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COMMERCIAL DIVISION UPDATE

Expert Analysis

Exceptions to the Enforceability Of Contractual Disclaimers of Reliance

It is increasingly common for commercial contracts between sophisticated parties to include a disclaimer that one party, perhaps the buyer, has not relied on any representations made by the counterparty, perhaps the seller, other than those representations set forth in the contract. While such disclaimers are generally enforceable, New York courts have drawn two exceptions to their enforceability. First, such disclaimers are generally enforceable only where they are specific and track the substance of the alleged mis-representation or omission.[1] For example, a general disclaimer that the buyer has not relied on any representation of the seller may be unenforceable, whereas a disclaimer limited to representations concerning environmental matters may be enforceable. Second, even where the disclaimer is specific and tracks the substance of the alleged misrepresentation, the disclaimer may not provide protection where the facts misrepresented or omitted were peculiarly within the knowledge of the party seeking the protection of the disclaimer.[2]

A recent decision by Justice Barbara Kapnick of the New York County Commercial Division applied both of these concepts on a motion to dismiss, the court concluding that additional factual development was required to determine the enforceability of the disclaimer at issue. *Harbinger Capital Partners Master Fund I Ltd. v. Wachovia Capital Markets LLC*, 602529/08 (May 10, 2010).

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Background

The *Harbinger Capital* case arose out of an alleged massive fraud orchestrated by Le Nature's Inc., a beverage manufacturer, bottler and distributor that was placed in involuntary bankruptcy in November 2006. For years prior to bank-ruptcy, the company allegedly issued false financial information. For example, for the year 2005, the company allegedly reported net sales of over $275 million, 10 times its actual revenues. Two months prior to the bank-ruptcy filing, Wachovia Capital Markets LLC arranged to syndicate a $285 million loan made to Le Nature's.

> The 'Harbinger Capital' decision provides a sound reminder to practitioners of the importance of specificity in reliance disclaimers.

The plaintiffs in this case were syndicate lenders who alleged, among other things, that Wachovia had defrauded them. Specifically, the plaintiffs alleged that Wachovia knew, but failed to disclose, that Le Nature's was reporting false sales data, that Le Nature's had systematically failed to make timely interest payments in the past, and that Le Nature's had improperly reported more than $200 million in capital leases as operating leases, thereby removing these liabilities from its balance sheet.

Wachovia moved to dismiss the fraud claim based on a reliance disclaimer in the credit agreement. The disclaimer provided, in relevant part:

> Each Lender expressly acknowledges that neither the Administrative Agent [Wachovia] nor any of their officers, directors, employees, agents, attorneys-in-fact or affiliates has made any representation or warranty to it and that no act by the Administrative Agent hereinafter taken, including any review of the affairs of the Credit Parties, shall be deemed to constitute any representation or warranty by the Administrative Agent to any Lender. Each Lender represents to the Administrative Agent that it has, independently and without reliance upon the Administrative or any other Lender, and based on such documents and information as it had deemed appropriate, made its own appraisal of any investigation into the business, operations, property, financial and other condition and credit worthiness of the Credit Parties and made its own decision to make its Loans hereunder and enter into this Credit Agreement.

Based on this language, Wachovia argued that the plaintiffs' alleged reliance on any alleged misrepresentation or omissions by Wachovia was unreasonable as a matter of law, thereby defeating an essential element of the fraud claim.

The Specificity Requirement

The court first addressed the enforceability of the disclaimer, plaintiffs arguing

that the disclaimer was too general to bar a claim for fraud. Plaintiffs pointed to the first sentence of the disclaimer section which provided that the Administrative Agent had not "made any representation or warranty to" the lenders, a clause that the plaintiff called mere "boilerplate." Plaintiff cited to the New York Court of Appeals decision of *Danann Realty Corp. v. Harris*[3] for the proposition that an "omnibus statement… that no representations have been made does not defeat a claim for fraudulent inducement."

The court noted that, under New York law, a reliance disclaimer is generally enforceable only where it "tracks the substance of the alleged misrepresentation." In reviewing the language at issue, the court concluded that the disclaimer was indeed specific. While the first sentence alone may have been too general, the next sentence went on to provide that the plaintiffs, independently and without reliance on Wachovia, had made their own appraisals of the company's f nancial condition. The court found that by this language "'the plaintiffs have in the plainest language announced… that [they] are not relying on any representations as to the very matter as to which [they] now claim [they were] defrauded. Such a specific disclaimer destroys the allegations in the plaintiffs' complaint that the agreement was executed in reliance upon these contrary oral representations.'"[4] The court did not address the added consideration imposed by some courts that the disclosure be a negotiated clause and not mere boilerplate.[5]

In *Jana Master Fund, Ltd. v. JPMorgan Chase & Co.*,[6] the New York County Commercial Division similarly found that the following disclaimer, in a private placement memo, to purchasers of securities, was specific enough to defeat a claim of negligent misrepresentation:

> [T]he securities are being offered only to a limited number of institutional accredited investors that are willing and able to conduct an independent investigation of the risks associated with ownership of the securities. By accepting delivery of this memorandum, prospective investors will be deemed to have acknowledged the need to conduct their own thorough investigation of the company and to exercise their own due diligence before considering an investment in securities.[7]

The court found that this disclaimer directly contradicted a claim of a duty owed to the purchasers, resulting in dismissal of the claim.[8]

'Peculiar Knowledge'

After the court in *Harbinger Capital* analyzed the specificity of the disclaimer at issue, it then went on to address the plaintiffs' assertion that the "peculiar knowledge" exception applied which vitiated the disclaimer defense. Under this exception, even where the plaintiff executed a specific disclaimer of reliance on the other party's representations, the plaintiff may not be precluded from claiming reliance if the facts allegedly misrepresented or omitted were peculiarly within the first party's knowledge and not discoverable by plaintiff.[9]

For this proposition, the court cited the Appellate Division, Second Department, case of *Tahini Invs. Ltd. v. Bobrowsky* , [10] in which the plaintiff had purchased from the defendant a horse farm and later uncovered 15 drums of industrial waste buried underground. Plaintiff alleged that the defendant was aware of the waste at the time it sold the property and that its failure to disclose it constituted fraud. The court found that whether the reliance disclaimer in the purchase contract barred the claim turned on a factual dispute of whether the defendant knew of the existence of the dumping site and whether plaintiff could have ascertained its presence with reasonable diligence.

> Under the 'peculiar knowledge' exception, even where the plaintiff executed a specific disclaimer of reliance on the other party's representations, the plaintiff may not be pre-cluded from claiming reliance if the facts allegedly misrep-resented or omitted were peculiarly within the first party's knowledge and not discoverable by plaintiff .

The court concluded that "a purchaser may not be precluded from claiming reliance on any oral misrepresentations if the facts allegedly misrepresented are peculiarly within the seller's knowledge."[11]

In *Chase Manhattan Bank v. New Hampshire Ins. Co.*,[12] the New York County Commercial Division found that the peculiar knowledge exception, recognized by the Second Department in *Tahini* , was not applicable where the parties to the insurance policies at issue contractually recognized that "the policy could not be avoided even if, e.g., the broker were guilty of misstatements or omissions."[13] . Significantly, while the court in Chase Manhattan Bank analyzed the *Tahini* peculiar knowledger exception, finding it inapplicable, l it questioned whether *Tahini* was -good law in the First Department. The court noted that, if a distclaimer does not protect against -that which is within the peculiar. knowledge of the speaker, then it would provide no more protection than no disclaimer at all. The court further observed that post- *Tahini* precedent has allowed disclaimers to bar claims for fraud even where r the fraudulent statements were within defendant's own peculiar knowledge.[14]

In arguing against the application of the peculiar knowledge exception in *Harbinger Capital* , Wachovia relied on the Southern District decision in *Unicredito Italiano SPA v. JPMorgan Chase Bank* ,[15] which held that the application of the peculiar knowledge exception generally was inappropriate where the plaintiffs were sophisticated investors and the defendant did not specifically undertake to provide the allegedly concealed information.[16]

Analyzing the peculiar knowledge exception, the *Harbinger Capital* court appeared to place considerable weight on the plaintiffs' allegations that Wachovia had been wearing multiple hats. For one, Wachovia allegedly had been responsible for all of Le Nature's financing arrangements. In addition, plaintiff alleged that Wachovia had acted as the company's exclusive financial adviser and investment banker and, in that connection, had explored a possible sale of the company. Indeed, the plaintiffs alleged that Wachovia had structured and underwritten securities offerings for the company, and had screened information

that the company distributed to investors. As such, the plaintiffs alleged that Wachovia had unusual access to Le Nature's financial records, personnel, outside accountants and law firms.

While acknowledging that the evidence might ultimately demonstrate that Wachovia did not have a peculiar knowledge, the court found the dismissal of the peculiar knowledge argument premature at the motion to dismiss stage.

> While the evidence might ultimately demonstrate that defendants did not, in fact, have any special knowledge upon which they relied or which plaintiffs could not have ascertained by exercising reasonable diligence, these issues are 'inappropriate to determine…as a matter of law based solely on the allegations in [the] complaint.'[17]

Conclusion

The book on this case is far from closed as Wachovia has filed a notice of appeal and, even if the denial of the motion to dismiss is not reversed on appeal, the plaintiffs will now have to prove their allegations. Regardless of what happens, the *Harbinger Capital* decision provides a sound reminder to practitioners of the importance of specificity in reliance disclaimers.

The likelihood of enforceability increases as the disclaimer gets more specific, but, on the other hand, as the disclaimer gets more specific, the scope of the misrepresentations and omissions that it catches may draw narrower. In addition, this case makes clear that, even with such specificity, disclaimers may not ultimately defeat fraud claims where the peculiar knowledge exception applies. However, at least one Commercial Division court has declined to apply that exception where the contract specifically disclaimed claims based on the other party's omissions and misrepresentations.

1. *Caiola v. Citibank, N.A.,* 295 F.3d 312, 330 (2d Cir. 2002) (quoting *Grumman Allied-Indus. Inc. v. Rohr Indus. Inc.,* 749 F.2d 729, 734-35 (2d Cir. 1984)).
2. *Tahini Invs. Ltd. v. Bobrowsky,* 99 A.D.2d 489, 490, 470 N.Y.S.2d 431, 433 (2d Dept. 1984).
3. 5 N.Y.2d 317, 320, 184 N.Y.S.2d 599, 602 (1959); see also *Mfrs. Hanover Trust Co. v. Yanakas,* 7 F.3d 310, 317 (2d Cir. 1993) ("Generalized" disclaimers do not preclude reliance on specific statements).
4. Citing *Danann Realty Corp. v. Harris,* 5 N.Y.2d 317, 320, 184 N.Y.S.2d. 599, 602 (1959).
5. See, e.g., *Superior Technical Resources Inc. v. Lawson Software Inc.,* 17 Misc.3d 1137(A), 2007 WL 4291575 at *11 (Erie Co. Dec. 7, 2007) (Curran, J.).
6. 19 Misc.3d 1106(A), 2008 WL 746540 (N.Y Co. March 12, 2008) (Fried, J.).
7. Id. at *2.
8. Id. at *5.
9. *Tahini Invs. Ltd. v. Bobrowsky,* 99 A.D.2d 489, 490, 470 N.Y.S.2d 431, 433 (2d Dept. 1984).
10. Id.
11. Id. (citing *Danann Realty Corp. v. Harris,* 5 N.Y2d 317, 322, 184 N.Y.S.2d 599, 603 (1959)).
12. 193 Misc.2d 580, 749 N.Y.S.2d 632 (N.Y Co. 2002) (Gammerman, J.).
13. Id. at 599, 749 N.YS.2d at 640.
14. Id. (citing *Gaidon v. Guardian Life Ins. Co. of America* , 94 N.Y2d 330, 704 N.YS.2d 177 (1999); *Benjamin Goldstein Productions v. Fish Ltd.* , 198 A.D.2d 137, 603 N.YS.2d 849 (lst Dept. 1993)).
15. 288 F.Supp.2d 485, 497 (SDNY 2003).
16. But see *Swersky v. Dreyer & Traub* , 219 A.D.2d 321, 643 N.YS.2d 33 (lst Dept. 1996) (trial court erred in dismissing fraud claims based on alleged misrepresentations and concealments because, though both parties were sophisticated, it was clear there were factual issues as to the information available to plaintiffs).
17. *Harbinger Capital Partners Master Fund I Ltd. v. Wachovia Capital Markets LLC,* 602529/08 (May 10, 2010) (citing *P.T. Bank Cent. Asia, N.Y. Branch v. ABM Amro Bank N.V.* , 301 A.D.2d 373, 378, 754 N.YS.2d 245, 252 (lst Dept. 2003)).

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