Waiver/Disclaimer of Reliance Provisions After Allen v. Devon Energy Holdings, L.L.C.

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A recent case regarding the effectiveness of disclaimers of reliance to avoid fraudulent inducement claims warrants dusting off your contract and settlement agreement forms to make sure they have an effective disclaimer (or to examine your clients' agreements to determine whether they have actually disclaimed reliance that would preclude an otherwise valid fraudulent inducement claim).

Purporting to rely on settled disclaimer of reliance law embodied in *Schlumberger Tech. Corp. v. Swanson*, 959 S.W.2d 171 (Tex. 1997) and *Forest Oil Corp. v. McAllen*, 268 S.W.3d 51 (Tex. 2008), the First Court of Appeals in Houston recently held that a sophisticated party represented by counsel had not effectively disclaimed reliance on pre-closing representations in a stock redemption case. See *Allen v. Devon Energy Holdings, L.L.C.,* No. 01-09-00643, 2011 WL 3208234 (Tex. App.—Houston [1st Dist.] July 28, 2011, no pet. h.).

The plaintiff in *Allen* was a former investor in Chief Holdings, LLC. ("Chief"), predecessor to Devon Energy Holdings, LLC ("Devon"), which purchased Chief in 2006. Allen sued Chief and its principal, Trevor Rees-Jones, for a litany of alleged wrongs, including fraudulently inducing Allen into a stock repurchase in 2004—two years before Chief sold to Devon for $2.6 billion. The stock redemption agreement, pursuant to which Chief repurchased Allen's shares, however, contained several provisions purporting to eliminate claims of fraud, misrepresentation, or fraudulent inducement, including the following (as summarized):

1. An "**Independent Investigation**" paragraph providing that: (i) Allen was basing his decision to sell on his independent due diligence, expertise, and the advice of his own engineering and economic consultants; (ii) appraisal and gas reserve analysis data provided to him by Chief were merely estimates and that other professionals might provide different estimates; (iii) events subsequent to the valuation reports might have a positive or negative impact on the company's value; (iv) Allen was given the opportunity to review any information he wished from Chief or the appraisers; and (v) the redemption price was based on the valuation reports regardless of whether those reports reflected the actual value and regardless of any subsequent change in value following the reports; and containing releases "from any claims that might arise as a result of any determination that the value of [Chief] . . . was more or less than" the agreed redemption price at the time of closing.
2. A "**Mutual Releases**" paragraph releasing each party from all claims that "they had or have arising from, based upon, relating to, or in connection with the formation, operation, management, dissolution and liquidation of Chief or the redemption of" Allen's interest in Chief, except for claim of breach of the redemption agreement and associated note.
3. A "**Merger**" clause providing that the redemption agreement "supersedes all prior agreements and undertakings, whether oral or written, between the parties with respect to the subject matter hereof."

Despite these seemingly clear statements of intent to disclaim reliance on representations made by Chief or its employees outside the four corners of the redemption agreement, the First Court of Appeals held that the redemption agreement did not contain an enforceable disclaimer of reliance provision and reversed the trial court's summary judgment for Chief.

NO CLEAR AND UNEQUIVOCAL DISCLAIMER OF RELIANCE

First, the court held that the above provisions did not satisfy the *Schlumberger* and *Forest Oil* requirement that an effective disclaimer of reliance must be clear, specific and unequivocal. In so holding, the court relied heavily on a recent opinion from the Texas Supreme Court in *Italian Cowboy Partners, Ltd. v. Prudential Ins. Co. of Am.*, No 08-0909, ___ S.W.3d ___, 2011 WL 1445950 (Tex. 2011). There, the Court held that a standard merger clause was, without more, insufficient to constitute a valid disclaimer of reliance on fraudulent misrepresentations or omissions. *Id*. at *7-8. Despite the difference between a bare merger clause and the three paragraphs in *Allen*, the First Court of Appeals held that *Italian Cowboy* was dispositive because the disclaimer language in the *Allen* redemption agreement was not as strong as the language in *Forest Oil and Schlumberger*. *Allen*, 2011 WL 3208234, at *8. The court also noted the "critical importance" of

the absence of the words “only,” “exclusively,” or “solely” in describing Allen’s reliance on his own judgment and independent investigation. *Id*.

The court, however, never dealt with the question of why such language would be included in the agreement if not to disclaim reliance. As bald recitations of fact, the Independent Investigation statements add nothing to the agreement unless intended to disclaim reliance.

Second, the court disposed of the Mutual Releases paragraph by finely parsing Allen’s claims, stating that the release related only to claims “that arise from a determination that the redemption price did not reflect Chief’s market value at closing,” while Allen’s claims “related to misrepresentation and omissions concerning Chief’s future prospects, rather than a misrepresentation of Chief’s value.” The court, however, ignored its own description of the Mutual Release paragraph only a few pages earlier, which quoted that provision, “each party releases the other from all claims that ‘they had or have arising from, based upon, relating to, or in connection with the formation, operation, management, dissolution and liquidation of [Chief] or the redemption of’ Allen’s interest in Chief . . . .” *Id*. at *6. The court also ignored the simple fact that information about Chief’s future prospects would necessarily relate to Chief’s value at the time of the redemption.

Third, the court held that a bare merger clause is insufficient to negate the element of reliance in a fraudulent inducement claim, relying on *Italian Cowboy* and ignoring the context of the Merger clause in the Allen agreement as one of three provisions expressing non-reliance.

MAGIC WORDS NOT NECESSARY, BUT UNCLEAR WHAT WOULD SUFFICE

The court also admitted that the words “disclaimer of reliance” are not necessary to preclude a fraudulent inducement claim. Yet, in another bit of internal inconsistency, the court stated that it would be sufficient to include: (1) a clear and unequivocal disclaimer of reliance (which seems to beg the question); (2) an express waiver specific to fraudulent inducement claims; (3) an all-embracing disclaimer of any and all representations and any duty to make any disclosures (which is inconsistent with its rejection of Chief’s argument that the Mutual Releases paragraph precluded the fraudulent inducement claim because “the ‘elevated requirement of precise language’ requires more than a general catch-all; it must address fraud claims in clear and explicit language”). Id. at 9-10.

GUIDANCE FOR FUTURE DRAFTERS

The court did, however, provide instructive language for drafters of future agreements. Specifically, in noting language missing from the Allen redemption agreement, the court suggested that the inclusion of such language might have yielded a different result. For example, the court noted that the redemption agreement did not:

1. state that the only representations that had been made were those set forth in the agreement;
2. contain a broad disclaimer than any extra-contractual representation had been made and that no duty existed to make any disclosures (again, however, this would appear inconsistent with the court’s statement regarding the “elevated requirement of precise language” requires more than a general catch-all);
3. provide that Allen had not relied on any representations or omissions by Chief (the court does not explain how one could affirmatively state they are not relying on omissions); or
4. include a specific “no liability” clause stating that the party providing certain information will not be liable for any other person’s use of the information. *Id*. at 9.

NEW ANALYSIS REQUIRED FOR FOREST OIL FACTORS

Though admittedly unnecessary, the court then addressed in dicta the four-factor test announced in *Forest Oil*. The *Forest Oil* factors in determining the validity of a disclaimer of reliance provision are 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.

After noting that it was unsettled among the courts of this state how many of the *Forest Oil* factors must be satisfied for a disclaimer of reliance to be effective, the court set out to determine what combination of factors must be present. The court concluded that two factors are absolutely necessary—the complaining party must be a sophisticated party and represented by counsel in the negotiation. Then, according to the *Allen* court, the sophisticated party represented by

counsel must also show that the party who agreed to the disclaimer either (i) did in fact negotiate the contract terms; or (ii) had the ability to negotiate the contract terms because the parties dealt with each other at arm's length. *Id*. at *10-13.

ALLEN NOT NECESSARILY A SHIFT IN THE TIDE

Arguably, the court's rejection of seemingly plain and unequivocal language disclaiming reliance on representations by a contracting counterparty calls into question many of the standard form mutual release clauses, merger clauses, and no-reliance clauses with which most attorneys are familiar and may suggest an erosion of these familiar principles. The Fourteenth Court of Appeals in Houston, however, recently affirmed a summary judgment for a defendant to a fraudulent inducement claim based on a disclaimer of reliance in an opinion just two days prior to the *Allen* opinion. See *McLernon v. Dynegy, Inc.,* No. 14-09-00312, ___ S.W.3d ___, 2011 WL 3062024 (Tex. App.—Houston [14th Dist.] July 26, 2011) (no pet. h.). There, the court held that the following was sufficient to establish a clear and unequivocal disclaimer of reliance:

[T]his [severance agreement] sets forth the entire agreement between the parties hereto and super-cedes any and all prior agreements or understandings, written or oral, between the parties pertaining to the subject matter of this [severance agreement]. This [severance agreement] expresses the full terms upon which [Dynegy] and [McLernon] conclude the employment relationship. All obligations or responsibilities of either party under the [employment agreement] are encompassed within or superseded by this [severance agreement]. There are no other representations or terms relating to the employment relationship or the conclusion of that relationship other than those set forth in writing in this [severance agreement]. ***[McLernon] hereby represents and acknowledges that in executing this [severance agreement], [McLernon] does not rely and has not relied upon any representations or statements made by any of the parties, agents, attorneys, employees, or representatives with regard to the subject matter, basis or effect of this [severance agreement]***. *Id*., at *9-11 (emphasis added).

Similarly, in its most recent decision relating to this issue, the Dallas Court of Appeals also affirmed a summary judgment on fraudulent inducement claims based on the following waiver of reliance provision (in relevant part):

[Worldwide Asset] has ***relied solely on its own investigation and it has not relied upon any oral or written information provided by [Rent-A-Center] and or [NLEX] or its personnel or agents*** and acknowledges that ***no employee or representative of [Rent-A-Center] and /or [NLEX] has been authorized to make, and that [Worldwide Asset] has not relied upon, any written statements other than those specifically contained in this Agreement.*** *Worldwide Asset Purchasing, L.L.C. v. Rent-A-Center East, Inc.*, 290 S.W.3d 554, 568-69 (Tex. App.—Dallas 2009, no pet.) (emphasis added).

CONCLUSION

The *Allen* opinion may not indicate a shift in disclaimer of reliance law, but it is a cautionary example of how seemingly sufficient language can be construed as falling short of its intended goal of complete waiver of reliance. For that reason, I have undertaken to conform a series of standard provisions in my form settlement agreements to the rule as announced by the First Court of Appeals. In addition to the *Allen* case, the following borrows from each of the cases cited herein. The following is in no way intended to be a form suitable for all circumstances and should be tailored for the needs of each deal/case.

STANDARD FORM RELEASE, NO-RELIANCE, AND MERGER CLAUSES

3.1 PLAINTIFF'S RELEASE OF DEFENDANT. For and in consideration of the payments referenced above, as well as the covenants and/or promises contained herein (and only those contained herein), the receipt and sufficiency of which are hereby acknowledged, PLAINTIFF, on behalf of itself and its directors, officers, trustees, beneficiaries, general or limited partners, representatives, agents, employees and/or attorneys, if any, hereby fully, finally and forever RELEASES, ACQUITS and FOREVER DISCHARGES DEFENDANT and its assigns, if any, as well as its general or limited partners, members, representatives, agents, employees and/or attorneys, if any (collectively, the "DEFENDANT Released Parties"), jointly and severally, from any and all claims, demands, actions, causes of action, other liabilities, and/or damages, if any, known or unknown, whether arising at law, by statute, or in equity, to which PLAINTIFF, or any other person or entity claiming by, through or under it, may have or claim to have, jointly or severally, against the DEFENDANT Released Parties that in any way arise out of or are connected with the acts, omissions, conduct, relationships, occurrences, dealings, communications, events, and/or transactions that have occurred on or before the date upon which PLAINTIFF executes this Agreement, including without limitation the negotiation and formation of this Agreement, and which relate in

any way to the matters alleged, or which could have been alleged, in the Lawsuit; provided, however, this release does not include any right of enforcement of the Agreed Judgment as set forth herein or any claims PLAINTIFF may have against the DEFENDANT Released Parties for their failure to comply with, or breach of, any provision in this Agreement.

3.2 DEFENDANT'S RELEASE OF PLAINTIFF. For and in consideration of the payments referenced above, as well as the covenants and/or promises contained herein (and only those contained herein), the receipt and sufficiency of which are hereby acknowledged, DEFENDANT on behalf of itself and its general or limited partners, members, representatives, agents, employees and/or attorneys, if any, hereby fully, finally and forever RELEASES, ACQUITS and FOREVER DISCHARGES PLAINTIFF and its directors, officers, shareholders, trustees, beneficiaries, general or limited partners, representatives, agents, employees, independent contractors, and/or attorneys, if any (collectively, the "PLAINTIFF Released Parties"), jointly and severally, from any and all claims, demands, actions, causes of action, other liabilities, and/or damages, if any, known or unknown, whether arising at law, by statute, or in equity, to which DEFENDANT, or any other person or entity claiming by, through or under it, may have or claim to have, jointly or severally, against the PLAINTIFF Released Parties that in any way arise out of or are connected with acts, omissions, conduct, relationships, occurrences, dealings, communications, events, and/or transactions that have occurred on or before the date upon which DEFENDANT executes this Agreement, including without limitation the negotiation and formation of this Agreement, and which relate in any way to the matters alleged or which could have been alleged in the Lawsuit; provided however, this release does not include any claims DEFENDANT may have against the PLAINTIFF Released Parties for their failure to comply with or breach of any provision in this Agreement.

4.2 NO RELIANCE. In executing this Agreement, the PARTIES unequivocally represent, acknowledge, and state that they were represented by counsel in the negotiation and formation of this Agreement, which negotiation was conducted by the PARTIES at arm's length, and the PARTIES are relying solely upon each PARTY'S own independent knowledge, understanding, and investigation of the matters pertinent hereto and have not seen, heard, or relied upon any promises, statements, representations, covenants, or warranties, whether written or oral, express or implied, made by one another or by any representative or other person or entity and that no such PARTY had any duty to make any disclosures, except to the extent that a matter is expressly stated in this Agreement. The PARTIES hereby waive, release, and disclaim any right or ability to seek to revoke, rescind, vacate, or otherwise avoid the operation and effect of this Agreement on the basis of any alleged fraudulent inducement, misrepresentation, or material omission by any of the undersigned or their representatives, or on the basis of mutual or unilateral mistake of fact or law, or newly discovered information, and acknowledge that they are completely satisfied with this settlement, as reflected in this Agreement.

4.4 ENTIRE AGREEMENT. This Agreement constitutes the entire understanding and agreement of the PARTIES, and supersedes prior understandings and agreements, if any, among or between the PARTIES with respect to the subject matter hereof. There are no representations, agreements, arrangements or understandings, oral or written, concerning the subject matter hereof between and among the undersigned PARTIES which are not fully expressed or incorporated by reference herein.

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