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WHO'S A BIG BOY?

**NON-RELIANCE PROVISIONS AND CLAIMS OF INSIDER TRADING
IN SECURITIES AND NON-SECURITIES MARKETS**

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I. INTRODUCTION

The reported settlements of two cases earlier this year involving the use (or misuse) of contractual disclaimers of reliance (so-called "Big Boy" provisions) in connection with distressed debt trading, and the recent widely-publicized request for information relating to potential insider trading from the SEC, present the question of the enforceability and utility of such provisions.

Both cases involved the purchase and sale of distressed bonds, which as securities are subject to a very different legal analysis than trades in distressed bank debt. While there are not a lot of cases that address the issue of Big Boy provisions¹ in distressed debt trading, the law is relatively clear that the enforceability of such provisions will depend on whether the instrument being traded is a security or a non-security and the specificity of the provision describing the information that is not disclosed.

A Big Boy letter:

- will be of no use in defending a breach of contract or breach of fiduciary duty claim arising from the purchase and sale of securities, including distressed bonds, or non-securities,

¹A Big Boy letter is an agreement entered prior to or contemporaneous with a transaction in which the parties acknowledge that the buyer and seller are both sophisticated investors, and that one party may possess material nonpublic information regarding the issuer to which the counterparty does not have access. Each party specifically disclaims any reliance on the other's disclosures or omissions, and represents in effect that it is a "big boy" and is entering into the transaction notwithstanding the information disparity and its potential effect on the value of the transaction.

such as distressed bank loans, when the trader is on a creditors' committee or owes some other duty of trust or confidence to the borrower;

- will be of no use in defending governmental civil or criminal proceedings arising from the purchase and sale of securities, including distressed bonds;

- will be of limited or uncertain usefulness in defending private lawsuits for fraud arising from the purchase and sale of securities, including distressed bonds; but

- may provide some protection in defending a fraud case brought by a counterparty arising from the purchase and sale of a non-security such as bank debt as long as the parties are sophisticated, the disclaimer is specific as to the information that is not disclosed and the counterparty acknowledges that it has had the opportunity to conduct its own diligence. The key to enforceability in these circumstances is a clear description of the type and quality of information being withheld.

II. THE RECENT EVENTS

In *Securities and Exchange Commission v. Barclays*, 07-CV-04427 (S.D.N.Y.), the SEC alleged that Barclays obtained material nonpublic information about various debtors through Barclays' membership on a creditors' committee. The Barclays employee who served as Barclays' representative on the creditors' committee also traded bonds of the debtor for Barclays' account. In some instances, Barclays issued Big Boy letters to inform its bond trading counterparties that it possessed material nonpublic information about the debtor, and the

counterparties agreed to trade with Barclays notwithstanding the possible information disparity. *See Barclays Bank Pays \$10.9 Million to Settle Charges of Insider Trading on Bankruptcy Creditor Committee Information*, S.E.C. Litig. Rel. No. 20132 (May 30, 2007). The case was settled before trial.

In *R2 Investments v. Salomon Smith Barney*, the plaintiffs alleged that they purchased bonds issued by an insolvent telecommunications company, World Access, and that defendant Salomon Smith Barney ("SSB") possessed material nonpublic information through its participation on a World Access creditors' committee about World Access' financial condition. SSB executed a Big Boy letter with Jefferies & Co. ("Jefferies"), a broker intermediary that subsequently sold the bonds to R2 Investments without disclosing that it had executed a Big Boy letter with SSB. Two days later, World Access announced that it was out of cash, and the value of the bonds R2 Investments purchased declined 30 percent. *See Jenny Anderson, Side Deals in a Gray Area*, New York Times, May 22, 2007, p. C1. The case settled on the first day of trial for an undisclosed amount.

Finally, the New York Regional Office of the Securities and Exchange Commission has recently formulated a new 27-page request for information that it is using in its examination of registered investment managers. *SEC Pushes for Hedge Fund Disclosure*, Wall Street Journal, September 19, 2007, p. C3. Among the many types of information that the SEC has requested are the following:

1. Disclosure of threatened, pending, and settled litigation or arbitration to which the Advisor was a party during the Examination Period, including a description of

the allegations forming the basis of each issue, the status of each pending issue, and a brief description of any "out of court" or informal settlement.

2. Disclosure, relating to receipt of non-public information/misuse of non-public information, of all companies on whose Creditors' Committees employees or affiliates of the Adviser serve.
3. Disclosure of all securities held in any client account during the past two years that were involved in a bankruptcy workout, identifying, for each security listed, all accounts that held equity and/or fixed income positions in the issuer at the time of the bankruptcy filing.

It is clear from these requests that the SEC is looking into the potential for insider trading in connection with distressed securities and that any litigation or threatened litigation involving claims of insider trading in distressed securities will come to the SEC's attention when a fund manager is examined.

III. Enforceability of Big Boy Provisions In Connection with Securities Transactions

Both *R2 Investments* and *Barclays* involved the trading of distressed bonds. The anti-fraud provisions of the federal securities laws prohibit trading in securities, including bonds, while in possession of material nonpublic information about the issuer, and current law requires anyone who possesses material nonpublic information about an issuer to disclose the information or abstain from trading. See 17 C.F.R. § 240.10b5-1 (2000); *Chiarella v. United States*, 445 U.S. 222, 228 (1980).

Under the misappropriation theory of insider trading, a person who has received confidential business information from another, pursuant to a fiduciary, contractual, or similar relationship of trust and confidence, has a duty to keep that information confidential. He commits fraud 'in connection with' a securities transaction, and violates § 10(b) and Rule 10b-5,

when he misappropriates confidential information for securities trading purposes, by breaching the duty owed to the source of that information. *U.S. v. O'Hagan*, 521 U.S. 642, 652 (1997). In the *Barclays* matter, the SEC alleged, without expressing any opinion on the legality of the Big Boy letters that Barclays entered into with some of its counterparties, that Barclays misappropriated the material nonpublic information it obtained through its participation on creditors' committees by failing to disclose its trades to the creditors' committees, the issuers, or any other "sources" of the information. Without admitting or denying any of the charges, Barclays agreed to pay more than \$10.9 million in disgorgement, prejudgment interest, and civil penalties. *Id.*

It is doubtful that the Big Boy letters would have provided Barclays with an effective defense had the case proceeded to trial. Big Boy provisions are only disclaimers of reliance, one of the usual elements necessary to prove a claim of fraud. The SEC, however, by statute, is not required to prove reliance to prove securities fraud in an insider trading case. *See* 17 C.F.R. § 240.10b5-1(b) (2000). A defendant could argue, perhaps, that his use of a Big Boy letter is proof that he had no intent to defraud, but that defense has not been tested.

On the other hand, private litigants must prove, by a "preponderance of the evidence," that they relied on their counterparty's representations or omissions. *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 127 S. Ct. 2499, 2513 (2007) (plaintiff alleging fraud in § 10(b)/10b-5

action must prove her case by a preponderance of the evidence).² Do Big Boy letters provide any better protection in private securities fraud cases?

Section 29(a) of the Securities Exchange Act of 1934 forbids waivers of compliance with obligations imposed by the federal securities laws. *See* 15 U.S.C. § 78cc (2005). A case can be made that a Big Boy letter is an impermissible and unenforceable waiver under § 29(a). *See AES Corp. v. Dow Chemical Co.*, 325 F.3d 174, 182 (3d Cir. 2003) (holding that to permit parties' disclaimer of reliance to bar relief under § 10(b) and Rule 10b-5 "would be fundamentally inconsistent with Section 29(a)"); *Rogen v. Ilikon Corp.*, 361 F.2d 260, 268 (1st Cir. 1966) ("Were we to hold that the existence of [a disclaimer of reliance] provision constituted the basis (or a substantial part of the basis) for finding non-reliance as a matter of law, we would have gone far toward eviscerating Section 29(a)"); *but cf. Harsco Corp. v. Segui*, 91 F.3d 337, 343 (2d Cir. 1996) (disclaimer of reliance merely "weaken[ed]" plaintiff's case and therefore was not an impermissible waiver of compliance with the Exchange Act). Courts, however, generally agree that disclaimers of reliance may be at least relevant in evaluating the reasonableness of any reliance in a private securities action for violations of § 10(b)/Rule 10b-5. *See, e.g., AES Corp.*, 325 F.3d at 181 (holding that while non-reliance clause could not itself bar relief on Rule 10b-5 claim, fact that parties' agreement contained a disclaimer of reliance was "among the circumstances to be considered in determining the reasonableness of any reliance"); *Harsco Corp.*, 91 F.3d at 343 (sophisticated corporate plaintiff that agreed to non-reliance provision in purchase agreement was precluded from establishing the reasonable reliance necessary to prove

² The burden of proof in a common law fraud case is the stricter "clear and convincing evidence" standard. *Weinberger v. Kendrick*, 698 F.2d 61, 78 (2d Cir. 1982).

its securities fraud claim).³ Therefore, in *R2 Investments*, a Big Boy letter may have helped Jeffries and SSB defend against the claims, but it does not appear that the defendants sought a Big Boy provision in the transaction with R2 Investments, or that R2 Investments knew that Jeffries had entered a Big Boy letter with SSB.

IV. Enforceability of Big Boy Provisions When Trading Non-Securities

A. Bank Loans Are Not Securities.

Above we discussed defending against fraud in securities cases brought by the SEC and by private plaintiffs. Bank loans, however, so far have not been held to be securities.⁴ Do Big Boy provisions provide greater protection in bank loan trading?

The first question is what type of non-public information does the party to the transaction possess? There are two types of confidential information that bank loan investors can typically acquire: Syndicate Confidential Information and Borrower Confidential Information.

Syndicate Confidential Information is "material information provided by or on behalf of a borrower (or its affiliates) which is nonpublic except that it is deliberately made available by or on behalf of such borrower to all of the members and potential members of a particular lending

³ In assessing the reasonableness of a plaintiff's reliance, courts consider "the entire context of the transaction, including factors such as its complexity and magnitude, the sophistication of the parties, and the content of any agreements between them." *Emergent Capital Investment Management, LLC v. Stonepath Group, Inc.*, 343 F.3d 189, 195 (2d Cir. 2003).

⁴ The Supreme Court's analysis in *Reves v. Ernst & Young*, 494 U.S. 56 (1990), provides the analytic framework for determining whether a particular transaction involves the purchase or sale of a "security." These factors include (1) whether the instrument is motivated by investment or commercial purposes; (2) the "plan of distribution" for the instrument; (3) the reasonable expectations of the public; and (4) whether an alternative regulatory scheme or other risk-inducing factor renders application of the securities laws unnecessary. *Id.* at 66-67. Is there a risk that, as an efficient secondary market for par and distressed bank loans continues to develop, these instruments may begin to look like securities to regulators (and potential private plaintiffs)? So far the answer has been "no".

syndicate." Section 2(a)(i), *Confidential Information Supplement to the LSTA Code of Conduct* (May 1998). Syndicate Confidential Information is *not* confidential between syndicate members, is readily available to brokers, and can be disclosed to potential buyers of the debt with an appropriate confidentiality agreement. *Id.* Bank loans generally are freely traded (among syndicate members and prospective members, not the public) on the basis of Syndicate Confidential Information, and the possessors of Syndicate Confidential Information typically do not owe any fiduciary duty to the borrower or other creditors. *See id.*; Section III(A)(1), *LSTA Statement of Principles for the Communication and Use of Confidential Information by Loan Market Participants* (Dec. 2006).

Borrower Confidential Information, on the other hand, is material information relating to a borrower that is nonpublic and is either obtained from the borrower or from another person that the market participant has reason to believe is subject to a duty not to disclose, and that has not been made available to all members or potential members of the syndicate. Section 2(a)(ii), *Confidential Information Supplement to the LSTA Code of Conduct*. Investors often acquire Borrower Confidential Information through their participation on creditors' committees or as an advisor to the borrower. Borrower Confidential Information typically cannot be shared without breaching a confidentiality agreement with, or a fiduciary duty to, the borrower, or violating a court order of confidentiality. *See* Section III(A)(2), *LSTA Statement of Principles for the Communication and Use of Confidential Information by Loan Market Participants* (Dec. 2006).

Trading in the debt of a borrower while in possession of Borrower Confidential Information presents a number of issues that are not present when trading while in possession of

Syndicate Confidential Information. A party who trades in the bank loans of a borrower while in possession of Borrower Confidential Information, which it does not disclose to the counterparty, may be susceptible to allegations of breaches of fiduciary duty to the bankruptcy estate and other creditors as well as claims for fraud. *See, e.g., In re Papercraft Corp.*, 211 B.R. 813, 825-26 (W.D. Pa. 1997).

The most common method of dealing with the problem of creditors who wish to continue trading the debt while at the same time serving on a committee is the creation of internal information walls that separate the traders from the recipients in the firm of Borrower Confidential Information. *See* Sections V(A)-V(C), *LSTA Statement of Principles for the Communication and Use of Confidential Information by Loan Market Participants* (Dec. 2006); Order Approving Specified Information Blocking Procedures and Permitting Trading in Securities of the Debtors Upon Establishment of a Screening Wall, *In re Fibermark, Inc.*, No. 04-10463, Docket No. 684 (Bankr. D. Vt. Oct. 19, 2004); Robert C. Pozen and Judy Mencher, "Chinese Walls for Creditors' Committees," 48 *Bus. Law.* 747, 756-57 (Feb. 1993).

If an information wall is not feasible, because the firm that wishes to trade is too small or there are other internal structural impediments to a wall, can a Big Boy letter provide protection? In such cases, a Big Boy letter may still protect against causes of action for fraud, but it will not help defend against allegations of breach of fiduciary duty, because the reliance or non-reliance of the counterparty to the trade is immaterial to claims of self-interest and unjust enrichment brought by other constituents of the borrower. *See, e.g., Granite Partners, L.P. v. Bear, Stears &*

Co., Inc., 17 F. Supp. 2d 275, 306, 311 (S.D.N.Y. 1998) (setting forth the elements of breach of fiduciary duty and unjust enrichment).

B. There Are Cases In Which The Courts Have Refused To Enforce Disclaimers Of Reliance On Public Policy Grounds Or On The "Peculiar Knowledge" Exception.

Blanket exculpatory agreements will not shield parties from liability for intentional, fraudulent, or grossly negligent conduct. *See Turkish v. Kasenetz*, 27 F.3d 23, 27-8 (2d Cir. 1994) ("parties cannot use contractual limitation of liability clauses to shield themselves from liability for their own fraudulent conduct"); *Kalisch-Jarcho, Inv. v. City of New York*, 58 N.Y.2d 377, 385 (1983) ("an exculpatory clause is unenforceable when . . . the misconduct for which it would grant immunity smacks of intentional wrongdoing"). This general rule has been relaxed, however, where sophisticated business people, negotiating at arms length, agree to a specific disclaimer provision that tracks the substance of the alleged misrepresentations or omissions. *Harsco Corp.*, 91 F.3d at 344-45 (*Turkish* does not apply where a contract "clearly delineates what representations have been made"); *Citibank, N.A. v. Plapinger*, 66 N.Y.2d 90, 94-5 (1985) (defendants who agreed to specific disclaimer of reliance were foreclosed from establishing reliance in cause of action for fraud); *Kalisch-Jarcho, Inc.*, 58 N.Y.2d at 384 (enforcement of contractual waiver clause is "especially" warranted when contract was "entered into at arms length by sophisticated contracting parties"). There is nevertheless a risk that a court that detects strong evidence of intentional fraud, or "picking off", will decline to enforce a Big Boy provision even between sophisticated parties.

Similarly, courts will not enforce disclaimers of reliance where the complaining party can demonstrate that its claims are based on facts peculiarly within the knowledge of the nondisclosing party, so that reasonable diligence could not have uncovered the undisclosed information. *Banque Arabe Et Internationale D'Investissement v. Maryland Nat'l Bank*, 57 F.3d 146, 155 (2d Cir. 1995); see *Merrill Lynch & Co., Inc. v. Allegheny Energy, Inc.*, 382 F. Supp. 2d 411, 418 (S.D.N.Y. 2003) (refusing to dismiss fraud claims, despite parties' specific, narrowly tailored disclaimer of reliance, where plaintiffs alleged that information about Merrill's "sham energy trades with Enron" and Merrill's concern that a principal had stolen \$43 million were peculiarly within Merrill's knowledge); *OnBank & Trust Cp. v. FDIC*, 967 F. Supp. 81, 86-7 (W.D.N.Y. 1997) (disparity between principal amount of mortgage pass-through certificates and the mortgage loan balance was peculiarly within RTC's knowledge because, as servicer of the loans, RTC knew that certain loans had been paid off but that the principal amount had not been reduced accordingly).

C. Big Boy Letters May Protect Against a Private Counterparty's Action For Fraud Arising From Trading in Non-Securities Under Some Circumstances.

The elements of a claim for fraud or fraudulent inducement are (1) that defendant made a material false representation, (2) with the intent to defraud the plaintiff, (3) the plaintiff reasonably relied upon the representation, and (4) the plaintiff suffered damage as a result of that

reliance. *Banque Arabe*, 57 F.3d at 153. Fraudulent concealment claims contain the additional element that the defendant had a duty to disclose the material information.⁵

First, while a Big Boy letter may successfully prevent a plaintiff from arguing that it relied on the non-disclosure, it can present other issues. Most importantly, it may affect the transaction itself, as the prospective counterparty may be reluctant to agree to the transaction without full disclosure, or may seek to insert a provision that would permit the parties to "unwind" the transaction if certain events occur. The presence of a Big Boy letter may also affect downstream marketability of the debt, as any subsequent purchasers may be unwilling to purchase debt that is already subject to a Big Boy provision.

Second, assuming all attendant concerns have been assessed and the parties agree to execute a Big Boy provision, the drafters of such provisions need to consider the following issues. Courts have enforced disclaimers of reliance where the disclaimer:

- i. is the product of negotiation among sophisticated parties;
- ii. specifically describes the type and quality of the information being withheld in terms that are tailored to the specific transaction at hand,
- iii. requires the parties to acknowledge that each party has voluntarily entered the transaction notwithstanding the nondisclosure of material non-public information;

⁵ The question of when a duty to disclose material non-public information in non-securities cases arises is itself an interesting question, but not one addressed here.

- iv. requires each party to perform its own due diligence and to disclaim any reliance on the other.

In addition, the Big Boy letter should contain a merger clause that clearly sets forth the parameters of the entire agreement between the parties, and the representations upon which the parties may rely.

1. The Big Boy Letter Must Be The Product of Negotiation Between Sophisticated Entities.

Parties to distressed bank loan trades in the secondary market should be, and almost always are, financially sophisticated, and all relevant documents between the parties should clearly reflect their sophistication. Sophisticated parties are presumed to have equal bargaining power and can negotiate terms or insist on greater disclosure. When a contract is between two sophisticated parties, courts recognize that reliance is unreasonable not merely on expressly disclaimed representations, but also on representations that a knowledgeable party should have insisted on including in the agreement but that were not included. For instance, in *UniCredito Italiano SPA v. JPMorgan Chase Bank*, 288 F. Supp. 2d 485 (S.D.N.Y. 2003), plaintiffs, sophisticated Italian and Polish financial institutions, alleged that JP Morgan Chase ("Chase") and Citigroup defrauded them in connection with the formation of and payment under certain Enron-related syndicated credit facilities for which Citigroup and Chase served as co-Administrative agents. The agreements precluded plaintiffs from claiming that they relied on *any* alleged representations by Chase or Citigroup. The court dismissed fraud and negligent misrepresentation claims against Chase and Citigroup on grounds that

[h]aving failed to bargain for the right to rely on the banks as monitors of Enron's compliance with its disclosure, financial condition and other covenants, or for the right to benefit from any knowledge gained by the Defendant banks or their affiliates in connection with their own business dealings with Enron and its affiliates, Plaintiffs cannot, as a matter of law, be held reasonably to have relied on any misrepresentations or omissions by the Defendants concerning those matters.⁶

Likewise, in *Lazard Freres & Co. v. Protective Life Ins. Co.*, 108 F.3d 1531 (2d Cir. 1997), negotiations for a time-sensitive sale of bank debt between two large, sophisticated bank debt traders required Protective to make an oral commitment to purchase the bank debt before it had a chance to review a key report on the debtor's financial condition. Protective subsequently alleged that Lazard's representative made false representations regarding the report. The court held that even though matters may have been peculiarly within Lazard's knowledge, Protective, as a "substantial and sophisticated player in the bank debt market," was under a duty to protect itself from Lazard's alleged misrepresentation regarding the underlying purchase of bank debt, and could easily have protected itself by insisting, as a condition to closing, on an examination of documents pertaining to the transaction or by negotiating contractual provisions to protect parties' interests. *Id.* at 1543. Protective's failure to protect itself rendered reliance on the misrepresentation "unreasonable as a matter of law." *Id.*

2. The Big Boy Letter Must Specifically Describe The Information Withheld.

Cases in the Second Circuit hold that a party who specifically disclaims reliance upon a particular representation in a contract cannot, in a subsequent action for fraud, claim it was

⁶ *Id.* at 499; see also *Emergent Capital Inv. Mgmt., LLC v. Stonepath Group, Inc.*, 165 F. Supp. 2d 615. 622 (S.D.N.Y. 2001) (dismissing fraud claim on grounds that "fraud claim will not stand where the clause was included in a multi-million dollar transaction that was executed following negotiations between sophisticated business people and a fraud defense is inconsistent with other specific recitals in the contract").

fraudulently induced to enter into the contract by the very representation it has disclaimed reliance upon. *Banque Arabe*, 57 F.3d at 155. To be effective, the Big Boy letter or provision should be specific enough that the counterparty clearly is on notice as to what may not be reasonably relied on, yet not so specific as to disclose the substance of the confidential information. The letter must avoid boilerplate generalities and specifically reference the representations and warranties on which each party is entitled to rely, if any. *See Harsco Corp.*, 91 F.3d at 346 ("the exhaustive nature of the [Agreement's] representations adds to the specificity of [the Agreement's] disclaimer of other representations.").

Where a party to a distressed bank loan transaction possesses Borrower Confidential Information, it would be advisable to disclose the type of information withheld, *i.e.*, business plans, earnings projections or financial statements, as well as the party's relationships with the issuer, *i.e.*, committee member, adviser, member of the Board of Directors.

For example, the plaintiff in *DynCorp v. GTE Corp.*, 215 F. Supp. 2d 308 (S.D.N.Y. 2002), purchased a telecommunications company from Contel, a wholly owned subsidiary of GTE. GTE in turn agreed not to compete with the business, and also agreed to guarantee its subsidiary's performance of certain obligations. The parties' purchase agreement specifically provided that GTE made no express or implied representations or warranties with respect to the business being sold, or to its probable success or profitability, or to any other information provided to plaintiff. In addition, plaintiff agreed that GTE would not be subject to any liability or indemnification obligation resulting from the distribution to plaintiff of the offering memorandum any other information or documents. The court held that the parties' particularized

disclaimers made it impossible for plaintiff to prove reasonable reliance. *DynCorp*, 214 F. Supp. 2d at 320-21.⁷

In contrast, in *Merrill Lynch & Co. v. Allegheny Energy, Inc.*, Merrill provided certain Evaluation Material to Allegheny in connection with the contemplated sale of Merrill's energy commodity trading business. After Allegheny acquired the business from Merrill, Allegheny discovered that Merrill knew that a principal in the business had been suspected of engaging in considerable fraudulent activity, and that the business' financial performance was based in part on sham trades with Enron. 382 F. Supp. 2d at 415. The court held that the parties' disclaimer did not track the substance of the alleged misrepresentations because the disclaimer did not state that Merrill Lynch disclaimed any prior representations about the Enron transactions or the principal's qualifications. *Id.* at 417.

3. The Disclaiming Party Should Acknowledge That It Has Agreed To Complete The Transaction Notwithstanding the Nondisclosure of Material Nonpublic Information.

Big Boy letters also must require the disclaiming party to acknowledge that its counterparty may have Borrower Confidential Information that it cannot disclose, but that the disclaiming party has voluntarily entered the transaction notwithstanding the nondisclosure. The *LSTA Distressed Standard Terms* suggest the following standard Big Boy provision:

⁷ See also *Danann Realty Corp. v. Harris*, 5 N.Y.2d 317, 321-23 (1959) (finding that where a party specifically disclaims reliance on a particular representation, the party is precluded from claiming fraudulent inducement to enter into the contract based on that very representation, and that a contrary result would allow the plaintiff to "deliberately misrepresent[]" its purported nonreliance in the contract).

5(n): Buyer acknowledges that (i) Seller currently may have, and later may come into possession of, information with respect to the Transferred Rights, the Assumed Obligations, Borrower, Obligors or any of their respective Affiliates that is not known to the Buyer and that many be material to a decision to sell the Transferred Rights and to retain the Assumed Obligations ("Buyer Excluded Information"), (ii) Buyer has determined to purchase the Transferred Rights and to retain the Assumed Obligations notwithstanding its lack of knowledge of Buyer Excluded Information and (iii) Seller shall have no liability to Buyer or any Buyer Indemnitee, and Buyer waives and releases any claims that it might have against Seller or any Seller indemnitee. . . ⁸

The Second Circuit has noted that a party who has been put on notice of the existence of material facts which have not been documented and nevertheless proceeds with the transaction without negotiating language into the agreement for his protection, "will not be heard to complain that he has been defrauded." *Lazard Freres & Co.*, 108 F.3d at 1543. Similarly, the courts in *McCormick v. Fund American Cos., Inc.*, 26 F.3d 869 (9th Cir. 1994) and *Jensen v. Kimble*, 1 F.3d 1073 (10th Cir. 1993), dismissed securities fraud charges by parties who were put on notice that their counterparties would not disclose certain information. Defendants in *McCormick* and *Jensen* explicitly informed plaintiffs that they would not disclose certain material information, and the plaintiffs entered the transactions notwithstanding the

⁸ ¶ 4(o) of the *LSTA Distressed Standard Terms and Conditions* contains a nearly identical provision for the Seller.

nondisclosures. The *Jensen* court held that there could be no fraud because the plaintiff "knew what he didn't know" when he entered the transaction. 1 F.3d at 1078.

Like all other aspects of the disclaimer, the acknowledgment of non-reliance must be specifically tailored to the agreement. For instance, the agreement in *Harsco Corp. v. Segui* provided that Harsco acknowledged that the sellers of a business were not warranting "projections, estimates or budgets ... of future revenues, expenses or expenditures, future results of operations, ... or any other information or documents made available" to Harsco. *Harsco Corp.*, 91 F.3d at 342. Harsco also acknowledged that it could only rely on those representations specifically set forth in the agreement. *Id.* Harsco purchased the business and subsequently filed suit, alleging that defendants misrepresented the status of the construction of several plants in Asia and Europe, the financial prospects of the business' operations, and the business' intellectual property rights. The Second Circuit affirmed dismissal of Harsco's claims, holding that many of the misrepresentations complained of were "exactly what [the agreement] disclaim[ed]." *Id.* at 345. The Second Circuit also held that to the extent Harsco claimed misrepresentations about plants other than those specifically referenced in the agreement, "Harsco should be treated as if it meant what it said when it agreed" to specifically disclaim reliance on representations not in the agreement. *Id.* at 345-46. *See also Danann Realty Corp. v. Harris*, 5 N.Y.2d 317, 320-21 (1959) (dismissing fraud claims by purchaser of lease, based on seller's alleged false representations as to the building's operating expenses and profitability, where plaintiff specifically acknowledged in the agreement that seller had not made and did not make any representations as to, among other things, "the physical condition, . . . expenses, [or] operation" of the premises).

4. The Big Boy Letter Must Require Each Party to Perform Its Own Due Diligence on the Underlying Transaction.

Parties to a Big Boy letter also should include language affirming that each party is responsible for its own due diligence, and that neither is entitled to rely on the other.⁹ Such language may forestall any subsequent invocation of the "peculiar knowledge" doctrine, which provides that express disclaimers of reliance will not be given effect because the facts are peculiarly within the knowledge of the defendant, and plaintiff had no independent means of ascertaining the truth. *Banque Arabe*, 57 F.3d at 155.

In the past, some courts have enforced disclaimers of reliance, over the plaintiffs' protests that facts concerning the transaction were peculiarly within the defendants' knowledge, where the disclaimers placed the burden on the buyer to perform its own due diligence. *See UniCredito Italiano*, 288 F. Supp. 2d at 500-01 (where plaintiffs specifically agreed they would make their own credit decisions and would not rely on defendants in deciding whether to enter Enron credit facilities, court refused to apply the peculiar knowledge exception to defeat the parties')

⁹ *See, e.g.*, Sections 5.1(f) and 5.1(f) of the LSTA *Standard Terms and Conditions*, which provide that the buyer:

has adequate information concerning the business and financial condition of the Borrower and Obligors . . . to make an informed decision regarding the purchase . . .

has independently and without reliance upon Seller, and based on such information as Buyer has deemed appropriate, made its own analysis and decision to enter into this Agreement, . . .

acknowledges that Seller has not given Buyer any investment advice, credit information or opinion on whether the purchase of the Transferred Rights or the assumption of the Assumed Obligations is prudent[; and] . . .

has not relied and will not rely on Seller to furnish or make available any documents or other information regarding the credit, affairs, financial condition or business of Borrower or any Obligor, or any other matter concerning Borrower or Obligor.

contractual allocations of risks away from the defendants). *But see Merrill Lynch v. Allegheny Energy*, 382 F. Supp. 2d at 415 (notwithstanding the general disclaimer of reliance, the language in the parties' agreement placed a disclosure burden on Merrill, rather than a diligence burden on Allegheny, and information about the sham trades and about Merrill's suspicions about the principal's conduct was peculiarly within Merrill's knowledge).

5. The Big Boy Letter Should Contain a Merger Clause.

Finally, to underscore the specific disclaimers and acknowledgments contained therein, a Big Boy letter also should contain a merger clause. *See Emergent Capital Investment Mgmt, LLC v. Stonepath Group, Inc.*, 195 F. Supp. 2d 551, 562 (S.D.N.Y. 2002), *vacated in part on unrelated grounds*, 343 F.3d 189 (2d Cir. 2003) ("when the contract states that the defendant makes no representations other than those contained in another more exhaustive clause of the contract, a fraud claim may be precluded"). The merger clause should indicate that the Big Boy letter and any other pertinent transaction documents constitute the entire agreement between the parties, supersede any prior agreements and understandings, written or oral, between the parties with respect to the subject matter of the agreement, and contain the only representations or warranties on which the parties are entitled to rely. *See, e.g., Harsco Corp.*, 91 F.3d at 345 ("no other representations" clause in merger agreement precluded claims alleging misrepresentations about Russian plant facility during due diligence process, where parties' agreement did not contain any representations about the Russian plant); *Consolidated Edison, Inc. v. Northeast Util.*, 249 F. Supp. 2d 387, 401 (S.D.N.Y. 2003), *rev'd in part on unrelated grounds*, 426 F.3d 524 (2d Cir. 2005) (plaintiffs could not prove reasonable reliance on oral statements made in the

course of due diligence where the parties' agreement contained specific disclaimer, combined with integration clause which provided that Merger Agreement and Confidentiality Agreement were the entire agreement between the parties and superseded all prior written and oral understandings).

V. CONCLUSION

When drafting a Big Boy provision, potential loan trading counterparties should consult the standards provisions in the LSTA Standard Terms and Conditions ("LSTA Standard Terms") as a springboard in their negotiations, but should supplement the LSTA Standard Terms with particularized language that is tailored to their contemplated transaction. Courts are more likely to enforce disclaimers of reliance in Big Boy letters where the parties specifically enumerate any and all representations, warranties or omissions on which the parties are entitled to rely, and specifically disclaim reliance on all others. The Big Boy letter also should clearly state whether the transaction involves undisclosed Borrower Confidential Information, and if so, should require that the counterparties acknowledge that they are entering the transaction notwithstanding the nondisclosure.