is still supposed to be binding law. Based on the District Court opinion, the "no other representation" clause in the acquisition agreement at issue in this new case seems to have been no broader than the clause in *Harsco*: that is, it did not disclaim reliance on all representations, but only those representations outside the sale contract. *See Citibank v. Itochu International Inc*., 2003 WL 1797847 (S.D.N.Y. April 4, 2003). Nonetheless, the *Citibank* opinion denied a motion to dismiss the securities fraud claims in that case, deciding without explanation that the clause before it was broader than the clause in *Harsco*.

These issues should be dealt with in the drafting of confidentiality agreements, offering memoranda and merger agreements. Otherwise, they have the potential to dramatically increase litigation risks. For example, these decisions make it more likely that dissatisfied buyers will file securities fraud suits against both the seller and its investment banker and make it harder for the defendant to win those cases on threshold motions.

Should you have any questions about the matters addressed in this issue of *M&A Notes*, please contact either of the following Kirkland & Ellis authors or the Kirkland & Ellis partner you normally contact.

Stephen Fraidin
(212) 446-4840

Yosef J. Riemer
(212) 446-4802

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