

The Transactional Lawyer

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Affirmative-Reliance Clauses: A Tool for Short-Circuiting Fraud Claims?

Tyler R. Whitney

Anti-reliance clauses, a boilerplate feature of many agreements, disclaim reliance by a contracting party upon the counterparty's prior representations. Such anti-reliance clauses are commonly used – somewhat unilaterally – in audited financial statements and legal opinions to stave off a claim from a third party who relied on the statement or opinion. See *Laible v. Bd. of Review*, [2011 WL 6568](#) n.1 (N.J. Super. Ct. App. Div. 2010) (untimely claimant could not reasonably rely on advice given on Oprah Winfrey Show when website disclaimed reliance on any supposed legal advice). They are also used in purchase and sale agreements to avoid a later claim of misrepresentation against the seller. See *Rissman v. Rissman*, [213 F.3d 381](#), 384-85 (7th Cir. 2000). Anti-reliance clauses have even been used in consent agreements for motion picture appearances. See *Psenicska v. Twentieth Century Fox Film Corp.*, [2008 WL 4185752](#) (S.D.N.Y. 2008), *aff'd*, [409 F. App'x 368](#) (2d Cir. 2009) (“Participant is not relying upon any promises or statements made by anyone about the nature of the Film or the identity of any other Participants or persons involved in the Film.”). In this sense, they are not unlike merger clauses that seek to shield a written agreement in the protection of the parol evidence rule. In general, courts give effect to anti-reliance clauses. See *Rissman*, [213 F.3d at 384-85](#); *FSL Acquisition Corp. v. Freedland Systems, LLC*, [686 F. Supp. 2d 921](#) (D. Minn. 2010).

What, then, about a clause declaring that a party has relied on a representation of the other party and that such reliance is reasonable? As the court in *Rissman* indicated, such a clause, “entitling one party to rely on every representation ever made by the other,” could be a useful way to allocate risk and set the foundation for a claim for misrepresentation or fraud if the represented facts prove not to be true. [213 F.3d at 385](#).

Unfortunately, the authorities and literature on these provisions is sparse. While the *Rissman* court based its decision in part on the fact that the parties had not included in their agreement an affirmative-reliance clause, suggesting that such a clause would be effective, [213 F.3d at 385](#), this discussion was merely dicta. Moreover, in the sole case cited for support, *LHLC Corp. v. Cluett, Peabody & Co.*, [842 F.2d 928](#) (7th Cir. 1988), in which the parties' agreement did include an affirmative-reliance provision, neither the district court nor the appeals court based its decision on that clause. In short, no court seems to have squarely held that an affirmative reliance clause is a valid mechanism for short-circuiting the reliance requirement of a fraud claim. Moreover, even the *Rissman* court said nothing about whether such a clause would be relevant to whether reliance was reasonable or justifiable. However, no court appears to have denied effect to an affirmative-reliance clause, leaving the door open for their growth.

Affirmative-reliance provisions might likewise be helpful to a creditor who seeks to have a debt declared nondischargeable because it was incurred under false pretenses, false representations, or actual fraud. [11 U.S.C. § 523\(a\)\(2\)\(A\)](#). For example, a creditor and debtor might, in settlement of a dispute, agree in writing that the debtor made a material misrepresentation to the creditor, that the creditor relied on that misrepresentation, and that such reliance was reasonable or justifiable. However, the efficacy of such declarations in this context is doubtful. A debtor cannot voluntarily waive the dischargeability of a debt. *In re Cole*, [226 B.R. 647](#), 653 (9th Cir. BAP 1998) (“[i]f bankruptcy courts enforced prepetition waivers of discharge, they would effectively be creating an exception to discharge that Congress had not enumerated”); *Klingman v. Levinson*, [831 F.2d 1292](#), 1296 n.3 (7th Cir. 1987). Moreover, even a consent judgment does not necessarily create a basis for

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collaterally estopping the debtor from challenging a nondischargeability complaint. See *In re Brown*, [162 B.R. 17](#), 19 (Bankr. D. Kan. 1993) (“preclusive effects should be measured by the intent of the parties”); but see *Klingman*, [831 F.2d at 1296](#) (preclusion is appropriate if it is clear that the parties intended it as a part of their agreement). Thus, it is doubtful that statements in the settlement agreement would actually preclude the debtor from denying that the creditor relied or that any actual reliance was reasonable or justifiable. See, e.g., *In re Bachinski*, [393 B.R. 522](#) (Bankr. S.D. Ohio 2008).

One final point is worth making. Practitioners should be wary to include an affirmative-reliance clause as a recital. Most courts treat recitals as having no legal relevance; they are not enforceable provisions. See, e.g., *Abraham Zion Corp. v. Lebow*, [761 F.2d 93](#), 103 (2d Cir. 1985) (quoting *Genovese Drug Stores v. Connecticut Packing Co.*, [732 F.2d 286](#), 291 (2d Cir. 1984)) (“[a]lthough a statement in a ‘whereas’ clause may be useful in interpreting an ambiguous operative clause in a contract, it cannot ‘create any right beyond those arising from the operative terms of the document’ ”); *Paloian v. Grupo Serla S.A. de C.V.*, [433 B.R. 19](#), 32 (N.D. Ill. 2010) (recitals are not binding unless referred to in the operative portions of the agreement); *Trafton v. Rocketplane Kistler, Inc.*, [2010 WL 771511](#), *4 (E.D. Wis. 2010) (“[t]he fact that one of the ‘whereas’ recitals sets forth both sides’ expectations does not create some kind of condition precedent. It is well-established, moreover, that ‘whereas’ clauses exist merely to provide context and are not themselves part of the agreement”). But see [Cal. Evid. Code § 622](#) (“[t]he facts recited in a written instrument are conclusively presumed to be true as between the parties thereto, or their successors in interest”). To be effective, an affirmative-reliance clause should be a declaration included in the body of the agreement.

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Very Interesting . . . or Is It: Limitations on Default Interest

Stephen L. Sepinuck

Several recent cases provide useful lessons on how to provide for – or, more accurately – how not to provide for – default interest.

Post-Default vs. Post-Acceleration

In *JCC Development Corp. v. Levy*, [146 Cal. Rptr. 3d 635](#) (Cal. Ct. App. 2012), a bit of bad drafting cost the lender over \$150,000 in interest. The lender in that case loaned the borrower \$2.7 million. The promissory note called for 5% interest, with payment of principal and interest due approximately one year after issuance. It also provided:

“If . . . Maker shall default in the payment of any interest, principal, or any other sums due hereunder, . . . then, at Lender’s option, all sums owing hereunder shall, at once, become immediately due and payable. Thereafter, interest shall accrue at the maximum legal rate permitted to be charged by non-exempt lenders under the usury laws of the State of California.

The borrower did not pay upon maturity because it was still negotiating to sell property to fund repayment of the loan. Several months later, the borrower requested a payoff letter. The lender complied and sent a payoff letter that computed interest after maturity at the default rate. The borrower paid under protest and sued for a partial refund, claiming that the default rate of interest was inapplicable. The trial court ruled for the lender but the appellate court reversed. It noted that the plain language of the note provided for higher interest after *acceleration*, not *default*. Specifically, “once one of the circumstances occurred which would accelerate the loan, ‘thereafter’ interest could accrue at the maximum legal rate.” [Id. at 643](#). Because the borrower paid after the loan had matured, and thus the acceleration clause was never triggered, the clause calling for higher rate was never triggered.

Moral: make sure default interest applies after any default, including non-payment at maturity, not after acceleration.

Pre-Judgment

In many states, California among them, a successful plaintiff on a contract action is entitled to pre-judgment interest if either the contract so provides or the amount of damages is certain or capable of being made certain with calculation. *See, e.g.,* Calif. Civil Code § 3287. These limitations proved problematic for the successful plaintiff in *Cataphora Inc. v. Parker*, [848 F. Supp. 2d 1064](#) (N.D. Cal. 2012).

The court concluded that the amount claimed was not certain or capable of being made certain with calculation because the plaintiff changed its damages theory as the litigation progressed and in fact presented two different calculations of damages to the jury. The court also ruled that the parties' agreement did not provide for pre-judgment interest because the agreement stated merely that interest would accrue on "any payments that are late," and the dispute was not over a late payment. Given that the plaintiff had drafted the agreement, the court had little sympathy for the fact that the agreement did not provide for pre-judgment interest on all successful claims arising out of the contract.

Moral: make sure pre-judgment interest applies to all claims, not merely claims liquidated in amount, or at least to all claims of a type that your client is likely to bring.

Post-Judgment

When a state-law claim is brought in federal court under diversity jurisdiction, state law governs the availability of pre-judgment interest but federal law governs the availability and rate of post-judgment interest. Post-judgment interest is mandatory, *see* [28 U.S.C. § 1961\(a\)](#), but the rate is currently very low: the weekly average 1-year constant maturity Treasury yield, as published by the Board of Governors of the Federal Reserve System, for the calendar week preceding the date of the judgment. *See* [Board of Governors Interest Rates](#).

Parties are free contractually to waive application of § 1961 and set their own – presumably higher – post-judgment interest rate, but their intent to do so must be clear and unequivocal. Most standard terms in a promissory note fail this test because they do not expressly refer to interest post-judgment. *See, e.g.,* *Kanawha-Gauley Coal & Coke Co. v. Pittston Minerals Group, Inc.*, [2012 WL 6622708](#) (4th Cir. 2012) (clause calling for interest at 2% above prime after default did not apply post-judgment); *FCS*

Advisors, Inc. v. Fair Finance Co., [605 F.3d 144](#) (2d Cir. 2010) (choice-of-law clause is insufficient to contract around § 1961); *In re Riebesell*, [586 F.3d 782](#) (10th Cir. 2010) (promissory note that made Colorado law applicable and provided for interest at 24% upon default and acceleration did not clearly and unequivocally express the intent to contract around § 1961); *Westinghouse Credit Corp. v. D'Urso*, [371 F.3d 96](#) (2d Cir. 2004) (federal rate applies to judgment despite the parties' express agreement to apply a 15.5% interest rate to any arbitration award "from the date payment was due to the date payment is made"); *Jack Henry & Associates, Inc. v. BSC, Inc.*, 753 F. Supp. 2d 665 (E.D. Ky. 2010) (agreement providing that "[a]mounts outstanding after the due date are subject to an interest charge to date of payment of the lesser of 18% per annum or the highest legally allowable rate" was not adequate to contract around § 1961); *Comerica Bank v. Stewart*, [2009 WL 4646894](#) (E.D. Mich. 2009) (term in promissory note providing for a higher interest rate after default did not evidence an agreement to contract around § 1961).

The same rule applies even if the judgment is merely one that confirms an arbitration award. *See* *Fidelity Federal Bank v. Durga Ma Corp.*, [387 F.3d 1021](#) (9th Cir. 2004). Indeed, one court recently ruled that an arbitration panel may not establish a post-judgment rate different from the federal statutory rate unless it determines the parties have clearly, unambiguously, and unequivocally contracted for their own rate. *Hosier v. Citigroup Global Markets, Inc.*, [858 F. Supp. 2d 1206](#) (D. Colo. 2012).

Moral: expressly reference interest accruing after any judgment or arbitration award. The following language should be sufficient.

Upon Default, all sums then and thereafter owing will bear interest at [the rate of percent (____%) per annum] [the maximum legal rate under the law of _____] (the "Default Rate"). The Default Rate applies both before and after any judgment or arbitration decision, until Lender receives full payment in cash.

Final Caveat

While lenders often draft promissory notes and loan agreements that provide for very substantial increases in the interest rate after default, it is advisable to remember that in some jurisdictions the parties' freedom of contract on this point is circumscribed. Not

only might usury laws restrict the applicable interest rate, but so too may general principles of contract law. See *California Bank & Trust v. Shilo Inn*, [2012 WL 5605589](#) (D. Or. 2012) (term in promissory note providing for the interest rate to increase by 5% upon default was an unenforceable liquidated damages provision under California Civil Code § 1671 because the creditor offered no evidence that the higher interest rate bore any relation to the anticipated harm arising from default); cf. *First Century Plaza, LLC v. Nguyen*, [2012 WL 6691880](#) (Cal. Ct. App. 2012) (guarantors had not established that 5% increase in interest rate after default was invalid under § 1671).

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Recent Cases

SECURED TRANSACTIONS

Wells Fargo Equip. Fin., Inc. v. Titan Leasing, Inc., [2012 WL 6184896](#) (N.D. Ill. 2012)

Equipment lessor that, in connection with its grant to lender of a security interest in an equipment lease, warranted that the lessee had accepted the goods and had not defaulted on its payment obligations, was not liable for breach of those warranties. Even though the lessee did not receive the goods until after the warranty was given and never used the goods because they were damaged in transit, the lessee had in fact accepted the goods because the lease agreement gave the lessee a right to inspect before shipment, expressly provided that shipment constituted acceptance, and the goods had in fact been shipped before the warranty was given. There was no payment default because no payment was yet due under the lease when the warranty was given.

Outsource Servs. Mgmt., LLC v. Nooksack Bus. Corp., [2013 WL 149876](#) (Wash. Ct. App. 2013)

Because tribal corporation formed to operate casino on reservation expressly waived sovereign immunity in the loan agreement and in several subsequent forbearance agreements, state court had subject matter jurisdiction to hear contract claim brought by lender. Because the waiver applied to “any dispute, claim or controversy between the parties hereto arising out of or relating in any way to this Agreement or any other

Loan Document or any actions contemplated to be taken in accordance herewith or therewith,” it was broad enough to waive not only the tribal corporation’s sovereignty but also the sovereign protection of its property. The loan agreement was not void due to lack of approval by the National Indian Gaming Commission because it was not a Class III management contract in part because, even though the loan agreement granted the creditor a security interest in certain proceeds from the casino, it excluded revenues needed to pay operating expenses, thus ensuring that the secured party could manage the gaming facility even if the debtor defaulted.

BANKRUPTCY

In re Beauchamp,

[2012 WL 5985321](#) (Bankr. M.D. Ga. 2012)

Restrictions on the debtor’s corporate stock that were properly created and noted on the certificates and that prohibited transfer to anyone for ten years and, at any time, to anyone other than the lineal descendants of the couple who created the business were unreasonable and invalid under Georgia law, in part because they gave the stockholder no means to realize the value of the stock. As a result, creditor that purchased the stock prepetition at a judicial sale was the owner of the stock and the stock was not part of the debtor’s bankruptcy estate.

GUARANTIES

Bank of America v. Freed,

[2012 WL 6725894](#) (Ill. Ct. App. 2012)

“Carve-out” provision in guaranty agreement by which guarantors, who otherwise guaranteed only \$50.3 million of the \$205 million loan, would be liable for the full amount of the debt if they contest, delay or otherwise hinder any action taken by the lenders in connection with foreclosure or the appointment of a receiver was enforceable and thus the guarantors were liable for the full debt. The carve-out provision was not an unenforceable penalty because the lenders are still permitted to recover only their actual damages: the amount remaining on the loan. The carve-out provision was also not an unenforceable restraint on the guarantors’ right to defend themselves and to seek due process because they could – and did – contest the appointment of a receiver; they were merely subject to consequences for doing so.

Principal Commercial Acc., LLC v. Buchanan Fund V, LLC, [2012 WL 6095236](#) (Tex. Ct. App. 2012)

Guaranty agreement obligating the guarantor to pay borrower’s unfunded deferred equity contributions to

construction project was not triggered when borrower defaulted in another manner – by failing to fund an operating escrow; the lender’s acceleration of the loan did not accelerate the obligation to pay the deferred equity contributions and hence there was nothing due on the guaranty. This was true even if the guarantor controlled the borrower and could therefore cause it to default other than by failing to make deferred equity contributions.

LENDING, CONTRACTING & COMMERCIAL LITIGATION

Bank of America v. FDIC,

[2012 WL 6105147](#) (D.D.C. 2012)

FDIC stated claim against custodian of mortgage loans despite exculpatory clause in Custodial Agreement because the clause excepted not only gross negligence, willful misconduct, and a bad-faith, material breach not cured within 10 days of notice, but also “other malfeasance,” which was undefined and too broad to constitute clear and unequivocal notice of what rights were contracted away.

In re Glazier Group Inc.,

[2012 WL 6005764](#) (Bankr. S.D.N.Y. 2012)

Creditor’s claim for attorney’s fees incurred after payoff of loan survived even though the payoff letter provided that upon receipt of payment “all obligations of the Borrower and any guarantors under any and all of the Loan Documents shall be deemed paid in full” because the payoff letter also expressly stated that the amount owed was “[a]s of December 5, 2011” and, in any event, the loan agreement contained an all-encompassing unambiguous survival clause that provided that all indemnification obligations survive repayment of the loan.

Synectic Ventures I, LLC v. EVI Corp.,

[2012 WL 6628093](#) (Or. 2012)

Factual issue required reversal of summary judgment in favor of debtor that exercised option to convert the secured party’s loan to equity after the secured party’s manager agreed to an extension of the debt because the manager – who was also chairman of the board and treasurer of the debtor and who stood to benefit personally from the extension – had a conflict of interest and the extension may not have been fair to the secured party, in which case the manager lacked authority to agree to the extension. Although the secured party’s operating agreement expressly gave members permission to: (i) invest in other ventures with no obligation to account to the secured party for such opportunities; and (ii) own securities issued by and participate in the management of other companies in which the secured party invested, neither of these authorizations expressly waived a conflict of interest by the managing member.

Riverisland Cold Storage, Inc. v. Fresno-Madera Prod.

Credit Ass’n, [2013 WL 141731](#) (Cal. 2013)

The fraud exception to the parol evidence rule is not limited and can include fraud directly at variance with a promise in the writing.

DZ Bank AG Deutsche Zentral-Genossenschaftsbank v.

Choice, [2013 WL 146344](#) (Wash. Ct. App. 2013)

Even though loan agreement provided that the lender may, “upon written notice to Borrower, declare Borrower to be in default,” notification of default was not required because the promissory note, which was expressly incorporated into the loan agreement, waived any right to notice of default and because the loan agreement stated that, to the extent its terms conflicted with those of the promissory note, “the provision which provides [the lender] most protection and grants [the lender] the greatest rights shall control.”

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