Freedom of Contract or Liberty to Lie? A Brief Survey Regarding the Enforcement of Non-Reliance Clauses

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Non-reliance clauses occupy a special place in the world of contracts: provisions that require parties to put all their cards on the table and state whether they are relying on representations outside of the contract. This article discusses all disclaimer clauses generally, the use of non-reliance clauses in selected jurisdictions across the country, and concludes by analyzing the public policy arguments in favor of and against non-reliance clauses.

I. Disclaimer Clauses Generally and Non-Reliance Clauses Specifically

Disclaimer clauses generally fall into three categories: "integration" or "merger" clauses, "waiver" clauses, and "non-reliance" (also called "anti-reliance" or "no-reliance) clauses. Integration clauses state that all oral representations or statements not expressed in the contract "merge into" and do not survive the execution of the contract.[1] "Waiver clauses" release any fraud or wrongdoing that occurred before execution of the contract.[2] Non-reliance clauses are agreements that the parties are not relying on any statements not set forth in the contract. While the differences between the three types of disclaimer clauses seem subtle, the effects are not.

A merger or integration clause, when used without other disclaimer clauses, can suffer from enforcement issues because courts are reluctant to allow a technical contractual device to eliminate fraud claims.[3] A contractual waiver of fraud clause faces even more scrutiny as critics argue these clauses immunize fraudulent conduct. One court even stated:

> But the contractual freedom to immunize a seller from liability for a false contractual statement of fact ends there. The public policy against fraud is a strong and venerable one that is largely founded on the societal consensus that lying is wrong. Not only that, it is difficult to identify an economically-sound rationale for permitting a seller to deny the remedy of rescission to a buyer when the seller is proven to have induced the contract's formation or closing by lying about a contractually-represented fact.[4]

Conversely, non-reliance clauses approach extra-contractual statements and representations from the perspective of the contract and provide a much better method of memorializing and enforcing the parties' true agreement.[5] These clauses appear to have originated in the securities industry,[6] but have now made their way into other contractual instruments. Not surprisingly, different states have different views on these clauses.

II. The Approach of Different Jurisdictions

A. New York

New York declines to enforce a "general, boilerplate disclaimer of a party's representations [to] defeat fraud,"[7] but permits non-reliance clauses that "track[] the substance" of the alleged misrepresentation.[8] The reason for the difference? A party cannot reasonably rely on extra-contractual statements when it states in the contract itself that it did not rely on such statements. An older real estate case demonstrates the type of language that properly disclaims reliance in contracts subject to New York law:

> The Seller has not made and does not make any representations as to the . . . expenses, operation or any other matter or thing affecting or related to the aforesaid premises,

continued on p. 20

continued from p. 19

> except as herein specifically set forth, and the Purchaser hereby expressly acknowledges that no such representations have been made . . . . It is understood and agreed that . . . this contract . . . is entered into after full investigation, neither party relying upon any statement or representation, not embodied in this contract, made by the other.[9]

B. Delaware

Unsurprisingly, business-friendly Delaware is more supportive of non-reliance clauses than many other jurisdictions. But even in Delaware, non-reliance clauses were initially greeted with skepticism. The Delaware courts' view of these clauses has, however, undergone somewhat of an evolution to reach the current state of enforcement. Specifically, Delaware's public policy favors enforcement of contract clauses,[10] but some of the same concerns raised in other states first gave some Delaware courts a moment's pause.

For example, the court in *Anvil Holding Corp. v. Iron Acquisition Co.*[11] found that an agreement that stated that neither party was "'making any other express or implied representation or warranty with respect to the Company' and that the Purchase Agreement constitutes the entire agreement of the parties" did not preclude a buyer's fraud claim because these statements did not sufficiently repudiate reliance on extra-contractual statements. Likewise, earlier Delaware case law held that a clause that does not limit preserved claims to intra-contractual representations contained in the contract itself is insufficient.[12] These decisions and others led some to believe that Delaware courts needed to see proverbial "magic language" in contracts to enforce disclaimer clauses.

The decision in *Prairie Capital*,[13] however, dispelled that notion by finding the following language in a contract's "Exclusive Representations Clause" sufficient to disclaim fraud claims:

> The Buyer acknowledges that it has conducted to its satisfaction an independent investigation of the financial condition, operations, assets, liabilities and properties of the Double E Companies. In making its determination to proceed with the Transaction, the Buyer has relied on (a) the results of its own independent investigation and (b) the representations and warranties of the Double E Parties expressly and specifically set forth in this Agreement, including the Schedules. SUCH REPRESENTATIONS AND WARRANTIES BY THE DOUBLE E PARTIES CONSTITUTE THE SOLE AND EXCLUSIVE REPRESENTATIONS AND WARRANTIES OF THE DOUBLE E PARTIES TO THE BUYER IN CONNECTION WITH THE TRANSACTION, AND THE BUYER UNDERSTANDS, ACKNOWLEDGES, AND AGREES THAT ALL OTHER REPRESENTATIONS AND WARRANTIES OF ANY KIND OR NATURE EXPRESS OR IMPLIED (INCLUDING, BUT NOT LIMITED TO, ANY RELATING TO THE FUTURE OR HISTORICAL FINANCIAL CONDITION, RESULTS OF OPERATIONS, ASSETS OR LIABILITIES OR PROSPECTS OF DOUBLE E AND THE SUBSIDIARIES) ARE SPECIFICALLY DISCLAIMED BY THE DOUBLE E PARTIES.[14] (emphasis in original)

This non-reliance clause was supported with what the court termed a standard integration clause, which read as follows:

> This Agreement ... set[s] forth the entire understanding of the Parties with respect to the Transaction, supersede[s] all prior discussions, understandings, agreements and representations and shall not be modified or affected by any offer, proposal, statement or representation, oral or written, made by or for any Party in connection with the negotiation of the terms hereof.[15]

continued on p. 21

Freedom of Contract...

continued from p. 20

The fact that the Buyer made a specific, positive statement of non-reliance ("I relied only on . . ." as opposed to "I have not relied on . . .") combined with an integration clause was sufficient to disclaim fraud in the eyes of the court. No "magic language" was necessary; it was clear from the contract and the court's explanation of the totality of the circumstances that the parties intended to disclaim reliance on extra-contractual statements. Or in the words of the court, "[i]f a party represents that it only relied on particular information, then that statement establishes the universe of information on which that party relied. Delaware law does not require magic words. In this case, the Exclusive Representations Clause and the Integration Clause combine to mean that the Buyer did not rely on other information. They add up to a clear anti-reliance clause."[16]

C. South Carolina

At the other end of the spectrum lies South Carolina, where the South Carolina Supreme Court decided *Slack v. James*[17], and held the following clause did not bar tort claims such as fraud and negligent representation:

> 21. ENTIRE AGREEMENT. This written instrument expresses the entire agreement, and all promises, covenants, and warranties between the Buyer and Seller. It can only be changed by a subsequent written instrument (Addendum) signed by both parties. Both Buyer and Seller hereby acknowledge that they have not received or relied upon any statements or representations by either Broker or their agents which are not expressly stipulated herein.[18]

The dispute in *Slack* arose because the purchasers' closing attorney found a four-inch sewer easement running across a portion of the property after the Slacks entered into the sales contract.[19] The purchasers alleged that seller's real estate broker represented that no easements existed on the property. The purchasers did not condition the purchase on there being no easements or include an inspection period with a unilateral right to terminate based on any discoveries (related to title or otherwise) that were not acceptable to purchasers.

The *Slack* decision turns on whether a motion to dismiss was properly granted (the court held it was not), but the opinion discusses differing views on non-reliance clauses. A majority of the court felt the buyers reasonably relied on the misrepresentation of the seller's sales agent because the "speedy nature of residential real estate contracts today, it is not feasible to expect a buyer to be able to research the title of the property they are buying before entering into a contract"[20] and because "the alleged misrepresentation by Sellers' agent may have induced Buyers to refrain from discovering the true facts regarding whether there were any easements on the property before entering into a contract."[21]

The majority also stated the contract section was not enforceable as a non-reliance clause because it failed to be set out clearly in a separate section of the sales contract (it was included in a provision whose heading "ENTIRE AGREEMENT" suggested it was a merger clause) and because it lacked the specificity necessary to preclude the tort theories of negligent misrepresentation and fraud.[22] Citing *Whelan v. Abell*,[23] the majority said an opposite finding "would leave swindlers free to extinguish their victims' remedies simply by sticking in a bit of boilerplate."[24] The Court concluded that the quoted section of the sales contract was a merger clause but not a non-reliance clause. The dissent, however, pointed out the clause clearly contained non-reliance language and the purchasers "effectively waived the right to argue reliance when they signed the sales contract" that included the non-reliance language, and therefore could not satisfy each element of fraud and negligent misrepresentation.[25]

D. Florida

Florida courts, however, seem inclined to enforce non-reliance clauses based upon the principles of freedom to contract. In fact, *Billington v. Ginn-LA Pine Island, Ltd., LLLP*[26] was a real estate dispute

continued on p. 22

Freedom of Contract...

continued from p. 21

similar to the one in *Slack v. James* involving two separate but similar contracts for two lots. The facts of the case are that Ian Billington initially purchased a $1.35 million residential lot in Lake County, Florida. Although unclear from the opinion whether the clause was contained in the sales contract or a related brokerage contract, the transaction documents contained the following clauses:

> 14. BROKER AGENCY DISCLOSURE; COMMISSIONS; DISCLAIMER OF REPRESENTATIONS.
> ....
> NOTE: BEFORE BUYER SIGNS THE CONTRACT, BUYER SHOULD READ IT CAREFULLY AND IS FREE TO CONSULT AN ATTORNEY OF BUYER'S CHOICE.
> ....
> c. Buyer understands and acknowledges that the salespersons representing Seller in connection with this transaction do not have authority to make any statements, promises or representations in conflict with or in addition to the information contained in this Contract and the Community Documents, and Seller and Broker hereby specifically disclaim any responsibility for any such statements, promises or representations. By execution of this Contract, Buyer acknowledges that Buyer has not relied upon such statements, promises or representations, if any, and waives any rights or claims arising from any such statements, promises or representations.
> ....
> ANY CURRENT OR PRIOR UNDERSTANDINGS, STATEMENTS, REPRESENTATIONS, AND AGREEMENTS, ORAL OR WRITTEN, INCLUDING, BUT NOT LIMITED TO, RENDERINGS OR REPRESENTATIONS CONTAINED IN BROCHURES, ADVERTISING OR SALES MATERIALS AND ORAL STATEMENTS OF SALES REPRESENTATIVES, IF NOT SPECIFICALLY EXPRESSED IN THIS CONTRACT OR IN THE COMMUNITY DOCUMENTS, ARE VOID AND HAVE NO EFFECT. BUYER ACKNOWLEDGES AND AGREES THAT BUYER HAS NOT RELIED ON ANY SUCH ITEMS. (emphasis in original)

Mr. Billington later bought a second lot in the same subdivision for $1.64 million, but filed suit for misrepresentation when he learned others paid less for their lots and that he could not build private boat docks on the lots.[28] The trial court dismissed the fraudulent inducement count in Mr. Billington's Fifth Amended Complaint because the contracts attached to the complaint contained the disclaimer clauses listed above which negated his claims of reliance on the alleged misrepresentations.[29]

The apellate court surveyed non-reliance clauses throughout the country and concluded the apparent majority rule is enforcement of non-reliance clauses,[30] and affirmed the trial court's ruling by holding the non-reliance clauses negated Mr. Billington's claims of reliance.[31] The Billington court then held that "an express waiver of the right to maintain a fraud claim is all that is required to avoid liability for fraud,"[32] eloquently stating:

> Accordingly, we hold that the "non-reliance" clauses in this case negate a claim for fraud in the inducement because Appellant cannot recant his contractual promises that he did not rely upon extrinsic representations. We also conclude, pursuant to [the Florida Supreme Court's decision in] *Oceanic Villas*, that an express waiver of the right to base a claim on pre-contract representations renders the contract "incontestable ... on account of fraud." We emphasize that the disclaimer clauses here are as clear and conspicuous as they are comprehensive. If these clauses are insufficient to render a claim for fraud "incontestable" within the contemplation of the *Oceanic Villas* court, then no disclaimer can possibly accomplish that objective—an objective that is both reasonable and essential

continued on p. 23

> in our complex and litigious society. Written contracts are intended to head-off disputes. Public policy strongly favors the enforcement of contracts.[33]

III. An Argument for Freedom of Contract

Enforcing non-reliance clauses presents a compelling argument for freedom of contract. Non-reliance clauses accomplish the primary function of contracts: to force parties to carry out the promises they made in a contract as those promises are set forth in the contract.

Whether because of a "channeling function" or a "moral function," non-reliance clauses force each party to tell the other party what deal points they are relying upon when entering into the contract. Not only does this lead to a more fair allocation of risk and pricing (i.e., each party knows exactly what it is selling or buying), disclaimer clauses also avoid the renegotiation and litigation that arise from undisclosed subjective beliefs. While doing so subtly, Delaware, Florida and other similar jurisdictions focus on what is fair for both parties - not just the allegedly defrauded party- and conclude that proper allocation of societal resources is best served by having the parties clearly express their deal and perform their deal as stated in the written signed contract.

This is not to say that non-reliance clauses are without detractors; some have even called these provisions "liberty to lie" clauses.[34] But arguments against non-reliance clauses miss on several points. First, such an approach places all inferences in favor of the allegedly defrauded party and relieves that party from the contractual obligations it agreed to. Second, such an argument already presumes the party claiming fraud is right[35] and that the alleged tortfeasor is wrong. Third, these arguments create an evidentiary Catch-22 where the alleged tortfeasor is forced to look into the subjective mind of the allegedly defrauded party, ascertain their contractually unstated beliefs and intentions, and perform the contract in accordance with these hidden desires. And perhaps most important of all, these arguments encourage contract breaches instead of promoting the societally beneficial goal of adherence to one's promises because a party unhappy with the contract they entered into has an escape clause by merely alleging fraud in the inducement for failure of the alleged tortfeasor to satisfy that party's undisclosed, subjective contractual goals.

Non-reliance clauses, on the other hand, force parties to trust but verify. Admittedly, non-reliance clauses are not perfect; one can always find extreme situations where a non-reliance clause can be used to swindle another party. Condoning such activity is certainly not in the best interest of society, but employing some of the protections found in different jurisdictions can greatly reduce the risk of contractual oppression.[36] Worse yet, not enforcing non-reliance clauses is less desirable as it allows parties to avoid their contractual obligations and use the courts to renegotiate contracts — outcomes that disserve society even more. On balance, non-reliance clauses are useful mechanisms for achieving what society needs most from contracts: channeling to make sure that all parties are on the same page and certainty of risk and outcome.

IV. Conclusion

Non-reliance clauses promote positive social norms by reinforcing well-accepted contractual principles of keeping one's promises and openly disclosing contractual goals while discouraging frivolous litigation and claims. Likewise, the alleged risks of non-reliance clauses appear overstated and can be greatly reduced - if not entirely eliminated - by conditioning their use together with safeguards found in other states such as creating exclusions for application of the principle when one party has superior knowledge of contractual conditions which another party cannot ascertain with reasonable diligence.[37] The use of specific, detailed non-reliance clauses should be greatly expanded so that parties may be free to contract without fear of being unjustifiably accused of fraud. ■

continued on p. 24

continued from p. 23

[1] *Mejia v. Jurich*, 781 So. 2d 1175, 1178 (Fla. 3d DCA 2001).
[2] *Texas Standard Oil & Gas, L.P. v. Frankel Offshore Energy, Inc*., 394 S.W.3d 753,768 (Tex.App.2012).
[3] *Northwest Bank & Trust Co. v. First Illinois National Bank*, 354 F.3d 721, 725-26 (8th Cir. 2003) (merger clause will not preclude a fraud claim even if the parties are sophisticated).
[4] *Abry Partners*, 891 A.2d at 1035 – 36.
[5] Obtaining a party's signature by fraud, i.e., the party signing did not recognize or consent to signing the document that was actually signed, is a form of alleged fraud that is outside the scope of this article.
[6] Note, Big Boy Letters: Trading On Inside Information, 94 Cornell L. Rev. 133, 140 (2008). Author Edwin D. Eshmoilit argues non-reliance clauses, often termed "Big Boy Letters" for the view that parties to sophisticated securities agreements were "big boys" and could take care of themselves, emerged in response to a United States Supreme Court case regarding the misappropriation theory of insider trading: "This liability carve-out in *[United States v.] O'Hagan* [,521 U.S. 642 (1997)] subsequently gave birth to the idea of big boy letters-agreements that allow a party to trade on material, nonpublic information without having to disclose any such information." Id.
[7] *JM Vidal, Inc. v. Texdis USA, Inc.,* 764 F. Supp. 2d 599, 623 (S.D.N.Y. 2011).
[8] *Harbinger Capital Partners Master Fund I, Ltd. v. Wachovia Capital Markets, LLC*, 27 Misc. 3d 1236(A) at *5, 910 N.Y.S.2d 762 (Sup. Ct. May 10, 2010).
[9] *Danann Realty Corp. v. Harris*, 5 N.Y.2d 317, 320 (1959). New York has an exception for "peculiar knowledge" where a party would face extraordinarily high costs or great difficulty in ascertaining the truth or falsity of statements. See, e.g., *Schooley v. Mannion*, 659 N.Y.S.2d 374, 375 (1997) (insulation within the structure was "not easily verified without destructive testing"). But the exception is subject to an exception if the party has the means to ascertain the truth using ordinary intelligence. See *ACA Fin. Guar. Corp. v. Goldman, Sachs & Co.,* 25 N.Y.3d 1043, 1044 (2015).
[10] *RAA Mgmt., LLC v. Savage Sports Hldgs., Inc.*, 45 A.3d 107, 118-19 (Del. 2012).
[11] *Anvil Holding Corp. v. Iron Acquisition Co*., 2013 WL 2249655, at *8 (Del. Ch. May 17, 2013).
[12] *Airborne Health, Inc. v. Squid Soap, LP*, 984 A.2d 126,141 (Del. Ch. 2009).
[13] *Prairie Capital III, L.P. v. Double E Holding Corp.* 132 A.3d 35 (Del. Ch. November 24, 2015).
[14] Prairie Capital III, L.P., 132 A.3d at 51.
[15] Id.
[16] Id.
[17] *Slack v. James,* 364 S.C. 609 (2005).
[18] *Slack*, 364 S.C. at 612.
[19] Id.
[20] Id. at 615.
[21] Id.
[22] Id. at 618.
[23] *Abel*, 48 F.3d 1247, 1258 (D.C. Cir. 1995).
[24] Id at 619.
[25] Id. at 620.
[26] *Billington*, 192 So. 3d 77 (Fla. 5th DCA 2016).
[27] *Billington*, 192 So. 3d at 79.
[28] Id.
[29] Id.
[30] Id.
[31] Id. at 79-80.
[32] Id. at 85.
[33] Id. at 84. The decision goes on to certify conflict with *Lower Fees, Inc. v. Bankrate, Inc*., 74 So.3d 517 (Fla. 4th DCA 2011), "to the extent that the disclaimer language there did not contain a waiver," and to list six questions of great public importance. Unfortunately, the intermediate appeal was not taken to the Florida Supreme Court and was eventually settled.
[34] Zeitlin, Andrew M and Baker, Alison P., At Liberty to Lie? The Viability of Fraud Claims after Disclaiming Reliance, American Bar Association Section of Litigation (April 23, 2013).
[35] This article obviously concerns itself with broader aspects of a fraudulent inducement claims as opposed to the judicial inferences of truthfulness of allegations at the motion to dismiss stage or the outcomes of evidentiary conclusions at trial. Those two topics are beyond the scope of this article.
[36] Some states require the combination of merger/integration clauses with non-reliance clauses, specific detailing of the representations relied upon, or require affirmative as opposed to negative "I have not relied on . . ." statements. Moreover, some states limit use of non-disclaimer clauses when one party has all the relevant information and the other party does not have the means to obtain the information.
[37]- An obvious example that comes to mind is superior knowledge of structural building components that could not be discovered through reasonable inspections.