

Securities Litigation & Enforcement News

Current Legal Developments in the Broker-Dealer Arena

March 1, 2012

Illinois Appellate Court Reaffirms Rulings That Nonreliance Clauses Bar Fraud Claims

Last month, in *Greer v. Advanced Equities, Inc.*, 2012 WL 335869 (Jan. 31, 2012), the First District of the Appellate Court of Illinois squarely held that “a purchaser of securities [who] contractually agrees through a non-reliance clause that it is not relying on any oral representation made in connection with its purchase of the securities” is “barred as a matter of law from thereafter pleading in an action alleging common law fraud that it relied on oral statements when purchasing the securities.” In so holding, the Court clarified existing law and made clear that in Illinois, as in many other jurisdictions, written nonreliance clauses are enforceable against fraud claims based on oral representations.

In *Greer*, the plaintiffs had received a private placement memorandum (PPM) prior to purchasing the shares at issue and then signed a subscription agreement in order to consummate the stock purchase. The subscription agreement contained a nonreliance clause wherein the plaintiffs represented that they had received a copy of the PPM and that, in “evaluating the suitability of an investment” in the company at issue, plaintiffs had “relied solely upon the [PPM], documents and materials submitted therewith, and independent investigations made by [plaintiffs] in making the decision to purchase the Shares subscribed for herein, and acknowledge[d] that no representations or agreements (oral or written), other than those set forth in the [PPM], have been made to the [plaintiffs] with respect thereto.” Despite signing the subscription agreement, the plaintiffs alleged common law fraud based on alleged oral misrepresentations about the company in which they invested.

The legal question before the court was whether the plaintiffs could “claim to have justifiably relied on an oral representation while simultaneously disclaiming such reliance in the nonreliance clause of the written subscription agreement?” The Court answered that question in the negative, reaffirming and clarifying the holdings in three prior decisions regarding nonreliance clauses: *Adler v. William Blair & Co.*, 271 Ill. App. 3d 117 (1995); *Tirapelli v. Advanced Equities, Inc.*, 351 Ill. App. 3d 450 (2004); and *Benson v. Stafford*, 407 Ill. App. 3d 902 (2010). Specifically, the court held that:

[b]ased on *Benson*, *Tirapelli*, and *Adler*, the law on this point seems quite clear: if a purchaser signs an agreement containing a nonreliance clause that disclaims reliance on any oral representations by the seller, then the purchaser cannot thereafter maintain a cause of action for common-law fraudulent oral misrepresentation. This is a logical rule, given that it is hardly justifiable for someone to rely on something that they have agreed not to rely on, and without justifiable reliance there can be no fraud.

In so holding, the Court rejected the plaintiffs' contention that the above rule — which the court referred to as the “*Adler* rule” — “only bars claims that are based on oral misrepresentations that contradict written representations such as those contained in the PPM.”

[O]ur decision in *Adler* did not depend on any contradiction between oral and written representations. Rather, the holding in *Adler* was grounded in the irreconcilable contradiction between the existence of the nonreliance clause, which disclaimed reliance on any information not contained in the PPM, and the plaintiffs' claims that they had, in fact, relied on information outside of the PPM.

Thus, “the *Adler* rule applies even where there is no contradiction between oral and written representations.” The Court likewise rejected the plaintiffs' contention that federal law should influence the interpretation or application

of the *Adler* rule since it is “clear that Illinois state law as expressed in the *Adler* rule is distinct from federal treatment of the same issue.”

The Court did recognize, however, that there could be “circumstances in which a nonreliance clause might not be dispositive, for example if the clause merely disclaimed reliance on written representations but was silent as to oral representations.” As a result, a nonreliance clause might not be dispositive if the clause did not cover the representations allegedly forming the basis for the a common law fraud claim.

Drafters of subscription documents should be vigilant and include oral representations in nonreliance clauses to avoid this potential gap in coverage.

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