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### Texas Supreme Court Ruling May Surprise Landlords

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Imagine sitting down at your favorite restaurant with a bowl of linguini, a glass of cabernet, and the putrid smell of sewer odors wafting delicately across the room. That is what diners at the Italian Cowboy restaurant faced in Keystone Park Shopping Center in Dallas a few years ago. As you might expect, the restaurant was forced to close. The restaurant's owner sued the landlord for fraud, claiming that the landlord's representative knew about the "ungodly" smell while assuring the future tenant that the building was in "perfect" condition.

In April, the Texas Supreme Court ruled in favor of the tenant in *Italian Cowboy Partners v. Prudential Insurance Company*. This is an important case for commercial landlords, tenants, or any other party to business transaction in Texas. The Supreme Court held that you may be able to avoid contractual obligations if the other party caused you to enter into the contract by fraud. Landlords may not actively conceal material information - such as the ungodly odors - from potential tenants. The same logic may extend to other business transactions in Texas in which one party to a contract has superior personal knowledge than the other.

#### The Lease

The Court's decision might come as a surprise to someone who only read the Italian Cowboy lease agreement. The lease contained two provisions which are often found in commercial leases:

*Representations.* Tenant acknowledges that neither Landord nor Landlord's agents, employees or contractors have made any representations or promises except as expressly set forth herein.

*Entire Agreement.* This lease is the entire agreement between the parties hereto with respect to the subject matter hereof.

#### The Law

If the lease was silent as to the existence or non-existence of any odors, and the lease specifically provided that there are no representations other than those set forth in the lease, how could the landlord be guilty of making a misrepresentation to the tenant regarding the odor? A party must clearly express an intent to waive claims for fraud in order for such a waiver to be binding. In the Court's opinion, the two lease provisions quoted above were legally inadequate to show the tenant intended to disclaim reliance on the landlord's representations or to waive tenant's claims for fraudulent inducement.

The Italian Cowboy lease involved a commercial transaction by two sophisticated parties, each represented by legal counsel. The parties exchanged seven drafts of the lease over five months before the lease was ultimately signed. The tenant had been in the restaurant business for twenty-five years and had two other successful Dallas-area restaurants. As noted by the Texas Supreme Court Justices offering a dissenting opinion in the Italian Cowboy case, “This was not their first rodeo.” Nonetheless, the Court looked beyond the terms of the lease to rule in favor of the tenant based upon the landlord having fraudulently induced the tenant to sign the lease. “Fraud vitiates everything it touches,” explained the Court.

## **The Takeaways**

There are a few takeaways from the Italian Cowboy case.

First, committing fraud or otherwise making misrepresentations in connection with a business transaction is never a good idea. Courts are reluctant to enforce contracts tainted by fraud. Even if the contract, such as the Italian Cowboy lease, provides that there are no representations not set forth in the contract, courts may still reject such provisions.

Commercial landlords wishing to limit their representations solely to those contained in the lease should consider including a lease provision in which the tenant explicitly disclaims reliance on any representations made by the landlord outside of the lease itself. Even such a disclaimer may be inadequate to protect a landlord who knows material information about the condition of the property that fails to disclose such information to a potential tenant, especially with regard to latent defects which would not be obvious to a tenant upon an inspection of the property.

Commercial tenants, on the other hand, should consider asking their landlord for a lease provision in which the landlord explicitly represents that the landlord is not aware of any information about the condition of the property which would have a material adverse effect on the tenant’s contemplated use of the property.

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