Private investment transactions between sophisticated parties often include a negotiated agreement, sometimes called a "big boy letter," in which the buyer acknowledges that it has made its own independent assessment of the risks involved, including that the seller or other counterparty may possess material, non-public information regarding the issuer which has not been disclosed to the buyer. Big boy letters typically contain a non-reliance provision in which the buyer represents that it has made its investment decision based on its own knowledge and investigation without regard to anything the seller has said or not said (or only relied on specific representations contained in the parties' definitive agreement). A non-reliance provision that is not boilerplate, but instead the product of negotiation between sophisticated parties dealing at arm's-length, may negate allegations of reasonable reliance on any extra-contractual representations.

The effect of non-reliance provisions on buyer claims alleging extra-contractual representations, however, has varied. The main line of division in the cases is whether a non-reliance provision may render reliance on extra-contractual representations unreasonable as a matter of law, or is only evidence relevant to reliance. A recent Ohio federal court decision in *In re National Century Fin. Enterp. Inv. Litig.*, giving post-discovery summary judgment dismissing state law fraud and negligent misrepresentation claims asserted against a placement agent in a private securities offering, gives strong support to big boy letters as an enforceable mechanism to allocate risk by delineating the scope and content of contractual representations and bar claims predicated on extra-contractual representations.

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Reception in the Courts and at the SEC

In a big boy letter, parties to a business or investment transaction acknowledge and represent that one party, usually the seller or its agent, may have non-public information regarding the underlying company, whether material or not, but because both are "big boys," they have decided to enter into the transaction notwithstanding the information asymmetry and its potential effect on pricing. A big boy letter typically includes a series of negotiated acknowledgments and representations from the buyer, including that "it is financially sophisticated; it is aware that the counterparty may have material, non-public information that may affect the value of the traded securities; it realizes that it is not privy to any such information, if there is any; it is not relying on any of its counterparty's non-disclosures, if there are any; it is not relying on any representations not expressly set forth in the big boy letter; it is waiving all claims against its counterparty arising out of the non-disclosure; and finally, it realizes the effect of this waiver and elects to proceed with the transaction, essentially stating, 'I am a big boy.'"

Chief among the virtues of non-reliance provisions is that contracting parties understand exactly what has and has not been represented, allowing each side to make a fair evaluation of the value of the transaction to it. Moreover, the buyer may be able to obtain a discounted price to compensate it for its assumed risk. A sophisticated party's express disclaimer of reliance on extra-contractual representations should preclude it from contending post-closing that it reasonably relied on such representations. A properly drafted big boy letter therefore may eliminate or limit potential liability of the seller and its representatives to the buyer under both federal securities laws and any common law claim requiring proof of reasonable reliance.

A brief aside from the private litigation context is needed to note important distinctions relating to the Securities and Exchange Commission (SEC). First, non-reliance clauses will not bar an enforcement action because reliance and damages are not elements of a securities fraud claim brought by the SEC. In the context of potential insider trading liability under the securities laws, when a purchaser of securities has been advised that the seller holds material non-public information, there is little or no room for insider trading liability under the "classical" theory of insider trading liability, which is predicated on fraud by a corporate insider on other traders. The SEC Enforcement Division has taken the position, however, that a big boy letter does not foreclose potential insider trading liability under the "misappropriation theory" of liability.
Under the "misappropriation" theory approved by the Supreme Court in *United States v. O'Hagan*, trading on the basis of non-public information by a corporate "outsider" in breach of a duty owed not to a purchaser or seller of the stock, but to the source of the information also is unlawful. The SEC takes the view that a fraud on the source of the confidential information is unaffected by a big boy letter. Moreover, although the SEC has not yet adopted an official position on the enforceability of big boy letters, certain Commissioners and senior members of the Enforcement Division have publicly expressed concern about the enforceability of big boy letters and non-reliance provisions to bar private federal securities claims.

In the context of transactions that may give rise to a private federal securities law claim, in addition to evaluating what the parties agreed to as a contract matter, the application of non-reliance provisions requires consideration of §29(a) of the Securities Exchange Act. Section 29(a) voids any purported waiver of compliance with federal securities laws. The case law generally recognizes an important distinction between a prohibited outright waiver of compliance with the securities laws, and a permissible negotiated agreement that negates a sophisticated party's ability to allege reliance on any extra-contractual representation.

The Second and Seventh Circuits have held that a particularized non-reliance clause agreed to by sophisticated parties that merely allows the parties to define, in writing, the material representations on which the buyer and seller both relied does not constitute a waiver of compliance with the federal securities laws. Where a sophisticated party in an integrated contract specifically disclaims reliance on representations not contained in the contract, interests in confirming reasonable commercial expectations counsel that the party cannot, in a subsequent action for fraud or other claim requiring proof of reasonable reliance, argue it was fraudulently induced to enter into the contract by a representation on which it has disclaimed reliance.

In *Harsco v. Segui*, the U.S. Court of Appeals for the Second Circuit affirmed the dismissal of a buyer's SEC Rule 10b-5 claims alleging reliance on extra-contractual representations, holding that the presence of a non-reliance clause in an acquisition agreement negotiated by sophisticated parties, in the context of 14 pages of specific representations and warranties, established that the sophisticated purchaser could not have reasonably relied on the extra-contractual representations. Though the non-reliance provision could "be described as weakening Harsco's ability to recover" under the securities laws," it did "not constitute a forbidden waiver of compliance."
The court emphasized that the analysis—which in *Harsco* was conducted in the Rule 12(b)(6) context—is "a question of degree and context." In *Harsco* plaintiff had "not waived its rights to bring any suit resulting from this deal." Each specific representation of the seller in *Harsco* was "a tooth which adds to the bite of" the non-reliance provision and merger clause in the sale agreement. "In different circumstances," the court cautioned, "(e.g., if there were but one vague seller's representation) a 'no other representations' clause might be toothless and run afoul of §29(a)."

Similarly, the Seventh Circuit in *Rissman v. Rissman*,7 affirmed summary judgment dismissing a buyer's Rule 10b-5 claims alleging oral misrepresentations notwithstanding a non-reliance provision in a stock purchase agreement. The court held that a non-reliance clause "precludes any claim of deceit by prior representations," explaining: "Securities law does not permit a party to a stock transaction to disavow such representations, to say, in effect, 'I lied when I told you I wasn't relying on your prior statements' and then to seek damages for their contents. Stock transactions would be impossibly uncertain if federal law precluded parties from agreeing to rely on the written word alone."

The maxim that "fraud vitiates everything it touches" may affect the enforceability of a non-reliance provision. In certain cases, New York courts have recognized a "peculiar knowledge" exception to contractual disclaimers, even where a sophisticated investor and negotiated disclaimer were involved. Generally, the peculiar knowledge exception has been applied to sustain extra-contractual claims only where the plaintiff has alleged with particularity that a counterparty in the transaction actively concealed or misrepresented material information, and rendered the truth so difficult to ascertain that mere access to available information sources would not reveal it.8

Other courts have concluded that a non-reliance clause is evidence of the absence of justifiable reliance, but is not automatically dispositive even if the buyer is a sophisticated investor. In *AES v. Dow Chemical*,9 the Third Circuit described §29(a) as foreclosing "anticipatory waivers of compliance" with the securities laws, and held that "a promise not to claim reliance on any representation not set forth in the agreement" is an anticipatory waiver proscribed by §29(a). Holding that determination of a buyer's reasonable reliance on extra-contractual representations must "be made on a case-by-case basis based on all of the surrounding circumstances," the court reversed summary judgment entered prior to discovery.
dismissing Rule 10b-5 claims of a sophisticated investor that signed a non-reliance clause and purchased securities after months of due diligence.

The Third Circuit acknowledged that a non-reliance clause demonstrates "that the seller was unwilling to vouch for the accuracy of the information it was providing and the fact that the buyer was willing to undertake to verify the accuracy of that data for itself." The Third Circuit added that "in such circumstances, a buyer who relies on seller-provided information without seeking to verify it has not acted reasonably." But rather than adopt a bright-line rule at the summary judgment stage, the Third Circuit held that a plaintiff buyer faced with a non-reliance clause will "have to show more to justify its reliance than would a buyer in the absence of such a contractual provision." For example, the Third Circuit afforded weight to the AES plaintiff's allegations that the defendant was in "exclusive control" of the information necessary to avoid fraud; the plaintiff had conducted a "diligent investigation" reasonably calculated to evaluate the reliability of the defendant's representations; and the defendant had allegedly prevented the plaintiff from obtaining information that would have uncovered the fraud.

In Brown v. Earthboard Sports USA, a federal securities case, a divided panel of the Sixth Circuit did not cite §29(a) but nevertheless rejected the proposition that a non-reliance clause forecloses reasonable reliance as a matter of law. The plaintiff Clinton Brown was "a wealthy businessman," who made a "risky investment in the securities of a small privately held California company." He invested on the basis of a "tip" received from an acquaintance and financial advisor who viewed Brown as a prospective client, that a public company was about to acquire the small company. The rumored acquisition turned out to be a fiction, resulting in a total loss of Brown's investment.

After Brown sued the financial advisor for federal securities fraud, the advisor sought summary judgment on the ground that the subscription agreement signed by Brown (to which the advisor was not a party) contained an integration clause in which Brown waived any claim that he relied on third-party advice in making his purchase. Reversing a grant of summary judgment in favor of the advisor, the Sixth Circuit rejected a per se rule "foreclosing the possibility of recovery for deceit in all situations where an allegedly injured party has signed a non-reliance clause," calling instead for "a contextual analysis in order to ascertain whether, as a matter of law, a party has introduced sufficient evidence of reasonable reliance to withstand summary judgment."
A court assessing the reasonableness of a plaintiff's alleged reliance on alleged extra-contractual representations in the face of a non-reliance clause will review the context of the transaction, and consider: (1) the sophistication and expertise of the plaintiff in financial and securities matters; (2) the existence of long-standing business or personal relationships; (3) access to the relevant information; (4) whether a fiduciary relationship exists; (5) concealment of the fraud; (6) the opportunity to detect the fraud; (7) whether the plaintiff initiated the stock transaction or sought to expedite the transaction; and (8) the generality or specificity of the alleged misrepresentations.\(^\text{11}\)

'National Century'

The U.S. District Court for the Southern District of Ohio recently concluded that a non-reliance provision contained in an agreement between a private equity investor and a placement agent constituted a bargained-for risk allocation between sophisticated parties, and after discovery granted summary judgment dismissing all common law fraud and negligent misrepresentation claims asserted against the placement agent (§29(a) therefore was not addressed). In National Century, Credit Suisse served as co-placement agent in connection with a private offering of convertible preferred stock of National Century Financial Enterprises (NCFE). After Pharos Capital approached Credit Suisse looking for an investment in the health care sector, Credit Suisse introduced Pharos to NCFE. Pharos conducted its own due diligence investigation over several months, during which its representatives met with NCFE management and had access to a data room of diligence materials.

After Pharos completed its diligence into the potential investment, but before it made the investment, Pharos and Credit Suisse negotiated and signed a Letter Agreement. In the agreement, Pharos acknowledged certain facts and made specific representations regarding its decision to make the investment. Pharos and its affiliates represented, among other things, that they were: (i) "a sophisticated institutional investor and have such knowledge and experience in financial and business matters and expertise in assessing credit risk; that we are capable of evaluating the merits, risks and suitability of investing in the Securities; that we have conducted our own due diligence investigation of the Company, that we are relying exclusively on our due diligence investigation and our own sources of information and credit analysis with respect to the Securities"; (ii) that Credit Suisse had neither "been requested to or has provided us with any information or advice with respect to the Securities nor is such information or advice necessary or desired," (iii) that Credit Suisse had made no representation as to Pharos or the
credit quality of the securities; and (iv) that Credit Suisse "may have acquired, or during the term of the Securities may acquire, non-public information with respect to the Company, which we agree need not be provided to us."

In addition, Pharos acknowledged that Credit Suisse had not acted as its financial advisor or as a fiduciary. In short, by agreement the buyer and placement agent specified on whom and what the buyer based its investment decision. After a massive fraud at NCFE was revealed and the company filed for bankruptcy, Pharos sued Credit Suisse for fraud and negligent misrepresentation, alleging that Credit Suisse "had knowledge of the material aspects of National Century's fraud and misrepresented to Pharos how NCFE ran its operations."

Noting that justifiable reliance is an element of both fraud and negligent misrepresentation, the court concluded after discovery that Pharos could not establish justifiable reliance in the face of the non-reliance provision. The court said the Letter Agreement was aptly described as a "big boy" agreement "because Pharos in essence said that it knew what it was doing and could take care of itself." The non-reliance provision was no "boilerplate disclaimer in a PPM." Rather, it "proved that the parties entered into a bargained-for, retrospective statement of their dealings," under which Pharos acknowledged that it was a "sophisticated institutional investor" that was "relying exclusively on its own due diligence investigation, its own sources of information, and its own credit analysis in deciding to invest."

In addition, "Pharos represented in the Agreement that Credit Suisse's information and advice was not 'necessary or desired,' that Credit Suisse had made no representations about National Century or the credit quality of the securities, and that any non-public information Credit Suisse possessed about National Century 'need not be provided' to Pharos." The court also rejected the argument "that the Letter Agreement should be disregarded because it was not signed until 'late' in the process and Pharos was led to believe that the Agreement was 'standard' and had to be signed in order to complete the stock purchase," seeing no "legal basis for why these considerations would invalidate the Agreement, but they could charitably be construed as an argument that Pharos was under duress," an extraordinarily difficult burden to meet.
Conclusion

Big boy letters and similar contractual disclaimers of reliance are an enforceable mechanism to foreclose post-disclosure disputes concerning alleged extra-contractual representations to a sophisticated buyer. Practitioners seeking to maximize the effectiveness of the provision should ensure that it is the product of negotiation between sophisticated parties, contains an acknowledgement that the buyer had the opportunity to conduct its own due diligence, evaluated the merits and risks of the transaction without reliance on the counterparty, and relied exclusively on its own due diligence sources of information (subject to any specific warranties). If practicable, the agreement should be reasonably specific as to categories of information not provided to the buyer and as to which no warranty is made, e.g., earnings projections and financial statements.

The buyer should acknowledge it understands that its counterparty may have non-public information concerning the relevant company, but notwithstanding the information asymmetry, wishes to proceed with the transaction. The buyer also should warrant that it will require any subsequent downstream purchaser to be bound by the non-reliance provision.

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Endnotes:

6 91 F.3d 337 (2d Cir. 1996).
7 213 F.3d 381 (7th Cir. 2000).
8 See Harbinger Capital Partners Master Fund I v. Wachovia Capital Markets, 910 N.Y.S.2d 762 (Table) (Sup. Ct. N.Y. Co. 2010) (denying motion to dismiss where plaintiff alleged defendant loan arranger concealed borrower's financial condition by "covertly fronting" interest payments to syndicate lenders without obtaining funds from borrower) with UniCredito Italiano v. JPMorgan Chase Bank, 288
F.Supp.2d 485, 501 (S.D.N.Y. 2003) (dismissing claims against administrative agents for credit facilities, holding that "[e]xtension of the peculiar knowledge exception to defeat contractual allocation of risks away from Defendant banks...because the principal (Enron) was so adept at concealment of its fraud would require at a minimum some factual basis for finding reasonable Plaintiffs' reliance on parties on whom it agreed it would not rely in any respect in making the operative decisions.").

9 325 F.3d 174 (3d Cir. 2003).
10 481 F.3d 901 (6th Cir. 2007).