BANKING ON CORPORATE

BY NEILL MAY

Limits of the law of common sense

It is often very comforting, and helpful, to remind oneself that laws can often be reduced to core concepts. For example, when searching for an interpretation of a statutory provision, and in understanding how legislative and regulatory frameworks work (and are intended to work), resort can often confidently be made to "first principles." This is particularly so where regulation is "principles-based," that is where applicable laws do not prescribe a comprehensive code of impermissible activity but instead articulate principles to be interpreted and applied.

There are limits to this approach. Early in my career a senior lawyer asked me to scour jurisprudence and commentary to find support for a certain proposition. Having searched every conceivable source, I had to report back that I had been unable to find even a single shred of support for the proposition. The senior lawyer seemed unfazed by my report, and picked up the phone to call counsel on the other side to report our view that the proposition should apply. When challenged to provide any support or precedent for that proposition, the senior partner replied: "It's the law of common sense." If there were only that one core principle, and all depended on it, much wasted time and effort could be avoided. However, that may have been pushing the concept a bit far.

What makes reliance on core principles particularly interesting is when they seem to contradict each other, or run contrary to people's general sensibilities or expectations. A recent case from the Delaware Supreme Court, which addressed the effectiveness of a contractual provision widely used in the United States and Canada as well, highlights this dynamic.

The facts in *RAA Management LLC v. Savage Sports Holdings Inc.* are simple. Private equity firm RAA had participated in a strategic auction process conducted by Savage, owner of one of the largest rifle manufacturers in the United States. As a precondition to Savage providing RAA with its confidential offering memorandum and other confidential information, RAA and Savage entered into a nondisclosure agreement. The NDA contained standard provisions to the effect that Savage was not "making any representation or warranty, express or implied, as to the accuracy or completeness of . . . any . . . information" provided to RAA during the diligence process, and further that only those representations and warranties that might ultimately be made in a formal purchase and sale agreement between the parties (if they got that far) would have any legal effect.

RAA claimed Savage told it at the outset of their discussions that there were "no significant unrecorded liabilities or claims against Savage," but then months into RAA's due diligence (and after negotiation of a letter of intent and exclusivity agreement) Savage disclosed three such matters, which led RAA to immediately cease negotiations and walk away. RAA asserted that had it known of those liabilities it would not have considered purchasing Savage, and Savage should be liable for the entirety of RAA's alleged $1.2 million in due diligence and negotiation costs for having intentionally misled RAA. The Delaware Supreme Court affirmed the lower court in rejecting RAA's claim for compensation.

Based on my own intuition and highly unscientific sampling, I expect that many people not regularly involved in commercial transactions would be surprised if a party that had intentionally misled another would not be held responsible for doing so. And it is not as if parties in the position of RAA, who are vulnerable to being misled in the circumstances, can easily protect themselves. Auction dynamics are such that it may be very difficult to negotiate amendments to nondisclosure agreements at early stages of the process, and staging diligence processes so more expensive activities occur at a later stage may be difficult where the vendors require some degree of certainty. In other words, it is not as if the fact of decisions such as this can easily lead to efficient changes in the conduct of strategic auctions.

Nevertheless, in *RAA Management*, the court, consistent with earlier decisions, held the parties to the language of the agreement. The principle it emphasized was the sanctity of the written agreement — were parties permitted to assert claims expressly precluded by the terms of a contract, the reasonable commercial expectations of the contracting parties would be defeated and the utility of written contracts would be eviscerated, or at least undermined. Lawyers are acutely aware other lawyers can creatively wedge complaints about behaviour into whatever carve-outs are included in a contract.

"First principles" led the way to this result. Certainty of contract is, of course, one of the most basic and widely respected principles. However, somewhere along the path to this decision, the appealing logic (and competing principle) that parties ought not to be protected from responsibility for the consequences of their own intentional misconduct got left behind (though it can be observed that a party looking to make a claim where it expressly waived its right to do so by contract is itself going back on its word, though this kind of logic can take you in circles). At the end of the day, first principles are available and of great assistance and support even if you need to think your way through and sometimes choose between them — it's only common sense. CL

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