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At Liberty to Lie? The Viability of Fraud Claims after Disclaiming Reliance

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Writing for the New York Court of Appeals, Judge Edward R. Finch once wrote, "[a] rogue cannot protect himself from liability for his fraud by inserting a printed clause in his contract."*Ernst Iron Works v. Duralith Corp.*, 270 N.Y. 165, 169 (1936). Today, many courts are disagreeing with Judge Finch's premise, holding that fraud claims are precluded where the complaining party contractually disclaims reliance on his or her opponent's statements. In sum, with a properly drawn contract, a party may be at liberty to lie.

Waiver of Reliance Provisions

Waiver of reliance provisions—also known as disclaimer of reliance provisions, contractual disclaimers of reliance (CDRs), or "big boy provisions"—have received significant attention in both state and federal courts in the past few years as they have gained popularity in commercial transactions. As the name suggests, by executing a contract containing a waiver of reliance clause, a party disclaims any reliance on statements made or information provided by the other party. Essentially, the party confirms that it is a "big boy" and is conducting its own due diligence.

Because reliance is a necessary element of fraud, a disclaimer of reliance provision is intended to prevent claims such as fraudulent inducement or fraudulent misrepresentation. Unlike traditional merger, "as is," or integration clauses, which generally do not preclude a claim of fraud in the inducement, a waiver of reliance clause may provide a shield to such claims, depending on the jurisdiction.

Origin of the Provision

In a case widely recognized as the first to address waiver of reliance provisions, the New York Court of Appeals in *Danann Realty Corp. v. Harris*, 5 N.Y.2d 317 (1959), considered whether a purchaser of a building could assert a claim for fraud against the seller for alleged misrepresentations as to the profitability of the property. In the purchase and sale contract, the purchaser had acknowledged that the seller had made no representations "as to the physical condition, rents, leases, expenses, operation or any other matter or thing affecting or related to the aforesaid premises." *Id.* at 320. Ruling that "[s]uch a specific disclaimer destroys the allegations in plaintiff's complaint that the agreement was executed in reliance upon these contrary oral representations," the court determined that the plaintiff had no cause of action for fraud. *Id.* at 320–21.

The court's holding appears to be founded on freedom of contract principles. Specifically, the court noted that to allow the fraud claim would be to hold that it is "impossible" for two parties to contractually waive reliance. *Id.* at 323. Further, in perhaps ironic fashion, the court concluded that in bringing the fraud claim, the alleged defrauded purchaser was, in effect, perpetrating its own fraud:

> [P]laintiff made a representation in the contract that it was not relying on specific representations not embodied in the contract, while, it now asserts, it was in fact relying on such oral representations. Plaintiff admits then that it is guilty of deliberately misrepresenting to the seller its true intention. To condone this fraud would place the purchaser in a favored position.

Id.

Today, courts in many other jurisdictions have followed the lead of the New York Court of Appeals and dismissed fraud claims as barred by a waiver of reliance provision. *See, e.g.*,*In re Capco Energy, Inc.*, 669 F.3d 274, 283 (5th Cir. 2012) (applying Texas law); *Barr v. Dyke*, 49 A.3d 1280 (Me. 2012); *RAA Mgmt., LLC v. Savage Sports Holdings, Inc.*, 45 A.3d 107, 117 (Del. 2012) (applying New York law, but concluding decision would have been the same under Delaware law); *Colo. Coffee Bean, LLC v. Peaberry Coffee Inc.*, 251 P.3d 9, 19 (Colo. Ct. App. 2010); *Schlumberger Tech. Corp. v. Swanson*, 959 S.W.2d 171, 179 (Tex. 1997) ("Parties should be able to bargain for and execute a release barring all further dispute. This principle necessarily contemplates that parties may disclaim reliance on representations. And such a disclaimer, where the parties' intent is clear and specific, should be effective to negate a fraudulent inducement claim.").

Limitations of Waiver of Reliance Provisions

However, even in jurisdictions enforcing waiver of reliance provisions, courts are not providing blanket approval. For example, the Supreme Judicial Court of Maine, in *Barr v. Dyke*, set forth six factors that a court must consider when determining whether to enforce the disclaimer of reliance provision, including whether the provision was negotiated, the parties' sophistication in business matters, and whether the parties were represented by counsel. 49 A.3d at 1289. Likewise, in *Forest Oil Corp. v. McAllen*, 268 S.W.3d 51, 60 (Tex. 2008), the Texas Supreme Court held that courts must consider these same factors in determining whether to enforce a CDR.

Further, some courts have declined to enforce a waiver of reliance clause where the facts alleged to be misrepresented are peculiarly within the defendant's knowledge. In such cases, courts have held that a plaintiff is entitled to rely on the representations because he or she has no independent means of ascertaining the truth. *See Warner Theatre Assocs. Ltd. P'ship v. Metro. Life Ins. Co.*, 149 F.3d 134, 136 (2d Cir. 1998). Other courts have rejected such an exception. *See, e.g.*, *RAA Mgmt., LLC v. Savage Sports Holdings, Inc.*, 45 A.3d 107, 116 (Del. 2012) (declining to apply peculiar-knowledge exception).

Although the applicable considerations vary among jurisdictions, most courts require waiver of reliance clauses to address the matter at issue specifically. *Barr*, 49 A.3d at 1286 (enforcing CDR where the provision was "specific" and "encompass[ed] the very challenge now presented"); *Slack v. James*, 614 S.E.2d 636, 641 (S.C. 2005) (clause stating plaintiffs "have not received or *relied upon* any statements or representations by either [defendants] or their agents" was not sufficiently specific and was not set apart from other contractual provisions, precluding conclusion that it was a true disclaimer of reliance clause); *Keller v. A.O. Smith Harvestore Prods., Inc.*, 819 P.2d 69, 74 (Colo. 1991) (disclaimer-of-reliance clause did not preclude plaintiff's claim because disclaimer was not "couched in clear and specific language"); *Schlumberger Tech. Corp. v. Swanson*, 959 S.W.2d 171, 181 (Tex. 1997) (provision disclaiming reliance on representations about "specific matters in dispute" may preclude claim of fraudulent inducement).

Courts in some jurisdictions have refused to honor waiver of reliance clauses entirely. For example, in *Snyder v. Lovercheck*, 992 P.2d 1079, 1086 (Wyo. 1999), the Supreme Court of Wyoming adhered to the principle that fraud vitiates a contract and concluded that enforcing CDRs "would open[] the door to a multitude of frauds and [thwart] the general policy of the law." Likewise, the Supreme Court of New Hampshire, in *Van Der Stok v. Van Voorhees*, 151 N.H. 679 (2005), declined to adopt the reasoning in *Danann* and held that a specific contractual disclaimer may not negate reliance.

Other courts have taken a hybrid approach, such as affording a no-reliance provision some weight without finding it dispositive. For example, in *Flakus v. Schug*, 213 Neb. 491, 494–95 (1983), *overruled on other grounds, Nielsen v. Adams*, 223 Neb. 262 (1986), the court held that the disclaimer clause did not preclude the assertion of a fraudulent inducement claim; rather, the existence of the disclaimer clause was one factor to consider when determining whether the plaintiff reasonably relied on a false representation. Likewise, in *Jared & Donna Murayama 1997 Trust ex rel. Murayama v. NISC Holdings, LLC*, 82 Va. Cir. 38 n.2 (2011) *aff'd*, 727 S.E.2d 80 (Va. 2012), the court held that although "a contractual disclaimer of reliance is itself not a prophylactic against a claim of fraud," the court would consider the language at issue in determining whether the plaintiff's reliance was reasonable.

The Special Case of Fiduciaries

When a defendant owes fiduciary duties to a plaintiff who disclaims reliance, courts are understandably reluctant to enforce the disclaimer. In those instances, enforcing a CDR would be seemingly incongruent with the law of fiduciary responsibilities, because the fiduciary could withhold necessary information, or provide inaccurate information, to a party to whom it owes a special degree of honesty and trust. For this reason, courts have frequently declined to enforce CDRs in the context of a fiduciary relationship unless the fiduciary has fully disclosed all material information—substantially defeating the very purpose of the CDR. As one court noted, "[i]f a fiduciary relationship already exists, the fiduciary must disclose all material facts before diving through the escape hatch of a contractual disclaimer." *Khan v. BDO Seidman, LLP*, 408 Ill. App. 3d 564, 589, 948 N.E.2d 132, 154 (2011), *aff'd sub nom. Khan v. Deutsche Bank AG*,

978 N.E.2d 1020 (Ill. 2012) ("where parties in a preexisting fiduciary relationship make a contractual representation to one another that no representations have been made, the contract, including its no-representation clause, is voidable unless the fiduciary has made full disclosure of all material facts").

New York courts originally followed this approach (*see Littman v. Magee*, 54 A.D.3d 14 (1st Dept. 2008)); however, the New York Court of Appeals recently ruled that a sophisticated party may release its fiduciary from fraud claims when the releasing party understands that the fiduciary is acting in its own interest and the release is knowingly executed. *Centro Empresarial Cempresa S.A. v. Am. Movil, S.A.B. de C.V.*, 952 N.E.2d 995, 1001 (N.Y. 2011). In addition to freedom of contract principles, the rationale for that position is that "when parties in a fiduciary relationship have become adversaries…they ordinarily have discarded the relationship of trust in pressing the dispute." *Barr v. Dyke*, 49 A.3d 1280, 1289 (Me. 2012).

Waiver of Reliance Provisions and Parol Evidence

Across jurisdictions, the parol evidence rule bars evidence of oral representations that contradict a contract. An exception to the parol evidence rule exists, however, when a party claims that it was fraudulently induced to enter into the contract by misrepresentations. When reliance on such misrepresentations is disclaimed, the question then becomes whether that waiver will operate as an exception to the exception, precluding evidence of oral representations.

Some courts have held that it does. Concerned that a suit for fraud may be used to circumvent the evidentiary limitations inherent in a suit for breach of contract, the S*eventh Circuit, in Extra Equipamentos e Exportacao Ltda. v. Case Corp.*, 541 F.3d 719, 724 (7th Cir. 2008), held that a disclaimer of reliance provision may "clos[e] the loophole in contract law" by foreclosing a suit for fraud and precluding contradictory oral evidence. *Seealso id.* (noting that "a suit for fraud can be a device for trying to get around the limitations that the parol evidence rule and contract integration clauses place on efforts to vary a written contract on the basis of oral statements made in the negotiation phase"); *Rosenblum v. Glogoff*, 946 N.Y.S.2d 167, 168–69 (1st Dept. 2012) ("Although a general merger clause will not preclude parol evidence regarding fraud in the inducement or fraud in the execution, where the parties expressly disclaim reliance on the particular misrepresentations, contrary parol evidence is barred." (internal citations omitted)).

Other courts have held, despite the existence of a disclaimer of reliance provision, that the parol evidence rule does not preclude evidence of fraud. *In re Heritage Org., LLC*, 375 B.R. 230, 263 (Bankr. N.D. Tex. 2007) ("the general rule in Texas is that waiver/release/merger/reliance disclaimer clauses … can be avoided by proof of fraud in the inducement, and the parol evidence rule does not bar proof of such fraud"); *Travelodge Hotels, Inc. v. Honeysuckle Enters., Inc.*, 357 F. Supp. 2d 788, 795 (D.N.J. 2005) ("the parol evidence rule does not bar evidence of prior oral communications between the parties, notwithstanding the integration clause and disclaimer of reliance").

Conclusion

Waiver of reliance provisions can provide some protection to parties who seek to limit their exposure to potential fraud claims. However, as discussed above, courts throughout the United States have taken widely different approaches—resulting in widely different conclusions—regarding the enforceability of such provisions. Parties must pay careful attention to the law of the governing jurisdiction and recognize that many factors—including a preexisting fiduciary relationship, the sophistication of the waiving party, representation by counsel, and availability of material information—will be considered in determining whether or not the waiver will be effective.

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