Where Is "As Is, Where Is" in Texas?

The Confusing State of the Impact of Contract Disclaimers on Tort Claims in Texas

Neil Kenton Alexander
Partner
(713) 226-6614 Telephone
kalexander@porterhedges.com

PORTER HEDGES LLP
1000 Main Street, 36th Floor
Houston, TX 77002

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Neil Kenton Alexander, Partner, Porter Hedges LLP[1]

Introduction

Contract parties, sophisticated and unsophisticated, often attempt to limit their exposure to post-execution claims of the contract counterparty, particularly to misrepresentation claims, by the contract language. These include merger clauses, "no representation" clauses, "no reliance" clauses, and others this paper refers to as "contract disclaimers." Texas courts have over many years repeatedly interpreted these contract disclaimers, sometimes applying them to cut off claims, and sometimes not. These decisions have created special challenges for lawyers assisting clients in drafting contracts and interpreting them, and created a minefield for non-lawyers preparing contracts. This paper attempts to identify the mines in the minefield, and examine the leading Texas Supreme Court decisions on this topic.

Unfortunately, Texas courts, including the Supreme Court, in deciding which contract disclaimers to enforce have often applied a mechanical approach more driven by what sophisticated lawyers do than what consumers or business people do, with little attention to the realities of the contracting process. They have interpreted some contract language to limit or eliminate claims, and interpreted other functionally indistinguishable contract language as not barring such claims.

For convenience, this paper refers to contract parties as "Sellers" and "Buyers." Most commonly, it is the Seller who is more interested in limiting post-contract exposure, but sometimes the Buyer also wants to limit liability. Sellers of goods, businesses, services, and real estate have devised many means attempting to limit that exposure, including the following contract disclaimers:

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[1] J.D. 1978, Harvard Law School, B.A., 1975, Rice University. Mr. Alexander has over forty years of experience representing clients in complex federal and state court litigation, including breach of contract and tort claims arising from acquisitions and dispositions of real estate, business enterprises, industrial equipment, and intellectual property, construction contracts, and environmental claims. http://www.porterhedges.com/Professionals/NeilKentonAlexander

1. Limitations of warranty

2. Limitations of Buyer's remedies (e.g. repair or replace only, no consequential or punitive damages)[2]

3. "As is, where is"

4. Buyer indemnification of Seller against certain kinds of claims.

Sellers also have devised language to limit Buyers from later claiming that Seller allegedly made promises or representations during the sales process that the Seller did not make or, if made, should not bind the Seller. Common contract language used for this purpose includes:

5. Merger clause – last written agreement is the only agreement

6. No representation clause – similar to "as is, where is"; an effort to limit to explicit written representations in the contract

7. No reliance clause – Buyer explicitly disclaims reliance on anything the Seller has represented

8. Warning provisions – Clauses drawing the Buyer's attention to risks

Texas courts and the Texas legislature have been battlegrounds over which contract disclaimers should preclude the assertion of claims in various circumstances, as a matter of contract law, tort law, or both. The results have been often inconsistent and irreconcilable, and usually without a meaningful discussion of the larger issues presented.

Court decisions and legislation that have enforced contract disclaimers, or declined to do so, implicitly or explicitly have considered such factors as:

1. The perceived bargaining power of the parties

2. The seriousness or nature of the harm caused (e.g. personal injury)

[2] The Texas Supreme Court has held that a waiver of punitive damages in a contract induced by fraud is enforceable. *Bombardier Aerospace Corp. v. SPEP aircraft Holdings, LLC*, 572 S.W.3d 213, 229-33 (Tex. 2019).

3. Whether a "defect" known to the Seller was "hidden" or "discoverable"

4. The ability to avoid the harm by the Seller, the Buyer, or both

5. Whether the parties were represented by lawyers

6. The "innocence," "negligence," or scienter of the Seller in failing to disclose material information or making a misrepresentation

7. Whether the Seller explicitly warned the Buyer to make Buyer's own assessment of specific information that later proved material.

8. The "negligence" of the Buyer in failing to learn of or deal with the misrepresentation or defect

9. The "conspicuousness" of the Seller's contract notice that Seller is limiting its liability or disclaiming representations.

10. Whether the risks imposed on the Buyer were obvious

11. Philosophical considerations behind "freedom of contract" and duty, or lack thereof, between contract parties dealing at arm's length

12. The impact on third parties to the contract

Unfortunately, Texas courts, including the Supreme Court, have often confused when these factors are (or should be) important, and when they are not.

This paper addresses prototypical contract situations and contract disclaimers on claims asserting that the Seller failed to disclose material facts or made misrepresentations regarding facts prior to the execution of the contract.

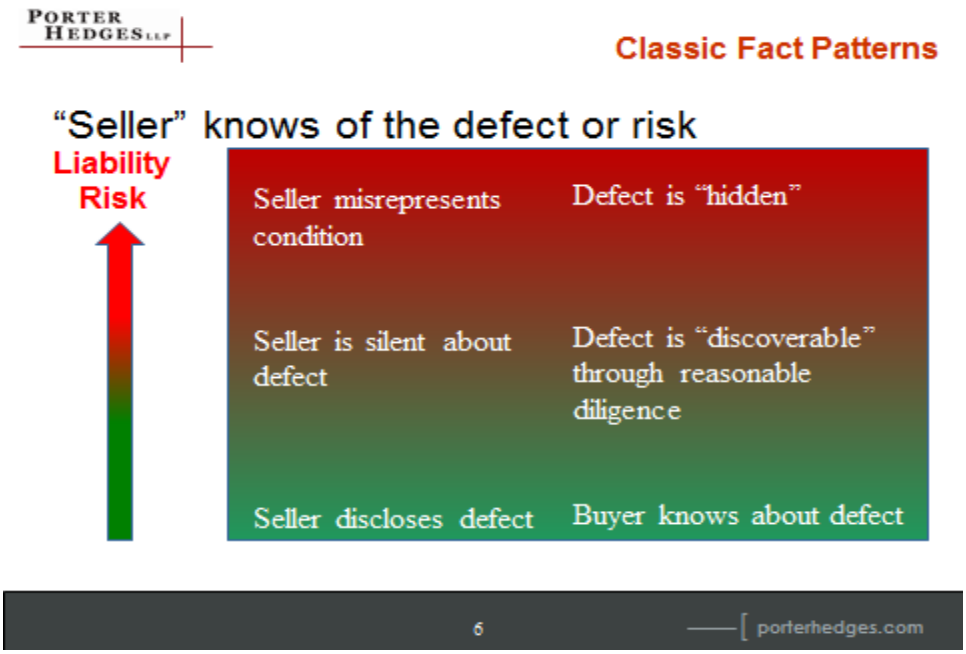
1. Prototypical Contract Situations

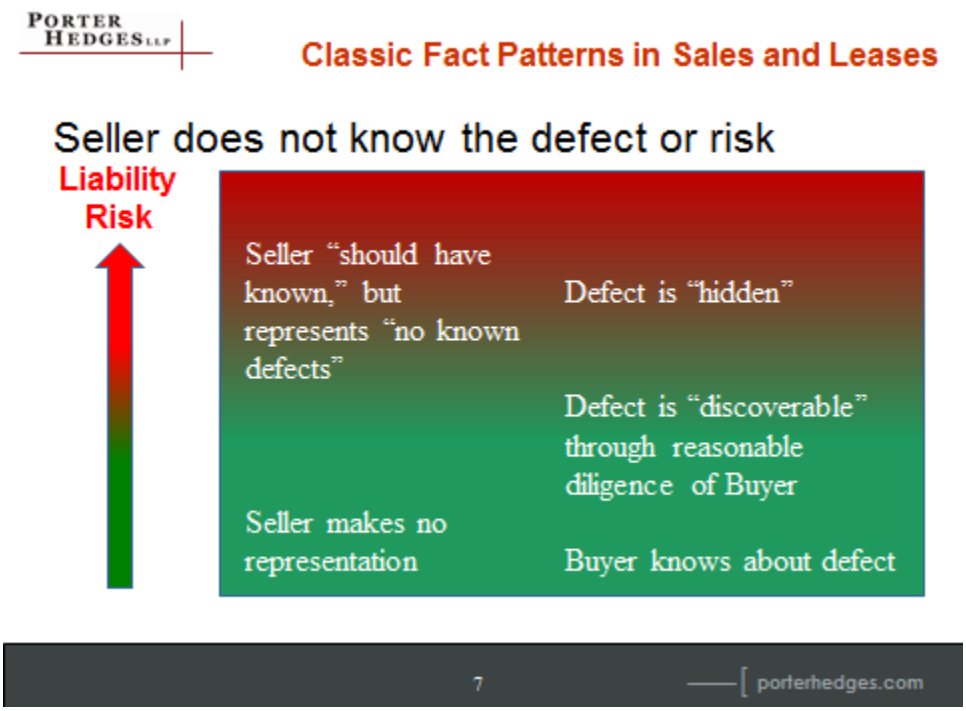
A Seller seeks to sell goods, services, securities, or real estate. Seller markets these, and inevitably makes representations regarding that which is offered for sale. The Seller often (although not always) knows more about what is to be sold than the Buyer. The Buyer conducts some investigation regarding what Buyer proposes to buy. At some point a contract is proposed or written. Drafting of the contract may occur at the beginning of the marketing process, or only at the end.

Seller and Buyer commonly make representations to one another regarding the subject matter of the proposed transaction. Sometimes those representations are not true or are "puffery." These types of alleged misrepresentations might be unintentional, negligent or just an outright lie. Other times they are incomplete. The Seller may know information that is material, and unknown to the Buyer, but chooses not to disclose it. Representations may occur during a sales process that long predates any commitment by either Seller or Buyer, or they may be incorporated in a final written agreement.

Where Seller and Buyer will have an ongoing relationship that is the subject of the contract following execution, as in a construction contract, lease, and some services contracts, both Seller and Buyer may have separate, strong interests in limiting post-contract liability. Where the contract essentially concludes the relationship, as in the one-time sale of goods, real estate, a business, or intangible assets, a Seller may have a much greater interest in limiting liability or remedies than the Buyer. This puts the practical burden on Buyer and Buyer's lawyers to identify both the exposures and the related risks shifted to the Buyer under the contract, some of which may be unfamiliar to them.

Courts are called on to decide how the parties' contractual bargain in fact allocated the risk, and whether there are public policy considerations for reallocating that risk. As a general matter, a significant factor has been whether the Seller knew of the risk or defect before executing the contract, as summarized on the following graphs:





The following fact patterns exemplify the differing incentives of Buyer and Seller, and are useful for examining how Texas courts have inconsistently determined when contract disclaimers should cut off the assertion of claims based upon alleged misrepresentations or non-disclosures by the Seller.

A. Fact Pattern 1 – Tractor Sale

Buyer purchases a tractor from Seller. Seller makes numerous representations about the capabilities of the tractor. The buyer, relying on those representations, buys the tractor. The tractor does not, in fact, have the capabilities represented. The purchase agreement is just a completed order form from Seller. The front of the form expressly states "no warranty was made or authorized other than in this agreement" and references the back of the form. The back of the form contains a six month warranty of the product but disclaims all other warranties and representations.

Does the contract bar Buyer's claims based on the tractor's lack of the capabilities represented?

B. Fact Pattern 2 – Real Estate Lease

A restaurateur is searching for space for a new restaurant. Lessor shows him an existing space and represents that the space has no problems, is like-new and perfect for a restaurant. The Lease states that the restaurateur is not relying on any representation not included in the written Lease, which is otherwise silent about the suitability of the property for a restaurant. Shortly after opening, the restaurateur notices a very strong sewage odor. The odor greatly reduces the number of customers the restaurant is able to attract. The lessor knew about the problem, as the prior lessee had left for the very same reason.

Does the contract bar Buyer's claims that the space was unsuitable?

C. Fact Pattern 3 – Construction Contract

A pipeline owner takes bids from various contractors to replace an existing, old pipeline. The pipeline owner represents that it will have exercised due diligence in investigating the site and discloses 280 foreign crossings along the path of the pipeline. The contractor is given the opportunity to inspect the pipeline and actually does so. The contractor submits the low bid and gets the project. The contract says the risk of "conditions pertaining to the Work, the site of the Work or its surroundings and all risks in connection therewith" is on the contractor. The contract also says the contractor will conduct its own investigation of the risks. After the project begins, the contractor finds more than 500 additional, previously unknown foreign crossings. The newly discovered crossings will cause the cost of the project to more than double.

Does the contract bar Buyer's fraud claim? Does it bar a breach of contract claim?

We will return to these Fact Patterns later in this discussion.

2. Seller's Potential Options for Avoiding Buyer Claims Based on Misrepresentations or Non-Disclosure

Logically, a Seller has the following options to eliminate or reduce the risk of a Buyer's claim based on the assertion of misrepresentation or non-disclosure:

A. Make full disclosure of material facts

This is the approach often required by statutory securities law, but generally not in other contexts. The Seller's challenge is both identifying what is "full disclosure" and identifying and documenting that disclosure, which may be difficult or expensive.

B. Make no disclosures at all

This is entirely impractical in many sales contexts, and for many Sellers, extremely difficult to enforce as a policy in the face of Seller efforts to sell and Buyer questions.

C. Contractually require Buyer to assume risk or release future claims based on misrepresentation or non-disclosure

Sellers and their counsel have been creative in devising contract language for this purpose. Examples:

1. "As is, where is, with all faults."
2. Buyer assumes all risks.
3. The contract is the entire agreement.
4. All agreements are merged into the final agreement. (Merger Clause)
5. Buyer is not relying on anything the Seller has said.
6. Buyer agrees seller has made no representations except . . . .

7. Buyer is relying solely on its own investigation.
8. Buyer indemnifies seller against all claims by Buyer and third-parties.

As shown below, Texas courts have been inconsistent in deciding whether the contract language in fact immunizes the Seller. This creates challenges for Buyers, Sellers, and their lawyers.

D. Contractually require Buyer to limit certain remedies

Sellers sometimes include provisions that limit remedies, whether for breach of contract or tort, by including disclaimers of consequential damages, limiting claims to the purchase price paid by the Buyer, and eliminating punitive damages.

3. Statutory Limitations on Seller's Contractual Ability to Allocate Risks to Buyers

Texas statutes have also altered the ability of Buyers and Sellers to allocate these risks contractually in certain kinds of transactions.

A. Texas Deceptive Trade Practices Act

One of the best examples is the Deceptive Trade Practices Act. In a consumer transaction, a seller must be concerned with claims where no reliance at all is required. For example, the Texas Deceptive Trade Practices Act only requires the consumer to prove that the false representation was the producing cause of the alleged injury and no reliance must be demonstrated. *See Prudential Ins. Co. of America v. Jefferson Assocs., Ltd.*, 896 S.W.2d 156, 161 (Tex. 1995). Waivers of D.T.P.A. provisions are void unless the consumer is represented by counsel, is not in a significantly disparate bargaining position and signs the waiver. TEX BUS. & COM. CODE § 17.42. The waiver must be conspicuous and substantially in the form set out in the D.T.P.A. *Id*. It is imperative that Seller attempting to require Buyer to waive D.T.P.A. provisions look to the act itself and ensure that any proposed waiver is in the form set out in the D.T.P.A. "I waive my rights under the Deceptive Trade Practices-Consumer Protection Act, Section 17.41 et seq., Business & Commerce Code, a law that gives consumers special rights and protections. After consultation with an attorney of my own selection, I voluntarily consent to this waiver."

B. Texas Solid Waste Disposal Act (Texas version of CERCLA)

Similar to the federal CERCLA law imposing liability on owners, operators, and arrangers for disposal of hazardous waste, the Texas Solid Waste Disposal Act imposes liability on such parties who are responsible for waste. In *Bonnie Blue, Inc. v. Reichenstein*, 127 S.W.3d 366 (Tex. App.—*Dallas 2004, no pet.)*, the Buyer, Bonnie Blue, purchased a property which subsequently required substantial environmental remediation. Bonnie Blue then sued the Seller to recover costs of the environmental remediation. The previous property owner was granted summary judgment based on the "as is" clause in the contract for sale. Bonnie Blue appealed to the Dallas Court of Appeals. The Dallas Court of Appeals held that an "as is, where is" clause does not bar Texas Solid Waste Disposal Act claims. Specifically, the clause in *Bonnie Blue* stated:

> Purchaser acknowledges that he has inspected all buildings and improvements situated on the property and is thoroughly familiar with their condition, and Purchaser hereby accepts the property and the buildings and improvements situated thereon, in their present condition, with such changes therein as may hereafter be caused by reasonable deterioration.

The court noted that the clause at issue might bar claims that were premised on any alleged reliance on misrepresentations, but the claim under the Solid Waste Disposal Act was a statutory claim with no reliance element whatsoever. The claim simply required the plaintiff to prove that the defendant was a "responsible party" under the Act. It should also be noted that the federal circuit courts of appeal are divided as to whether an "as is" clause bars similar CERCLA claims.

4. Innocent or Negligent Misrepresentation by Seller

Texas courts have been reasonably consistent on the impact of contract disclaimers on claims grounded in a Seller's alleged innocent or negligent misrepresentation of material facts. A properly drawn contract disclaimer will be enforced to prohibit such claims. *See, e.g., Matlock Place Apartments, L.P. v. Druce*, 369 S.W.3d 355 (Tex. App.—Fort Worth 2012, pet. denied); *Simpson v. Woodbridge Properties, L.L.C.*, 153 S.W.3d 682 (Tex. App.—Dallas 2004, no pet.); *Coastal Bank SSB v. Chase Bank of Texas, N.A.*, 135 S.W.3d 840 (Tex. App.—Houston [1st Dist.] 2004, no pet.). What constitutes a properly drawn

disclaimer? The question is not easily answered, but reference to disclaimers enforced by the courts to bar negligent misrepresentation claims is helpful. For instance, the disclaimer in *Matlock Place* stated:

> BUYER ACKNOWLEDGES THAT IT WILL INSPECT THE PROPERTY AND BUYER WILL RELY SOLELY ON ITS OWN INVESTIGATION OF THE PROPERTY AND NOT ON ANY INFORMATION PROVIDED OR TO BE PROVIDED BY SELLER. BUYER FURTHER ACKNOWLEDGES THAT THE INFORMATION PROVIDED AND TO BE PROVIDED WITH RESPECT TO THE PROPERTY WAS OBTAINED FROM A VARIETY OF SOURCES AND SELLER (I) HAS NOT MADE ANY INDEPENDENT INVESTIGATION OR VERIFICATION OF SUCH INFORMATION; AND (II) DOES NOT MAKE ANY REPRESENTATIONS AS TO THE ACCURACY OR COMPLETENESS OF SUCH INFORMATION.

Matlock Place Apartments, 369 S.W.3d at 370-71. In *Simpson*, the agreement at issue contained a merger clause which further stated, "[t]he Parties shall not be bound by any stipulations, representations, agreements or promises, oral or otherwise not printed or inserted in written form in the Agreement." *Simpson*, 153 S.W.3d at 683. In *Coastal Bank*, the disclaimer at issue was found in a confidential information memorandum provided to potential investors. The memo expressly stated that the information was provided for solely for informational purposes and that Chase had not "independently verified any of the information and data contained herein and make[s] no representation or warranty as to the accuracy of completeness of such information. . . . Each recipient of the information and data contained herein should perform its own independent investigation and analysis of the transaction and the creditworthiness" the mortgage company borrower. *Coastal Bank*, 135 S.W.3d at 844.

5. Is Silence a Defense to Fraud?

Ordinarily, true silence is a defense to fraud. There must be a duty to disclose before failure to disclose can be a basis for fraud. However, the Texas Supreme Court in *Smith v. Nat'l Resort Communities, Inc.*, 585 S.W.2d 655, 658 (Tex. 1979), held that a seller of real estate has a common law duty to disclose material facts which would not be discoverable by the exercise of ordinary care and diligence on the part of the purchaser, or which a reasonable investigation and inquiry would not uncover, and the failure to do so is a predicate for a fraud claim.

6. Intentional or Reckless Misrepresentation or Non-Disclosure by Seller

On the other hand, Texas courts have been inconsistent in their analysis of the impact of contract disclaimers on fraud claims grounded in allegations of intentional or reckless misrepresentation or non-disclosure by Sellers.

A. *Dallas Farm Machinery Co. v. Reaves*, 307 S.W.2d 233 (Tex. 1957)

Dallas Farm Machinery is a seminal case of Texas common law fraud. It held that parol evidence is admissible to prove fraud, and is part of a long line of cases that viewed proof of fraud as vitiating the defrauded Buyer's "consent" to the terms of its written contract. It left to a jury to decide whether the allegedly defrauded party was in fact defrauded, notwithstanding contract disclaimers that seemingly contradicted the fraud elements of Seller's misrepresentation or Buyer's reliance. *Dallas Farm Machinery* is the rare case where the Texas Supreme Court admitted that prior decisions were irreconcilable and attempted to resolve whether fraudulent inducement or fraud in the execution was sufficient to void a contract.

(1) Facts

The facts should sound familiar (see Fact Pattern 1 above). In *Dallas Farm Machinery*, Reaves purchased a tractor from Dallas Farm Machinery. Reaves traded in his old tractor as part of the purchase. One of the partners in Dallas Farm Machinery represented to Reaves that the new tractor had certain capabilities which it ultimately proved not to have. *Id*. at 234. After taking delivery of the new tractor, Reaves became aware of the salesman's misrepresentations, returned the new tractor and demanded return of his old tractor. *Id*. at 241. Dallas Farm Machinery refused to return the trade-in tractor and took possession of the new tractor under a writ of sequestration. *Id*. Reaves filed a cross-action for rescission of the contract and recovery of the value of the trade-in tractor. *Id*.

(2) Procedural history

The trial court entered judgment for Reaves and the Fort Worth Court of Appeals affirmed. *Id*. at 233-34. On appeal to the Supreme Court, only the discrete issue of whether parol evidence is admissible to establish that the contract containing a merger clause was induced by fraud was considered. *Id*. at 233.

(3) Discussion

The contract at issue (a completed order form) contained two relevant clauses:

> I have read the matter on the back hereof and agree to it as a part of this order as if it were printed above my signature. I also acknowledge receipt of a copy of this order which is understood to be the entire contract relating to the sale and warranty of the above described equipment excepting as to any notes, conditional sales contracts or chattel mortgages entered into as above specified.
>
> and
>
> **Warranty and Agreement**
> Seller warrants that new Oliver goods herein described are well made and of good material, and agrees to replace, F.O.B. sellers place of business, for a period of six months after delivery of such goods to Buyer by Seller, such parts found upon inspection to be defective in workmanship or material. . . . This warranty is made in lieu of all other warranties, express or implied, and no warranty is made or authorized to be made other than herein set forth.

Id. at 234.

The Supreme Court noted that "[a] review of Texas cases on the question reveals conflicting decisions and indicates a resulting confusion which can hardly be explained away with nice distinctions." *Id*. at 234. Interestingly, the Court looked to a similar case decided by the Supreme Judicial Court of Massachusetts for guidance. *Id*. at 239. The Court observed that Massachusetts law had been similarly conflicted and the Massachusetts Court held under very similar facts that "a written contract containing a merger clause can be avoided for antecedent fraud or fraud in its inducement and that the parol evidence rule does not stand in the way of proof of such fraud." *Id*. The Court then held that the contract at issue could be avoided despite the presence of both the merger clause and the disclaimer of warranties. *See id*.

B. *Prudential Ins. Co. of America v. Jefferson Assoc., Ltd.*, 896 S.W.2d 156 (Tex. 1995)

(1) Facts

Buyer purchased an office building from Prudential. Prudential made representations that the building was "superb" and "super fine." Prudential did not know the building contained asbestos and did not disclose that fact to the buyer. *Id*. at 159. Approximately two years after the purchase, the building was found to contain asbestos. *Id*. at 158. The buyer sued for damages and Prudential asserted that buyer's claims were barred by the "as is" clause in the contract. Specifically, the contract stated:

> As a material part of the consideration for this Agreement, Seller and Purchaser agree that Purchaser is taking the Property "AS IS" with any and all latent and patent defects and that there is no warranty by Seller that the Property is fit for a particular purpose. Purchaser acknowledges that it is not relying upon any representation, statement or other assertion with respect to the Property condition, but is relying upon its examination of the Property. Purchaser takes the Property under the express understanding there are no express or implied warranties (except for limited warranties of title set forth in the closing documents). Provisions of this Section 15 shall survive the Closing.

Id. at 160.

(2) Procedural history

After a jury verdict in favor of the Buyer, the trial court rendered judgment for more than $25,000,000. The court of appeals affirmed. The Texas Supreme Court reversed.

(3) Discussion

The Supreme Court held that the Buyer could not recover because it could not prove causation. *Id*. at 161 The Court noted that the "as is" clause in the contract precluded Buyer from proving that he relied on any representations, or omissions, made by Prudential and therefore any damages were not caused by Prudential's representations. *Id*. Importantly, the Court also noted that "[a] buyer is

not bound by an agreement to purchase something 'as is' that he is induced to make because of a fraudulent representation or concealment of information by the seller." *Id*. at 162. Confused? The Court's statement as to when an "as is" clause might not be effective seems to be the exact situation the buyer in *Prudential* was complaining about.

Why did the Court find in favor of Seller (Prudential)? The answer likely hinges on the very specific facts surrounding the case. The Court noted that the Buyer had an unimpeded opportunity to inspect the building, an opportunity to review original architectural drawings and testified that even had he known the trade name of the asbestos containing material, he would not have known it contained asbestos. *Id*. at 159-60. Most importantly, the Court noted that Seller was not aware that the building contained asbestos, although they did have information which might have suggested it did. *Id*. Also, the "as is" clause at issue expressly disclaimed any reliance on representations made by Prudential. *Id*. at 160. In short, Seller didn't intentionally conceal a known defect or make knowing misrepresentations nor did it impair or impede the buyer's right to inspect the property.

Finally, the Court noted that not all "as is" clauses are created equal. *See id*. at 162. The Court said that where an "as is" clause is an integral part of a freely negotiated contract between sophisticated parties, as in *Prudential*, it should be enforced. *See id*. However, if the clause at issue is a boilerplate term in a standard form contract which cannot be negotiated, the Court said it is not part of the parties' bargain and is therefore not enforceable. *See id*.

C. *Schlumberger Technology Corp. v. Swanson*, 959 S.W.2d 171 (Tex. 1997)

(1) Facts

Swanson entered into an agreement with Schlumberger regarding the mining of diamonds from the ocean floor. *Id*. at 173. Over the course of almost ten years, the project moved along with Schlumberger entering into a joint venture with DeBeers and Seltrust. *Id*. Schlumberger eventually desired to exit the joint venture and entered into negotiations to sell its company co-owned with Swanson to the joint venturers. *Id*. at 174. The joint venturers had concerns regarding Swanson's interest in the project. *Id*. As a result, Schlumberger negotiated to purchase Swanson's interest and eventually did so for $814,000. *Id*. The agreement between Schlumberger and Swanson included a release of all causes of action against Schlumberger and expressly stated that (1) Swanson was not relying on any

statement or representation of Schlumberger, its affiliates or predecessors, (2) Swanson was relying on his own judgment, and (3) Swanson had been represented by counsel who had explained the entire contents and legal consequences of the release. *Id*.

Shortly after purchasing the Swanson interests, Schlumberger sold its interest in the project to DeBeers and Seltrust for approximately $4,100,000.00. *Id*. Swanson sued Schlumberger and claimed that Schlumberger had misrepresented the project's viability and value. *Id*. Schlumberger maintained that the release barred Swanson's claims. *Id*. at 175.

(2) Procedural history

A jury returned a verdict in favor of Swanson and awarded more than $60 million in actual and exemplary damages. *Id*. at 174-75. The trial court rendered a judgment notwithstanding the verdict. *Id*. at 175. The court of appeals reversed and entered judgment for Swanson in accordance with the jury's findings. *Id*. The Texas Supreme Court reversed and rendered judgment for Schlumberger.

(3) Discussion

The Court first found that Swanson and Schlumberger were not partners and no fiduciary duty was owed to Swanson. *Id*. at 176-77. With regard to the disclaimer of reliance in the agreement, the Court held "that a release that clearly expresses the parties' intent to waive fraudulent inducement claims, or one that disclaims reliance on representations about specific matters in dispute, can preclude a claim of fraudulent inducement. We emphasize that a disclaimer of reliance or merger clause will not always bar a fraudulent inducement claim." *Id*. at 181. The Court noted several factors which were important to its holding. First, the agreement and release were meant to end an ongoing dispute between Swanson and Schlumberger over the value of the enterprise. The Court noted the concern that parties be able to fully and finally resolve disputes between them. *Id*. at 179. The Court also pointed out that both parties were sophisticated, represented by competent counsel and dealing at arm's length. *Id*. at 180. The Court detailed the history of the dispute between the parties and gave significant weight to the ability of parties to negotiate and settle ongoing disputes. *Id*. The Court did, however, decline Schlumberger's invitation to hold that a party represented by counsel is precluded from asserting that it was fraudulently induced to execute a release. *Id*. at 178. The Court recognized that a release is merely a contract and subject to avoidance on grounds such as fraud or mistake. *Id*.

In *Schlumberger*, the Court noted two competing considerations – avoiding fraudulent inducement and the need for parties to fully and finally settle their disputes. It was vitally important to the Court's holding that the release at issue was part of an agreement that was negotiated for the express purpose of settling an ongoing dispute over the value of Swanson's interest in the project. The alleged misrepresentations were as to that very value.

D. *Forest Oil Corp. v. McAllen*, 268 S.W.3d 51 (Tex. 2008)

(1) Facts

McAllen, a landowner and lessor under an oil and gas lease, entered into a settlement agreement with Forest Oil, the lessee, to end a long-running lawsuit over oil and gas royalties. *Id*. at 53. The settlement agreement was the product of a week-long mediation and released "any and all" claims "of any type or character known or unknown" related to the McAllen leases. *Id*. The parties agreed to arbitrate any future claims for environmental liability, surface damages, personal injury, and wrongful death. *Id*. at 53-54. The settlement agreement expressly disclaimed reliance "upon any statement or any representation of any agent of the parties" in executing the releases. *Id*. at 54. It was undisputed that the parties were each represented by counsel with regard to the content and consequences of the release.

Later, McAllen sued Forest Oil for environmental damages and personal injuries. Forest Oil moved to compel arbitration and McAllen alleged that the arbitration provision was induced by fraud and was unenforceable. *Id*. at 54-55. McAllen alleged that an attorney for Forest Oil assured him before signing the settlement agreement that there were no environmental issues to worry about despite having full knowledge of certain radioactive-contaminated pipe and mercury-contaminated materials. *Id*. at 55.

(2) Procedural history

The trial court denied Forest Oil's motion to compel arbitration. The Corpus Christi court of appeals affirmed. The Supreme Court reversed, ordering arbitration.

(3) Discussion

The Texas Supreme Court noted the similarity of the release language in the settlement agreement to the release language in *Schlumberger* and held that the disclaimer of reliance barred McAllen's fraudulent inducement claim. *Id*. at 56. McAllen attempted to distinguish his case from *Schlumberger* by pointing out that environmental and personal injury claims were not the core claims settled by the agreement. *Id*. at 57. The Court acknowledged the validity of the distinction, but correctly noted that environmental and personal injury claims, while not settled, were expressly anticipated and subject to arbitration. *Id*. at 58.

Enforcing the contract disclaimer in *Forest Oil* would impose a consequence far less significant on the allegedly defrauded plaintiff than was true in *Schlumberger*. The plaintiff was only required to take his claims to arbitration, not surrender them, as was the case in *Schlumberger*. The Supreme Court might easily have viewed *Forest Oil* as controlled by its decision in *Schlumberger*, and the policy considerations for enforcing the *Forest Oil* parties' agreement to submit future disputes to arbitration as even more compelling than the policies reasons for enforcing the release at issue in *Schlumberger*. But the majority of the Supreme Court, in a decision by Justice Willett, chose not to so limit its decision. The court proceeded to identify five "factors" it viewed as especially relevant in deciding whether to enforce contract disclaimers to defeat a fraud claim. *Id*. at 60. The *Forest Oil* factors are:

"

1. Whether the terms of the contract were negotiated, rather than boilerplate, and if the parties specifically discussed the disputed issue during negotiations;
2. Whether the complaining party was represented by counsel;
3. Whether the parties dealt with each other in an arm's length transaction;
4. Whether the parties were knowledgeable in business matters; and
5. Whether the release language was clear and unequivocal. *Id*.

The court noted that all five factors were present in *Forest Oil*, just as they had been in *Schlumberger*. *Id*. But the opinion also cautioned, "[t]oday's holding should not be construed to mean that a mere disclaimer standing alone will forgive intentional lies regardless of context. We decline to adopt a *per se* rule that a disclaimer automatically precludes a fraudulent-inducement claim . . . ." *Id*. at 61.

Forest Oil reached the correct result, but its reasoning is flawed. Its "five factors" do not identify circumstances where a Buyer has meaningfully and intentionally promised not to pursue claims based on intentional material misrepresentations of the seller. Instead they focus on the sophistication of the "victim." Indeed, *Forest Oil* seems to create a roadmap that would allow a defrauding Seller to cause a Buyer to surrender unwittingly its fraud claims. It implicitly assumes that lawyers can police this. It is silent about the impact that intentional material misrepresentations might have on innocent third parties. In the name of "freedom of contract," it seems to run counter to the trend towards more full disclosure of known or difficult-to-discover defects.

Unlike the Supreme Court's prior decisions in *Dallas Farm Machinery, Prudential, and Schlumberger*, *Forest Oil* suggests that even in the absence of a "settlement agreement," a contract between parties represented by counsel with the right "magic language" can immunize a Seller against fraud claims, that is, claims based on a Seller's intentional misrepresentations on which the Buyer has in fact relied.

In effect, the Court seems to allow Sellers to shift the risks created by their intentional misrepresentations to "innocent" Buyers, fools, and ***their lawyers.***

E. *Italian Cowboy Partners, Ltd. v. Prudential Ins. Co. of America*, 341 S.W.3d 323 (Tex.2011)

(1) Facts

Three years after *Forest Oil*, *Italian Cowboy* rode into the Supreme Court. The facts of Italian Cowboy will sound familiar (see Fact Pattern 2 above). The plaintiffs were experienced restaurateurs who were searching for space for their new Dallas restaurant, Italian Cowboy. Prudential's property manager, Powell, represented that its space was "in perfect condition" and that there was "never a problem whatsoever." The lease contained a clause which stated that the parties acknowledge "that neither Landlord nor Landlord's agents . . . have made any representations or promises with respect to the Site . . . except as expressly set

forth herein." The lease further provided that it was "the entire agreement between the parties . . . ." *Id*. at 328.

While preparing to open Italian Cowboy, plaintiffs learned that the prior restaurant tenant in the space had experienced a problem with a very bad odor inside the restaurant. They asked Powell about the odor and she claimed to have no knowledge of the issue. Plaintiffs noticed the odor during remodeling and the odor became pervasive when remodeling crews removed hardened grease which blocked the inlet pipe to the grease trap. *Id*. at 329.

Italian Cowboy opened while plaintiffs feverishly attempted unsuccessfully to remedy the problem. Italian Cowboy was unable to attract customers because of the odor. Plaintiffs learned that Powell had been made aware of the odor by the prior tenant and had even experienced it herself. *Id*. at 330. Plaintiffs closed Italian Cowboy and brought suit against Prudential.

(2) Procedural history

The trial court found for Italian Cowboy on all claims and entered findings of fact that (1) Powell had known of the odor during the prior tenancy and had experienced the odor, calling it "horrid" and "ungodly," (2) Powell described the building as "her baby" and had superior knowledge to plaintiffs of what had transpired in the building during the prior tenancy, (3) Powell's statements that the building was "practically new," had no problems and was a perfect restaurant site were statements of fact upon which plaintiffs relied, and (4) Powell's attempted cover-up of the prior issues with the odor evidenced consciousness of guilt on her pre-lease and pre-guaranty misrepresentations to plaintiffs. *Id*. at 330-31. The court of appeals, relying primarily on *Schlumberger*, reversed as to each of Italian Cowboy's claims and entered a take-nothing judgment. *Id*. at 331. The Texas Supreme Court reversed.

(3) Discussion

The language of the clause in the Italian Cowboy lease is clear – there were no representations made. The lease also contained a merger clause. The lease terms were not boilerplate, but were negotiated. Italian Cowboy was represented by counsel. The parties dealt at arm's length. Finally, plaintiffs were experienced restaurateurs, having more than twenty years of experience with three prior restaurant ventures. It would seem that this was *Forest Oil* all over again.

Italian Cowboy loses, right? No. The Court in an opinion by Justice Green, who was in the majority in *Forest Oil*, held that there was no disclaimer of ***reliance*** in the lease, only a "no representation other than in this contract" and a merger clause *Id*. at 334. Justice Willett, the author of *Forest Oil*¸ dissented.

The Court compared the language of the Italian Cowboy lease to the disclaimer language found in *Schlumberger* and *Forest Oil*. *Id*. at 335-36. The Court noted that in both *Schlumberger* and *Forest Oil* the disclaimers at issue expressly stated that the parties were not relying on any representations made, whereas in the Italian Cowboy lease the disclaimer merely stated that no representations had been made. *Id*. The Court said that merely saying there were *no representations made* was not the equivalent of *disclaiming reliance on any representations made*. *See id*. at 336.

Prudential argued that the language of the lease clearly stated that no representations had been made and therefore Italian Cowboy had impliedly agreed not to rely on any external representations. *Id*. at 334. The Court found this argument unpersuasive and noted that parties must use "clear and unequivocal language" to disclaim reliance. *Id*. at 336. The Court reasoned that "[t]his elevated requirement of precise language" ensures that even sophisticated parties represented by counsel understand that the contract at issue intends to disclaim reliance. *Id*. The Court also pointed out that Prudential's argument would, in effect, have the Court hold that parties are not required to disclose known defects if they include a general merger clause in a contract. *Id*. at 335-36. The Court said such a holding would be outside the "well-settled body of law" and would represent unsound policy. *Id*. at 336. In the end, the Court did not apply the *Forest Oil* factors, because there was no disclaimer of reliance to consider.

The facts of *Italian Cowboy* seem to have caused a majority of the Supreme Court to back away from their *Forest Oil* standard for enforcing contract disclaimers to defeat fraud claims. But the Supreme Court's rationale in *Italian Cowboy* suffers from the same defect as its rationale in *Forest Oil*. Both cases attempt to separate contract disclaimers that are effective to defeat fraud claims from those that are not based on subtle word distinctions that only a lawyer – a lawyer very well-schooled in Supreme Court decisions – could love. Neither case takes a sophisticated look at what Buyers and Sellers actually do.

Italian Cowboy makes clear that a standard merger clause, unaccompanied by ***specific*** no reliance language is not sufficient to defeat a fraud claim as a matter of law. Disclaimers of reliance must be specific – it must be expressly discussed

and not assumed. A "no representation other than those contained herein" in conjunction with "this is the entire agreement" does not bar fraud claims.

Italian Cowboy suggests that there *is* language that, if inserted in an ordinary contract, will bar claims of intentional misrepresentation by the Seller, but the opinion is less much clear on what that "magic language" is. *Italian Cowboy* says the language must be "precise," but the Court does not say precisely what it must be. It must include a "clear and specific disclaimer-of-reliance." Does that mean clear and specific as to the *identity* of the specific facts not relied upon (e.g. whether the space is suitable as a restaurant or is prone to bad odors). Or is it sufficient merely to state the hoped-for *legal effect* of the disclaimer (e.g. "by this disclaimer of reliance you are surrendering your right to sue Seller based on any misrepresentation Seller has made regarding the property")?

For example, under the facts of *Italian Cowboy*, would any of the following clauses suffice to prohibit Buyer from bringing a fraud claim against Seller?

1. "Buyer disclaims reliance on any representations by Seller."

2. "Buyer has conducted its own investigation and is not relying on any representation of Seller, if any, or any requirement that Seller disclose any fact regarding the subject of this contract."

3. "Buyer disclaims reliance on representations by Seller and surrenders any right to sue based on any misrepresentations of the Seller not contained in this written agreement."

4. "Buyer acknowledges that Seller may have provided information regarding the premises, but it is only relying on those representations written in the agreement."

Italian Cowboy doesn't say. But as we will see, subsequent cases have further addressed these issues.

F. *Allen v. Devon Energy Holdings*, 367 S.W.3d 355 (Tex. App.—Houston [1st Dist.] 2012), *pet. granted, judgment set aside and remanded by agm't*, 2013 WL 273026 (Tex. 2013))

(1) Procedural history

Allen teed up a fact situation perfect for exposing the meaning and weaknesses of the opinions and holdings of *Forest Oil* and *Italian Cowboy.* The Houston court of appeals dissected these decisions, applied them to an extensive list of fraud claims, and the Supreme Court granted the petition to review the Houston court's opinion. Alas, for those interested in what the Supreme Court would say, the parties settled before the Court acted further on the case.

The trial court granted Devon summary judgment dismissing Allen's fraud claims in 2009, after *Forest Oil* was decided but before *Italian Cowboy*. In March 2012, the Houston court of appeals reversed in part, and remanded for trial.

(2) Facts

Rees-Jones solicited Allen to be a minority investor in a new oil and gas company, Chief, of which Rees-Jones owned 60 percent. Chief flourished by virtue of its holdings in the Barnett Shale. By fall, 2003, Chief was preparing to shift its resources to the less certain "expansion" area of the Barnett Shale. Rees-Jones offered to redeem the interests of the other investors. Chief had two reports prepared, one appraising its oil and gas reserves (the "Haas Report") and the other appraising its market value, based on the Haas Report (the "Phalon Report"). Chief's net asset value was appraised at approximately $138.3 million. This meant each one-percent interest in the company was worth approximately $1.13 million after discounting. *Id*. at 366-67.

The discounting of the value of the ownership interests included factors that could negatively impact Chief's future value. These factors included the shift to the less-certain production in the expansion area. Rees-Jones noted that Chief's first well in the expansion area cost $1.4 million and appeared to be a dry hole. Other wells drilled by other companies also appeared to be "non-economic." Rees-Jones explained to the investors that "further technological advancement needs to be made in order for the Barnett Shale in the 'expansion' area to become economic." *Id*. (internal quotations omitted).

The closing on redemption of the ownership interests was delayed for approximately eight months. No update of the Haas or Phalon report was

completed. Allen alleges that he asked Rees-Jones if updates were needed and Rees-Jones said it was not necessary. Based on the Haas and Phalon reports, Allen redeemed his interest for approximately $8.2 million. The redemption agreement contained two clauses which are relevant to our discussion. The first is the "Independent Investigation" clause. This clause acknowledged that the Haas and Phalon reports were not up-to-date and might not accurately reflect Chief's value. *Id*. The clause also provided that Allen had the opportunity to obtain additional information about intervening events to permit him to evaluate the redemption offer and had an opportunity to discuss and obtain answers from Chief, Haas, Phalon or other Chief advisors regarding information Chief provided related to the redemption,. *Id*. at 376-77. The clause also stated that Allen based his decision to sell on his own independent investigation, his own expertise and the advice and counsel of his own advisors. *Id*. at 377. The second relevant clause was titled, "Finality." The court noted that this clause was merely a standard merger clause. *Id*. at 378-79.

Two years later, Devon purchased Chief for $2.6 billion. The sale price was nearly twenty times the value used to calculate the redemption values. After the sale, Rees-Jones told Allen that advances in horizontal drilling technology "unlocked" the expansion area and accounted for the sharp rise in Chief's value. *Id*. Allen sued Chief and Rees-Jones. Allen complained that Rees-Jones had failed to disclose advances in horizontal drilling technology, increased success by Chief and others in the expansion area, and subsequent acquisitions by Chief in the expansion area that occurred between the Haas and Phalon reports and closing of the redemption. *Id*. at 373. Allen alleged that statements made by Rees-Jones regarding the lack of success in the expansion area, the absence of certain drilling technology, his plans not to sell Chief and his plans to work less in the future all were actionable statements on which Allen relied in selling his interests. *Id*. at 373-76.

(3) Discussion

a. Was there a disclaimer of reliance?

The court spends considerable time evaluating which of Rees-Jones various statements are actionable statements of fact, non-actionable statements of opinion or some combination of the two. That discussion is captured in table 1 below. However, for purposes of this discussion, the court's most salient discussion revolves around the language of the "Independent Investigation" clause and whether the clause was a valid disclaimer of reliance.

The court notes that the clause expressly states that Allen relied on his own investigation and advice of counsel in deciding to sell his interests in Chief. *Id*. at 377. That seems pretty clear. However, the clause does not say that Allen did not rely on any representations made by Rees-Jones or Chief. It also contemplates Allen having an opportunity to make inquiry of Chief employees and advisors, including Haas and Phalon. *Id*. at 376-77. The court held that the clause does not "clearly and unequivocally negate the possibility that Allen's decision was also based on information provided by Chief." *Id*. at 379. Recall the earlier suggestion to include language making it clear that the buyer (or seller in this case) relied ***solely*** on his own investigation. The court expressly states "the disclaimer needed limiting language making it clear that Allen relied 'only,' 'exclusively,' or 'solely' on his own investigation. *Id*.

The court did, however, find that the "Independent Investigation" clause clearly and unequivocally disclaimed reliance on any representations concerning the redemption price, the bases for that price (the Haas and Phalon reports) and whether those documents accurately reflected the value of Chief or its assets. *Id*. at 380. But what about the other statements, or types of statements, made by Rees-Jones? As previously mentioned, the court considered each allegedly untrue statement separately. The table below reflects what the court found.

b. Rees-Jones and/or Chief's Statements and Representations (*Id*. 372-76.)

Statement	**Actionable?**	**Why?**	**"Clear & Unequivocal" Disclaimer of reliance?**
"Chief now has approximately $400,000 per month of overhead, so making a profit of $5 million per year simply brings us to break even."	Yes	Fact	No

Statement	Actionable?	Why?	"Clear & Unequivocal" Disclaimer of reliance?
"**You should be aware that Chief's relationship with Mr. Bob Millard . . . has recently become strained.** Conflicts of a substantial nature have developed that may result in protracted litigation that will be very expensive, with the outcome unknown at this time."	Text in bold - Yes Other text - No	Mixed statement. Bold text actionable Other text not actionable	No
"**Our first horizontal 'stepout' well . . . appears to be a dry hole** . . . . With respect to the 'expansion' area, the approximately dozen Barnett Shale wells on production . . . would show to be non-economic, indicating that **further technological advancement needs to be made in order for the Barnett Shale in the 'expansion' area to become economic.**"	Yes	Opinion or prediction, but based on factual statement re: technology not existing (text in bold).	No

Statement	Actionable?	Why?	"Clear & Unequivocal" Disclaimer of reliance?
"Chief will be taking a lot more risk moving forward from here . . . . I do not expect 'step-out' or 'expansion area' wells to carry anywhere near the value of the 'core area' wells, and the end result of this drilling could be a decline in the value of our company."	Yes	Factually intertwined with statements re: technology not existing (see above)	No
"I intend to work over the next 10 years at a much more relaxed pace, perhaps taking a good bit of time off."	Yes	Fact	No
"I don't expect our growth to continue at this pace, which has been nothing short of phenomenal."	No	Prediction of future events not tied to any factual representation	N/A
"I frankly consider creating new value of $5 million per year consistently in the oil and gas business to be very difficult."	No	Prediction and opinion	N/A
"Having made the decision not to sell the company . . . ."	Yes	Fact	No

Statement	Actionable?	Why?	"Clear & Unequivocal" Disclaimer of reliance?
Redemption price equals value of the interest at the time of sale	Yes	Fact	Yes. Redemption agreement is "clear and unequivocal" regarding issues of valuation.

As shown above, most of Rees-Jones alleged representations to Allen were found to be actionable. The redemption agreement was also found to lack a clear and unequivocal disclaimer of reliance with regard to these specific representations. Should a proposed disclaimer expressly state what representations have been made? The *Devon* opinion would certainly seem to indicate that it is a good idea.

The redemption agreement did not expressly address specific representations and as a result, most of the complained of representations were not subject to the disclaimer language. However, Chief's representations regarding the value of the company were the one species of representations which the court found the alleged disclaimer to cover. But, as we learned in *Forest Oil*, the inquiry does not stop there. Having found that the disclaimer with regard to valuation representations was clear and unequivocal, the court moved on to consider the other four *Forest Oil* factors.

(4) The *Forest Oil* factors

The remaining Forest Oil factors to be considered by the court were whether (1) the terms of the contract were negotiated or boilerplate, (2) the complaining party was represented by counsel, (3) the parties dealt with each other at arm's length, and (4) the parties were knowledgeable in business matters. The court found that factors two and four weighed in favor of Chief. Allen, an attorney, represented himself in a matter in which he had particular expertise. *Id*. Further, Allen was an oil and gas attorney and was knowledgeable in business matters specific to the oil and gas industry. The third factor was not so clear. The court noted that Allen acted as a passive investor in Chief and relied heavily on Rees-Jones advice regarding the company. In addition, the court noted that Chief had

failed to conclusively negate Allen's claim that Rees-Jones owed him a formal fiduciary duty in the transaction. Therefore, the third factor was not shown to weigh in favor of Chief. *Id*. at 383. Finally, as to the first factor, the court again noted that Chief had presented no evidence to show this factor should weigh in its favor. In fact, the court pointed out that Allen was given only three days to review the agreement. Further, when asked if the valuation needed to be updated, Allen seems to have relied on Rees-Jones assertion that it wasn't necessary. The court found that the first factor also did not weigh in favor of Chief. *Id*. at 384.

The net result? Three of the five *Forest Oil* factors are present and weigh in favor of Chief. Is that enough? The court of appeals said "No." The court noted that fraudulent inducement claims have been barred when not all of the *Forest Oil* factors were present. *Id*. However, the court refuses to enforce the disclaimer in this case. *Id*. at 384-85. The court's reasoning is interesting. The court says that in the case at hand, only the three public policy factors are present. The court explains that a clear and unequivocal disclaimer in a commercial transaction between sophisticated parties represented by counsel is not enough because the three factors present only address the concern that the parties are capable of understanding the terms of the agreement. The court places great importance on the concern that the complaining party be able to alter the terms of the agreement. In other words, the terms must be either negotiated or the agreement the result of an arm's length transaction. The court's ultimate holding was that where only the three so-called "public policy" factors are present, the disclaimer is not enforceable. *Id*. at 384-85.

The *Devon* case adds yet another piece to the puzzle that is evaluating disclaimers of reliance. Not only do we now have *Forest Oil's* five factors to consider, one court of appeals has held that one particular combination of three of the five factors is not sufficient to effectively disclaim reliance. How about other combinations? The court doesn't explicitly answer that question, although its differentiation between the "public policy"/comprehension factors versus the freely negotiated factors seems to give some guidance. Would an arm's length transaction between sophisticated parties with clear and unequivocal language be enough? At least one Texas court has upheld a disclaimer of reliance when the only factor not present was sophistication of the parties. *See Atlantic Lloyds Ins. Co. v. Butler*, 137 S.W.3d 199, 216-17 (Tex. App.—Houston [1st Dist.] 2004, pet. denied). One take-away from *Devon* is that any proposed disclaimer of reliance must be drafted with a great level of detail and address all known representations. This is especially true if the representations arguably go to different aspects of the transaction. Further, it is not enough merely to recite that the counter-party conducted its own

investigation. An agreement must say that the counter-party relied on its own investigation to the exclusion of Seller's representations.

G. *JPMorganChase Bank, N.A. v. Orca Assets G.P., L.L.C.*, 546 S.W.3d 648 (Tex. 2018)

(1) Facts

In *Orca Assets,* the Texas Supreme Court again faced a fraud claim based on alleged pre-contract representations despite contract disclaimers. Plaintiff Orca Assets claimed it was fraudulently induced into an oil and gas lease by JP Morgan's pre-contract representation that the acreage covered by the lease was "open," which the Court determined was "essentially equivalent to stating" that the owner "had not leased the property and, thus had good title." *Id*. at 659. JP Morgan served as trustee for the Red Crest Trust, which owned about 40,000 acres of non-contiguous mineral interests throughout the Eagle Ford Shale. The parties signed a letter of intent under which the Trust committed to lease various tracts totaling 1,680 acres to Orca Assets, but granting Orca thirty days to re-examine its title work on the subject acreage, and giving Orca the "sole and absolute discretion" to elect not to lease any tract if its "re-examination of title should reveal [previously unknown] information … that brings into question the ownership." The letter of intent (and later the lease signed pursuant to the letter of intent) specifically provided:

> **Negation of Warranty.** This lease is made without warranties of any kind, either express or implied, and without recourse against Lessor in the event of a failure of title, not even for the return of the bonus consideration paid for the granting of the lease or for any rental, royalty, shut-in payment, or any other payment now or hereafter made by Lessee to Lessor under the terms of this lease.

Orca Assets decided to proceed on leases for just 919.31 of the 1,680 acres described in the letter of intent. At the closing on the leases, JP Morgan again stated orally that the acreage was "open."

In fact, JP Morgan had leased the acreage at issue six months previously to GeoSouthern. GeoSouthern recorded its leases three days after the letter of intent was signed. Orca Assets had done a title search as of the date of the letter of intent, but did not update that search prior to the closing about 30 days later. When GeoSouthern discovered Orca's leases in the property records two weeks later, it

informed JP Morgan, which immediately informed Orca of the title defect. About a month later, JP Morgan sent Orca a check refunding the $3,217,585 bonus payment. Orca refused the tender and sued.

(2) Procedural History

The district court following a pretrial conference under Rule 166(g) granted judgment as a matter of law for JP Morgan. On appeal, the Dallas Court of Appeals reversed on the dismissal of the fraud and negligent misrepresentation claims relying on *Italian Cowboy*, opining that the Negation of Warranty clause did not clearly and unequivocally disclaim reliance on prior representations, and thus could not preclude justifiable reliance by Orca Assets as a matter of law. The court of appeals also concluded that the Negation of Warranty clause did not directly contradict the pre-contractual "open" acreage representation because it did not explicitly refer to the existence, or lack thereof, of prior leases.

JP Morgan convinced the Supreme Court that Orca Assets could not establish justifiable reliance on the "open acreage" representations as a matter of law, and the court reinstated the district court's dismissal of Orca Assets' claims.

(3) Discussion

JP Morgan persuaded the Supreme Court with two arguments, each of which it said established no justifiable reliance by Orca Assets:

1. Factual "red flags" known to Orca Assets negated justifiable reliance by rendering it objectively unreasonable.
2. The "open acreage" oral representations were directly contradicted by the parties' explicitly negotiation contractual provisions.

JP Morgan argued that the following "red flags" precluded justifiable reliance:

1. JP Morgan employee Mettham's statement that he "would have to check" whether the property was open for lease
2. JPMorgan's insistence on the unusually strict negation-of-warranty provision

3. JPMorgan's refusal to accept responsibility for verifying title
4. the letter of intent itself
5. Mettham's statement that other lessees were not doing careful title work
6. Orca's knowledge that competitors might delay recording their leases
7. Orca's knowledge that it ceased checking property records after signing the letter of intent;
8. Orca's landman's "doubts" at the closing, manifested by her request that Mettham confirm once more whether the property was "open."

The Court held that these factual "red flags" negated justifiable reliance as a matter of *law* (i.e. no genuine issue of material fact and thus no jury issue). But before discussing them in detail, the Court interestingly first disclaimed that any one of these facts could preclude justifiable reliance. Further, "We especially reject the notion that the mere use of the negation-of-warranty and no-recourse provision in the letter of intent and the leases could wholly negate justifiable reliance." *Id.* at 655-56. So, if taken as gospel, this means that had JP Morgan merely moved for summary judgment based **solely** on the existence of the "Negation of Warranty" clause, its motion should be denied.

The facts did show the sophistication of the parties, particularly with regard to the import and importance of title examination and the unusually strict "Negation of Warranty" clause. The Supreme Court characterized the testimony of some of the Orca witnesses as showing JP Morgan employee Mettham's alleged representations as "equivocal" (a characterization that I doubt Orca's counsel agreed with). It seems that the Supreme Court simply did not believe that Orca Assets' sophisticated employees, with so much of Orca's money on the line, really relied on the oral representation, particularly in the face of the especially strict "Negation of Warranty" clause and the express contemplation of a "re-examination of title" by Orca in the letter of intent. The Court criticized sophisticated Orca Assets for failing to update its deed examination prior to the closing on the lease as showing a failure to exercise ordinary care for the protection of its interests.

Then in a final *coup de grâce* on Orca's fraud claims, the Court held that not only was the "Negation of Warranty" one of multiple "red flags" collectively sufficient to conclusively defeat Orca's justifiable reliance, it also **standing alone**

meant Orca did not justifiably rely because as between these sophisticated parties, the "Negation of Warranty" clause *directly contradicted* the "open acreage" oral representation.

It is challenging to reconcile the Court's holding that the "Negation of Warranty" clause, standing alone, directly contradicted the "open acreage oral representation and thus conclusively established no justifiable reliance, with its statement, "We especially reject the notion that the mere use of the negation-of-warranty and no-recourse provision in the letter of intent and the leases could wholly negate justifiable reliance." *Id.* at 655-56. They seem utterly contradictory.

The Court rejected the court of appeals' view that *Italian Cowboy* required a different result. It quoted the language from *Italian Cowboy* requiring "clear and unequivocal language" of a disclaimer of reliance. "This elevated requirement of precise language helps ensure that parties to a contract—even sophisticated parties represented by able attorneys—understand that the contract's terms disclaim reliance, such that the contract may be binding even if it was induced by fraud." *Id.* at 660 n.2, quoting *Italian Cowboy*, 341 S.W.3d at 336. The Court interpreted its decision in *Italian Cowboy* as addressing whether contract clauses "expressly waive fraud causes of action" by expressly negating justifiable reliance. This case was different, said the Court, "and because this is a direct-contradiction case and not a waiver case, it falls outside *Italian Cowboy*'s purview." *Id.* at 660 n.2.

The *Orca Assets* decision's characterization of *Italian Cowboy* as a "waiver case", not a "direct-contradiction case," is peculiar. The contract at issue in *Italian Cowboy* did expressly state that the parties acknowledge "that neither Landlord nor Landlord's agents . . . have made any representations or promises with respect to the Site . . . except as expressly set forth herein." 341 S.W.3d at 328. That language of the contract directly contradicted the tenant's assertion that the Landlord's agents had made pre-contract factual misrepresentations concerning the restaurant property, but *Italian Cowboy* found the contract language insufficiently precise to put the tenant on notice it had no justifiable reliance on those pre-contract representations. The *Orca Assets* decision characterizes the *Italian Cowboy* issue as deciding that contract language was not enforceable as a "waiver," but that contract explicitly said nothing about "fraud" or "waiver."

So what is the real difference between the contract language in *Orca Assets* (sufficient to defeat justifiable reliance as a matter of law) from that in *Italian Cowboy* (insufficient to defeat justifiable reliance as a matter of law)? The contract clause in *Orca Assets* is very specific to the topic on which the fraud claim was premised: title to real property, itself conclusively determined by a public record.

The contract language in *Italian Cowboy* is utterly non-specific, so much so that the Supreme Court now characterizes it as an ineffective attempt at a general waiver of fraud claims, without ever even calling attention to the possibility of fraud or waiver.

In *Orca Assets*, once again the Supreme Court seems to have reached the right result, but with analysis that muddies as much as it clarifies. It seems to authorize a trial court, when evaluating a fraud claim between sophisticated parties, to decide that a set of facts concerning even an acknowledged misrepresentation may collectively establish no justifiable reliance as a matter of *law*, even when none of those facts alone would do so, particularly when contract language is at least inconsistent with the misrepresentation. It also holds that as between parties sophisticated in the import of contract terms, a direct, unambiguous contradiction in a written contract of a pre-contract representation defeats as a matter of law a claim of justifiable reliance on the pre-contract representation.

The Texas Supreme Court has applied the "direct contradiction" test in subsequent cases, including *Mercedes-Benz USA, LLC v. Carduco, Inc.*, 583 S.W.3d 553 (Tex. 2019) (reversing jury verdict for fraud), *Barrow-Shaver Resources Co. v. Carrizo Oil and Gas Inc.*, 590 S.W.3d 471 (Tex. 2019) (reversing jury verdict for fraud).

H. *International Business Machines Corp. v. Lufkin Industries, LLC*, 573 S.W.3d 224 (Tex. 2019)

In this case, the Texas Supreme Court rejected a judgment based on a jury verdict of fraud based on contract language it ruled was sufficient as a matter of law to specifically disclaim reliance on proven misrepresentations.

IBM made numerous knowing misrepresentations regarding software systems for business operations it proposed to license to Lufkin, a manufacturer of machinery and equipment used in the energy industry. When IBM implemented it at Lufkin, "the system failure crippled Lufkin's business." *Id.* at 227. Lufkin spent millions with other providers "to salvage the system IBM had delivered." *Id.* Lufkin sued IBM for fraud inducement, and won. In the Supreme Court, IBM argued that the following provisions in the Statement of Work ("SOW") incorporated into the contract defeated as a matter of law Lufkin's claim of reliance on the misrepresentations:

> In entering into this SOW, Lufkin Industries is not relying upon any representation made by or on behalf of

> IBM that is not specified in the Agreement or this SOW, including, without limitation, the actual or estimated completion date, amount of hours to provide any of the Services, charges to be paid, or the results of any of the Services to be provided under this SOW. This SOW, its Appendices, and the Agreement represent the entire agreement between the parties regarding the subject matter and replace any prior oral or written communications.
>
> This SOW and the referenced Agreement identified below are the complete agreement between Lufkin Industries and IBM regarding Services, and replace any prior oral or written communications between us. Accordingly in entering into this SOW, neither party is relying upon any representation that is not specified in this SOW including without limitation, any representations concerning 1) estimated completion dates, hours, or charges to provide any Service; 2) the experiences of other customers; or 3) results or savings Lufkin Industries may achieve.

The Supreme Court viewed these provisions as including a merger clause (which alone did not bar a fraud claim per *Italian Cowboy*). It reaffirmed that a clause that "merely recites the parties have not made any representations other than those contained within the written contract is not effective to bar a fraudulent inducement claim," again citing *Italian Cowboy*. *Id.* at 229.

> But a clause that clearly and unequivocally expresses the party's intent to disclaim reliance on the specific misrepresentations at issue can preclude a fraudulent-inducement claim. . . .

The Supreme Court viewed the provisions as containing such a disclaimer of reliance. But more analysis was needed:

> Not every such disclaimer is effective, and courts "must always examine the contract itself and the totality of the circumstances when determining if a waiver of reliance provision is binding." *Forest Oil*, 268 S.W.3d at 60. Specifically, courts must consider such factors as whether

(1) the terms of the contract were negotiated, rather than boilerplate, and during negotiations the parties specifically discussed the issue which has become the topic of the subsequent dispute;

(2) the complaining party was represented by counsel;

(3) the parties dealt with each other at arm's length;

(4) the parties were knowledgeable in business matters; and

(5) the release language was clear.

573 S.W.3d at 229 (repeating the non-exclusive list of "factors" from *Forest Oil*). Lufkin argued that the disclaimers were "non-negotiated boilerplate," but acknowledged it negotiated "certain deal points," and did not contend it could not have negotiated the disclaimers if it had wanted to. Lufkin argued it was not knowledgeable about business-operations software systems, but did not dispute it was generally knowledgeable about "business matters." The Court professed "no trouble concluding that the factors generally support a finding that Lufkin effectively disclaimed reliance on IBM's misrepresentations." *Id.* "The factors do not require that every sentence in a contract be negotiated." *Id.* at n.4. Once again, the Court's reliance on participation by counsel should give pause to lawyers representing clients in a contract that arguably contains a disclaimer of reliance. Were Lufkin's lawyers expert in business-operations software systems?

Lufkin attempted to persuade the Court that some of the misrepresentations fell within the representations made in the contract, and that there were "string-along" misrepresentations made following the execution of the contract, but the Court rejected both arguments.

I. The Chickens Come Home to Roost: *Pogue v. Williamson,* 605 S.W.3d 656 (Tex. App. – Houston [1st Dist.] 2020)

So how are these decisions applied in more "consumer-oriented" disputes not involving big corporations with sophisticated counsel?

In this homeowner case, the court of appeals applied "as is" and "no reliance" clauses in a sale contract for a residence to bar fraudulent inducement claims, reversing a jury verdict and judgment for the plaintiff buyer.

Homeowners Mr. and Mrs. Pogue sold their vacant house, which had many obvious defects, and 4 ½ acres of land to Williamson, a first-time home buyer. Pogue provided a seller's disclosure that had a number of errors in it. Pogue took a note and a deed of trust from Williamson for part of the consideration. The deed of trust conspicuously stated:

> As a material part of the consideration for the Property, [the Pogues have] executed this deed and … sold … the above described property, … and [Williamson] has accepted this deed and purchased the above-described property … "AS IS." [The Pogues] and [Williamson] agree that there is no warranty by [the Pogues] that the Property is fit for a particular purpose. [Williamson] acknowledges that [she] is not relying upon any representations, statements, assertions or non-assertions by the [Pogues] with respect to the Property condition, but is relying *solely* on [her own] examination of the Property.

(Emphasis in original.) Williamson also signed a document acknowledging that she had instructed the attorney who prepared the closing documents to refrain from doing 19 specific actions on her behalf, among them "having a termite inspection, and/or having experts inspect the premises and/or appliances."

Several years later, Williamson sued the Pogues alleging various claims, including fraudulent inducement. Williamson proved that contrary to the Pogues' statement in the seller's disclosure that they were not aware of any defects or malfunctions with any of the home's electrical fixtures, floors, walls, and ceilings. There was water damage and other structural damage throughout the home. A jury found for Williamson on all her claims.

The court of appeals reversed, finding as a matter of law, and after reviewing all the "factors" described in *Forest Oil* and *Lufkin*, that the "AS IS" and disclaimer-of-reliance clauses defeated Williamson's claim that she had justifiably relied on the Pogues' misrepresentations. Notable in the court's analysis of the "factors" are the facts that Williamson was a first-time home buyer, was not represented by counsel (although she was specifically advised to seek a lawyer's advice), inspected the property herself but declined to have experts do so, and was aware of at least some of the defects in the property and errors in the seller's disclosure. As in *Lufkin*, the court viewed the fact that Williamson negotiated *some*

of the provisions of the sales agreement sufficient to establish that the agreement was not "boilerplate," even though the "as is" in disclaimer-of-reliance clauses were not negotiated.

7. Contract Assumptions of Risk -- *El Paso Field Services v. MasTec North America*, 389 SW3d 802 (Tex. 2013)

The Texas Supreme Court has also enforced contract disclaimers in breach of contract suits without fraud claims.

(1) Facts

Mastec wished to expand its business from installing underground fiber-optic cables and telephone lines to installing pipelines. El Paso was taking bids from contractors to replace a 68 mile, eight inch butane pipeline. *Id*. at 803. Mastec decided to bid the project. El Paso had commissioned a survey of the pipeline by a survey mapping company prior to soliciting bids. This survey was compiled in the form of alignment sheets, which showed the locations of 280 foreign crossings. Foreign crossings are locations where other pipelines, roads, rivers, canals, cables or other structures intersect the pipeline. The alignment sheets were included in the pre-bid package distributed to Mastec and other contractors. *Id*. at 803-04.

Mastec hired Bill White as its general manager for the El Paso bid. White had more than forty years of experience in the pipeline construction business. White attended the pre-bid meeting with El Paso and received the alignment sheets. At the pre-bid meeting, El Paso encouraged all bidders to perform an aerial inspection of the pipeline, but no "walk-through" or tour of the pipeline was conducted. White and his son conducted an aerial inspection of the pipeline via helicopter before preparing and submitting Mastec's bid. The Mastec bid of $3,690,960 was substantially lower than the average bid of approximately $8.1 million. El Paso met with Mastec regarding its bid. The facts are disputed as to whether the low bid price was discussed and Mastec given an opportunity to withdraw its bid. Regardless, Mastec was awarded the contract and began its work on the pipeline. *Id*.

After beginning work, Mastec encountered 794 foreign crossings, almost three times the number of crossings previously disclosed by El Paso in the alignment sheets. Many of the undisclosed crossings required a special "tie-in" weld that greatly increased the number of man-hours required for the project. *Id*. White raised the issue of the extra cost with El Paso, but El Paso responded that the

contractual provision placed the risk on Mastec and that the undiscovered foreign crossings were within Mastec's scope of work. *Id*. 804-05. Mastec sued.

The contractual provisions at issue are as follows:

1. "[El Paso] will have exercised due diligence in locating foreign pipelines and utility line crossings. However, [Mastec] shall confirm the location of all such crossings . . . .";

2. "[Mastec] fully acquainted itself with the site, including without limitation . . . subsurface conditions, obstructions and all other conditions pertaining to the Work.";

3. "Just because an item of Work is not specifically identified, does not mean such Work is not included in [Mastec's] scope of Work. Any item of Work [Mastec] knows is required for completion of the installation but not specifically identified is to be included in [Mastec's] Lump Sum Proposal."

Id. at 807.

Each of these provisions was agreed to "notwithstanding" "anything in any of the Contract documents or in any representations, statements or information made or furnished by [El Paso] or its representatives." *Id*.

(2) Procedural history

At trial, a jury found that El Paso had failed to comply with the contract and awarded Mastec $4,763,890. The jury also found that Mastec failed to comply with the contract by not completing the work required and awarded El Paso $104,687.09 in damages *Id*. at 805. Importantly, Mastec abandoned its fraud claims against El Paso and sought recovery based on the terms of the contract. El Paso moved for judgment notwithstanding the verdict, arguing that regardless of the due diligence clause, Mastec disclaimed reliance on any warranty or representation by El Paso regarding foreign crossings or other conditions. The trial court agreed, entering a take-nothing judgment in favor of El Paso. The court of appeals reversed. The court of appeals reasoned that Mastec's commitments and representations under the contract did not preclude recovery because El Paso failed to exercise due diligence in locating the foreign crossings. *Id*. at 802-08. The Texas Supreme Court reversed.

(3) Discussion

The Supreme Court pointed out that because Mastec had abandoned its fraud claims, it was bound by the terms on the contract. *Id*. at 807-08. The Court then noted that the due diligence clause of the contract anticipated that El Paso "*will have exercised* due diligence." *Id*. at 809 (emphasis in original). Mastec's obligation to confirm the locations of the foreign crossings was a joint obligation. The Court said that the risk of additional crossings and obligation to conduct further investigation fell squarely on Mastec. *Id*.

With respect to an ordinary breach of contract claim, the Supreme Court did not require any heightened "clear and specific" disclaimers of reliance in the contracts to enforce the contract's imposition on Mastec of the risk to that El Paso's "due diligence" missed most of the foreign crossings, significantly increasing the cost of Mastec's performance.

8. Helping Clients Evaluate Contract Disclaimers

Contract parties have a legitimate interest in bracketing their liability with respect to a transaction, and contract disclaimers are a legitimate means toward that end. But the Texas Supreme Court has left a path by which a Seller may, through the use of the right magic contract language, limit or even eliminate claims based on the Seller's deliberate misrepresentations to the Buyer, depending on arcane interpretations of contract language. That creates hazard not only for the Buyer, but for the attorneys of both Buyer and Seller.

A. Ethical obligations – Texas Disciplinary Rules of Professional Conduct

A Texas attorney must also consider his or her own ethical obligations, beyond competent representation of a contract party. For instance, Rule 1.02 of the Texas Disciplinary Rules of Professional Conduct states,

> (c) A lawyer shall not assist or counsel a client to engage in conduct that the lawyer knows is criminal or fraudulent. A lawyer may discuss the legal consequences of any proposed course of conduct with a client and may counsel and represent a client in connection with the making of a good faith effort to determine the validity, scope, meaning or application of the law.

> (d) When a lawyer has confidential information clearly establishing that a client is likely to commit a criminal or fraudulent act that is likely to result in substantial injury to the financial interests or property of another, the lawyer shall promptly make reasonable efforts under the circumstances to dissuade the client from committing the crime or fraud.
>
> (e) When a lawyer has confidential information clearly establishing that the lawyer's client has committed a criminal or fraudulent act in the commission of which the lawyer's services have been used, the lawyer shall make reasonable efforts under the circumstances to persuade the client to take corrective action.

Other rules also present concerns for a lawyer advising a client with regard to what disclosures should be made to the counter-party. Rule 4.01 prohibits a lawyer from knowingly making "a false statement of material fact or law to a third person[] or fail[ing] to disclose a material fact to a third person when disclosure is necessary to avoid making the lawyer a party to a criminal act or knowingly assisting a fraudulent act perpetrated by a client." Rule 8.04 further states that a lawyer shall not "engage in conduct involving dishonesty, fraud, deceit or misrepresentation . . . ."

These rules further complicate the balancing act that a lawyer must undertake to determine what disclosures must be made. Further, in light of the lawyer's ethical obligations, it becomes even more important to draft contract provisions that clearly spell out what representations have been made and what the client knew at the time of the sale.

B. Advising Sellers

What contract disclaimers should a prudent Seller include in the contract that may affect claims (legitimate or ill-founded) that the Seller made misrepresentations or failed to disclose material facts prior to signing the contract? That is measured, of course, to an important degree on what is marketable to a Buyer.

1. "As is, where is, with all faults" – if the seller has limited knowledge of the property, e.g. foreclosure property, say so. Make clear that the

seller cannot represent the condition of the property and has no superior knowledge.

2. "Buyer is relying **exclusively** on his own independent judgment and sole investigation."

3. "Buyer is not relying on any representations or promises made by seller at any time." The effectiveness of this provision probably depends on the nature of the alleged non-disclosure. It is better than "Seller has made no representations other than those stated in this written agreement," but there are likely circumstances where this provision, standing alone, is not sufficient to get a ruling that fraudulent inducement claim is barred as a matter of law.

4. "Buyer is not relying on Seller's representations regarding . . . ." The more specific the description of the representations not relied upon (e.g. specific environmental conditions, property conditions, regulatory issues, or performance characteristics), the more likely this disclaimer will be effective against a fraud claim based on that representation.

5. "Buyer disclaims reliance on representations by Seller and surrenders any right to sue based on any misrepresentations of the Seller not contained in this written agreement." As discussed below, a well-advised Buyer would not normally agree to such a clause.

6. Address the "factors" described in *Forest Oil*, *Orca Assets*, and *Lufkin*

    a. Buyer is represented by counsel

    b. Buyer is knowledgeable in the specific business (if applicable)

    c. The terms of the contract have been freely negotiated

    d. Buyer and seller are dealing at arm's length

    e. Make sure the disclaimer is clear and unequivocal – remember the magic words, "reliance" or "rely." You can't disclaim it if you don't mention it.

Remember, even the best drafting may not protect your client from claims of intentional misrepresentation regarding material facts known to the client.

C. Advising Buyers

Sellers often, but not always, have superior information to Buyers. It is therefore especially important for well-advised Buyers to consider the impact of contract disclaimers. A particular challenge for Buyer's counsel is it may be difficult for counsel to identify all of the Seller's representations that Buyer, in fact, is relying on, especially if counsel is not involved in the negotiations that led to the agreement or is not intimately familiar with the business that is the subject of the agreement.

A few things to consider in advising Buyers:

1. Discourage Buyers from signing anything that is untrue! If Buyer is *in fact* relying on what the Seller says, Buyer should not sign a contract disclaiming that reliance.

2. "As is, where is" is OK – in certain situations. Make sure the Buyer client understands what it means. Insist on a broad pre-closing opportunity to inspect and/or test the property that is the subject of the contract. Make sure there is no significant penalty to walk away.

3. Beware of "Buyer is relying exclusively on his own independent judgment and sole investigation." This is often untrue, particularly with regard to environmental, hidden structural, and economic issues, where information supplied by the Seller often underlies any analysis by Buyer or Buyer's consultants. Unless that evaluation is truly ***fully independent*** of information supplied by Seller, a Buyer is at risk by disclaiming reliance.

4. The same applies to "Buyer is not relying on any representations or promises made by Seller at any time." Rarely is this true. It may be OK to disclaim reliance on some representations, but any and all? Avoid such broad, sweeping language.

5. Beware of "Buyer acknowledges that Seller has made no representations, except those in this contract." This is also sometimes untrue, and requires identifying what the Buyer is *in fact* relying on and whether each of those representations *are actually in the contract.*

If an environmental or structural inspection involves an interview of the seller, make sure those representations make it into the contract and don't disclaim reliance as to those issues. It is also often difficult for lawyers advising Buyers to know with any precision what representations made by the Seller the Buyer is in fact relying on. Would Italian Cowboy's lawyers have known about the threat of sewer odor or the statements made by Seller? Did Lufkin's lawyers appreciate the scope of the representations in the contract and whether they included the representations IBM made before the contract was signed?

6. The *Forest Oil, Orca Assets,* and *Lufkin* "factors"

    a. "Buyer is represented by counsel." (So you, as the attorney, are the expert, right?)

    b. "Buyer is knowledgeable in the specific business." What business are we talking about? Is a farmer knowledgeable about tractor performance? A restaurateur knowledgeable about sewer systems? A landowner knowledgeable about environmental contaminants? In *Lufkin,* the Texas Supreme Court seems to say that a Buyer that is just generally knowledgeable in "business matters," even if not in the specific subject of the contract, meets this "factor."

    c. "The terms of the contract have been freely negotiated." Just because you haggled over price doesn't mean all terms were freely negotiated. In *Lufkin,* the Court wasn't concerned that the parties had not negotiated the specific disclaimer clause at issue. The fact that they had negotiated "certain deal points" was sufficient to meet this "factor."

    d. "Buyer and Seller are dealing at arm's length." Are they?

7. Where a contract contains disclaimers, it often needs to be equally clear about what Buyer is *not* disclaiming reliance on. If the contract contemplates future activities between the parties, expressly except future disputes over those activities from any proposed disclaimer.

In advising a Buyer, don't let your malpractice carrier be the guarantor against a Seller's fraud.