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An important Financial Services update from the law firm of Jackson Walker.

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Texas Case Law Update

By **Gordon M. Shapiro** & **Brian A. Kilpatrick**

In an ongoing effort to update our financial institution clients about important developments in Texas jurisprudence that may impact them, we bring to your attention two recent decisions of particular import. Dallas trial associates **Colin LeCroy** and **Minoo Sobhani** contributed to this e-Alert.

Certain Merger Clauses Will Not Preclude Fraudulent Inducement Claims After Recent Texas Supreme Court Decision

In *Italian Cowboy Partners, Ltd. v. The Prudential Ins. Co. of America*, ___ S.W.3d ____, 2011 WL 1445950 (Tex. April 15, 2011), the Texas Supreme Court issued an opinion concluding that a fairly typical merger clause, absent an expressed clear and unequivocal intent to disclaim reliance or waive claims for fraudulent inducement, did not have the effect of precluding claims for fraudulent inducement. The Court narrowly construed the contract language at issue to permit the fraud claims to survive.

This dispute arose when the owners and operators of a restaurant, Italian Cowboy, terminated the restaurant's lease because of a persistent sewer gas odor. In a suit against the landlord and its property manager, the tenant sought to rescind the lease and recover damages for fraud, among other things.

During the lease negotiations, the property manager told the tenant that the building was practically new and had no problems. The lease included a so-called standard merger clause, along with language stating that the "tenant acknowledges that neither Landlord nor Landlord's agents, employees, or contractors have made any representations or promises with respect to the site, the Shopping Center or this Lease except as expressly set forth herein."

After signing this lease, the tenant discovered that the property had a severe odor problem, that such problem had plagued the previous tenant, and that the property manager had prior knowledge of such problem. Italian Cowboy brought this lawsuit asserting claims for fraud, including both a theory of fraud in the inducement of the lease as well as fraud based on later misrepresentations. The trial court found for Italian Cowboy on all claims. The court of appeals, however, reversed as to each of Italian Cowboy's claims and rendered a take-nothing judgment, while rendering judgment in favor of the defendant on its counterclaim for breach of contract.

The Texas Supreme Court determined that the lease contract did not effectively disclaim reliance on representations made by the property manager, which would negate an element of Italian Cowboy's fraud claim, because a plain reading of the contract language at issue indicated the parties' intent was merely to include the substance of a generic merger clause. In addition, even if the parties had intended to disclaim reliance, the contract provisions did not do so by clear and unequivocal language.

The Court recognized that it is possible for a contract's terms to preclude a claim for fraudulent inducement by a clear and specific disclaimer-of-reliance clause. The Court discussed two previous Supreme Court cases in which it found particular contract language sufficient to preclude fraudulent inducement claims. In each of those cases, *Schlumberger Technology Corp. v. Swanson*, 959 S.W.2d 171 (Tex. 1997) and *Forest Oil Corp. v. McAllen*, 268 S.W.3d 51 (Tex. 2008), the intent to disclaim reliance on others' representations was evident from the language of the contract itself, with the parties using clear and unequivocal language. To reach this conclusion, the Court emphasized that there is a significant difference between a party disclaiming its *reliance* on certain representations, and therefore potentially relinquishing the right to pursue any claim for which reliance is an element, and disclaiming the *fact* that no other representations were made.

With this holding, a generic merger clause will not necessarily suffice to avoid later claims by a borrower or other contracting party that it was relying on representations made by the financial institution or its agents prior to signing the contract. A disclaimer of reliance clause is enforceable, but should be written with clear and unequivocal language evidencing the parties' specific intent to disclaim reliance.

Loan Servicer Has Standing To Enforce Note Against Borrower Even Though It Was Not the Holder of the Note

In *ECF North Ridge Assocs., L.P. v. ORIX Capital Mkts*., ____ S.W.3d ____, 2011 WL 856902 (Tex. App.—Dallas March 14, 2011), the Dallas Court of Appeals held that a loan servicer (ORIX) had standing to sue the borrowers of a loan it serviced for breach of the loan agreement in spite of the fact that it was not the holder of the promissory note in question.

ORIX was the servicer of certain pooled and securitized loans on behalf of the loan pools' trustees and was responsible for collecting monthly payments, monitoring whether the properties were properly insured, and addressing issues of default under the loan documents. The borrowers, ECF Northridge Associates ("ECF"), the owner of an apartment complex, and TCI 9033 Wilshire Boulevard ("TCI"), the owner of a medical office building, brought suit against ORIX for breach of contract and for declaratory relief, asserting that ORIX breached the loan documents by declaring defaults arising from the borrowers' alleged failures to comply with certain insurance requirements in the loan documents to maintain terrorism insurance. ORIX responded by filing counterclaims for breach of contract and declaratory relief. The owners joined U.S. Bank, the trustee and former owner of ECF's loan, and Wells Fargo Bank, the trustee and owner of TCI's loan.

TCI argued that ORIX, as the servicer and not the holder of TCI's note, had no standing to sue TCI. Wells Fargo was still the holder of the note. The Court of Appeals, in addressing this threshold issue, noted that no Texas case had previously addressed whether a servicer who was not the holder of the note had standing to sue to enforce it. Relying on a recent Seventh Circuit decision addressing the same question, the Court held that the loan servicer did have standing to sue TCI in light of its equitable interest in the property. *Citing CWCapital Asset Mgmt., LLC v. Chicago Props., LLC*, 610 F.3d 497 (7th Cir. 2010). The Court noted that the contractual language in the ORIX Pooling and Servicing Agreement was almost identical to that in *CWCapital*, both of which granted the servicer full power and authority to do all things related to the servicing of the loan, required the trustee to support the servicer's efforts to service the pooled loans, and permitted the servicer to institute lawsuits in its own name.

ORIX had pointed the Court's attention to the San Antonio Court of Appeals' decision in *ORIX Capital Markets, LLC v. La Vallita Motor Inns*, J.V., 329 S.W.3d 30, 39-42 (Tex. App.—San Antonio 2010, pet. filed), which similarly held. The San Antonio Court of Appeals reversed the trial court's determination that ORIX had failed to prove that it was entitled to enforce the note, holding that ORIX conclusively established its right to enforce the note as special servicer and rejecting the borrower's argument's to the contrary in light of the contractual language set forth in the servicing agreement.

In light of the common use of loan servicers for pooled loans in Texas, these decisions by the Dallas Court of Appeals and the San Antonio Court of Appeals are quite important to lenders in Texas. Although we have previously argued that Section 3.301 of the Uniform Commercial Code (codified in Texas in the Texas Business and Commerce Code) allowed non-holder servicers to sue on behalf of holders, no Texas appellate court had directly addressed the issue. A Petition for Review has been filed (but not ruled upon) in the Texas Supreme Court by the borrowers in the San Antonio case. We will closely monitor any further developments in the case, particularly if the Supreme Court decides to take it.

If you have any questions regarding this e-Alert, please contact **Gordon M. Shapiro** at 214.953.6059 or **gshapiro@jw.com**, or **Brian A. Kilpatrick** at 214.953.5933 or **bkilpatrick@jw.com**.

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