UNITED STATES COURT OF APPEALS
FIFTH CIRCUIT

No. 93-1499

VEREX ASSURANCE, INC. and
VEREX MORTGAGE CORPORATION,

Plaintiffs-Appellants,

VERSUS

FIRST INTERSTATE BANK OF CALIFORNIA,

Defendant-Appellee.

Appeal from the United States District Court
for the Northern District of Texas
(5:92-CV-243-C)

(August 22, 1994)

Before GOLDBERG, HIGGINBOTHAM, and EMILIO M. GARZA, Circuit Judges.

EMILIO M. GARZA, Circuit Judge:[*]

Plaintiffs, Verex Assurance, Inc. and Verex Mortgage Corporation (collectively "Verex"), sued First Interstate Bank of California ("First Interstate"), alleging that First Interstate had (1) fraudulently induced Verex to release certain claims against First Interstate; (2) breached the Release agreement; (3) negligently misrepresented the value of certain claims assigned to Verex under the Release; and (4) breached its duty as trustee

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[*] Local Rule 47.5.1 provides: "The publication of opinions that have no precedential value and merely decide particular cases on the basis of well-settled principles of law imposes needless expense on the public and burdens on the legal profession." Pursuant to that Rule, the Court has determined that this opinion should not be published.

and fiduciary. The district court granted First Interstate's motion to dismiss, under Fed. R. Civ. P. 12(b)(6), on the grounds that Verex's claims were predicated on extrinsic representations by First Interstate, proof of which was barred by the parol evidence rule. Verex appeals, and we affirm in part and reverse and remand in part.

I

Verex and First Interstate were involved in mortgage revenue bond programs in Lubbock, Abilene, and Baytown, Texas, which were designed to provide financing for low income housing. Under those programs, bonds were issued, and the proceeds of the bonds were then used to fund mortgages. Verex Assurance, Inc. insured the lending institutions against default on the mortgages, and Verex Mortgage Corporation acted as a servicing agent for the loans. First Interstate served as the trustee under the bond indenture, and as such was responsible for overseeing the bond programs and acting as depository for the funds involved.

As the bonds approached maturity, it became apparent that the funds held by First Interstate were insufficient to satisfy the bond obligations. To avoid litigation with the bond holders, Verex and First Interstate agreed that Verex would advance to First Interstate the amount it needed to meet the bond obligations))over one million dollars. First Interstate agreed to place $200,000 in escrow for the benefit of Verex. Verex and First Interstate further agreed to complete a comprehensive audit of the mortgages and meet at a later date to negotiate a settlement of disputes

between them concerning responsibility for the shortfall in the bond programs. When the audit and settlement negotiations failed to materialize, Verex filed suit against First Interstate in federal district court in Fort Worth. Settlement negotiations followed, leading to the Agreement of Settlement and Mutual Release ("the Release") which is the subject of this lawsuit.

The Release provided that Verex would dismiss the lawsuit in Fort Worth, and that Verex would receive $325,000 in cash, including the $200,000 held in escrow. Verex waived virtually all rights with respect to the Abilene and Baytown bond programs, but the Release provided:

> Verex shall have the exclusive responsibility and authority on behalf of all parties (including, without limitation, [First Interstate]) to pursue and collect upon all claims associated with The Lubbock Bond Program, whether listed on Schedule 2 attached hereto or not, and [First Interstate] shall execute any necessary documents/assignments to effectuate that authority.[1]

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[1] Schedule 2, to which the foregoing provision made reference, appears as follows:

CLAIMS PROCESSED BY FIRST INTERSTATE BANK

(as of 5/31/90)

ABILENE-none

BAYTOWN	Amount	Date Claimed	Date Rec'd	Date Rec'd
Sunbelt (Chase/Miller)	50,017.29	04/18/90	open	
Continental (Pike) FSLIC	61,319.90	11/01/89	open	
Commonwealth (various)	166,899.59		12/18/89	open
Sunbelt (various)	30,795.00		12/18/89	
02/28/90	30,795.00			
Bayshore (Romo)	18,836.38		N/A	

Record on Appeal, vol. 2, at 313. The Release also contained the following provisions:

> 6. REPRESENTATIONS AND WARRANTIES: Each of the parties to this Release represents, warrants and agrees as follows:
>
> * * *
>
> 6.6 Except for the express warranties and representations set forth in this Release, such party has not relied on any representations or warranties of any other party, or any agent, attorney, officer, director, shareholder or other representative of any other party, in entering into this Release or in making the settlement provided for herein.
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> * * *
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> 8. MISCELLANEOUS

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open 327,868.86
30,795.00

LUBBOCK

Lomas (various) 12,773.73 02/09/90
05/01/90 9,439.59
LHFC (Lindsey & Moore) 71,000.00 03/05/90 &
open
05/31/90
NCNB (various) 232,383.57 02/09/90 & open
05/01/90
Southeast (various) 4,553.25 05/01/90 FSLIC
Investor Residential (various) 16,767.34 04/30/90 bal
denied 6,009.00
(rec'd
12/24/89)
Plains National (various) 20,006.40 04/30/90
05/20/90 1,640.93
Blue Bonnet (various) 133,848.58 04/30/90 FDIC
Mortgage & Trust (Baber) 8,136.05 04/30/90 denied

Caprock (Ferell) 27,785.92 04/30/90 open
Mera Bank (various) 62,028.21 04/30/90 open

589,283.05
17,089.52

Record on Appeal, vol. 2, at 321.

> 8.1 This Release represents the complete and entire agreement between the parties with respect to the subject matter hereof and supersedes all prior and contemporaneous oral and written understandings, negotiations and agreements. This Release may not be modified, supplemented, amended, terminated or superseded except by an agreement in writing signed by the party or parties to be charged.

Id. at 316-17.

Thereafter Verex instituted this suit, alleging that First Interstate fraudulently induced Verex to enter into the Release.[2] Verex alleged that First Interstate "knew the accounts/claims in the Lubbock program were worthless or non-existent" but "represented the contrary to Verex." More specifically, Verex alleged: (1) First Interstate represented it "had recently reviewed its records and audited the accounts in [the bond] programs and that certain claims and accounts receivable from third parties existed pertaining to the Lubbock and Baytown Bond Issues which made up the shortfall;" (2) "the viability of the accounts was represented and discussed at length by First Interstate;" (3) "First Interstate represented and warranted to Verex that as trustee under the Lubbock and Baytown Bond Programs, it had thoroughly reviewed and audited the accounts and claims, that no payments or insufficient payments on certain accounts and claims had been made by the lenders, that as trustee First Interstate was entitled to receive the payments, and that despite a demand by First Interstate, no payments or insufficient payments had been

[2] Verex originally filed suit in state court. First Interstate removed the case to federal district court, which had jurisdiction based on diversity of citizenship.

made;" and (4) First Interstate represented that the "total value for Lubbock was $589,283.05," less several thousand dollars already collected by First Interstate. *See* Record on Appeal, vol. 2, at 278-80. Verex contended that the foregoing representations by First Interstate were false because many of the claims and accounts in the Lubbock bond program had been paid or settled, were subject to undisputable offsets, or simply had never existed within the Lubbock bond program.

Verex also claimed that First Interstate breached the Release agreement. Verex alleged that "[u]nder the terms of the Agreement, First Interstate promised and agreed that it would assign to Verex certain accounts receivable and claims connected with the Lubbock bond program, as set out in schedule 2 to the Agreement, totalling $572,193.52." Verex alleged that First Interstate breached that agreement by failing to assign to Verex viable accounts receivable, because the "actual accounts assigned were worthless and were not the Lubbock accounts represented by Schedule 2 to the Agreement."

Verex further alleged that First Interstate had negligently misrepresented the existence and viability of the Lubbock bond program claims, and that First Interstate had breached its duty as trustee and fiduciary. Verex sought damages or, in the alternative, rescission of the Release.

First Interstate moved to dismiss under Fed. R. Civ. P. 12(b)(6). The district court granted First Interstate's motion, explaining that Verex had "made representations within the terms of the contract which [Verex] seek[s] to set aside by this action

which effectively negate each and every cause of action pled by [Verex]." "Therefore," the district court held, Verex "can prove no set of facts which would warrant relief under the causes of action pled, because any such facts would be barred from introduction into evidence by the parol evidence rule."

Verex appeals, arguing that the district court erred by dismissing its complaint on the basis of the parol evidence rule, since (a) "the parol evidence rule does not preclude the introduction of evidence which is consistent with the terms of a written agreement," and "[a]n express representation regarding the existence and viability of the Lubbock accounts is set forth in Schedule 2 to the Agreement;" and (b) "even if the parol evidence rule applies, it is well settled that parol evidence may be admitted to prove fraudulent inducement to enter into a release or contract."

II

Verex contends that the district court erred by granting First Interstate's motion to dismiss under Fed. R. Civ. P. 12(b)(6). We review *de novo* the dismissal of a complaint under Rule 12(b)(6). *See Garrett v. Commonwealth Mortgage Corp. of America,* 938 F.2d 591, 593 (5th Cir. 1991). "Unless it appears to a certainty that [Verex] can prove no set of facts that would entitle [it] to relief, we cannot uphold an order of dismissal under rule 12(b)(6)." *Id.* "We must accept all material allegations of the complaint as true and construe them in the light most favorable to the nonmoving party." *Id.*

The district court dismissed Verex's suit on the basis of the parol evidence rule. "When parties have concluded a valid integrated agreement with respect to a particular subject matter, [that] rule precludes the enforcement of inconsistent prior or contemporaneous agreements." *Hubacek v. Ennis State Bank,* 317 S.W.2d 30, 31 (Tex. 1958). "On the other hand, the rule does not preclude enforcement of prior or contemporaneous agreements which are collateral to an integrated agreement and which are not inconsistent with and do not vary or contradict the express or implied terms or obligations thereof." *Id.* "The parol evidence rule excludes evidence of a prior or contemporaneous oral agreement between the parties to a written contract if such evidence changes or contradicts the terms of the written contract." *Wagner v. Morris,* 658 S.W.2d 230, 231 (Tex. App.))Houston [1st Dist.] 1983, no writ); *see also Bridges v. Pitzer Realtors, Inc.*, 524 S.W.2d 430, 432 (Tex. Civ. App.))Eastland 1975, writ ref'd n.r.e.) (stating that parol evidence "cannot be received in evidence" to vary the terms of a written instrument).

A

Verex first contends that the district court erred because the parol evidence rule does not exclude evidence which is consistent with the terms of a written agreement. Verex argues: "An express representation regarding the existence and viability of the Lubbock accounts is set forth in Schedule 2 to the Agreement. Consequently, proof of Verex's claims will not change or contradict the express terms of the Agreement."

The record does not support Verex's argument. Comparison of the terms of the Release with the extrinsic representations alleged by Verex, *see supra* part I, reveals that the alleged extrinsic representations would vary the terms of the agreement by supplementing First Interstate's representations concerning the claims in the Lubbock bond program.

Schedule 2 is merely a list of "claims processed" by First Interstate as of 31 May 1990. The schedule mentions neither an audit nor the "viability" of the claims indicated. Neither does the schedule state that insufficient payments had been made on the claims, or that the figure $589,283.05 represented the "total value" of the Lubbock bond program. Contrary to Verex's argument, Schedule 2 does not "specifically represent[] that $572,193.53 in accounts receivable . . . were due and owing" on the claims listed. The figure $572,193.53 does not appear on Schedule 2, and the schedule does not represent that any amounts listed were "due and owing".

Furthermore, the release purports to represent "the complete and entire agreement between the parties," and provides that "[e]xcept for the express warranties and representations set forth" neither party has "relied on any representations or warranties of any other party." Therefore, any proof that First Interstate made representations about the Lubbock accounts in addition to those contained in Schedule 2, and that Verex relied on such representations, would vary the terms of the agreement. *See Tripp Village Joint Venture,* 774 S.W.2d 746, 749 (Tex. App.))Dallas 1989,

writ denied) (stating that extrinsic evidence is inadmissible to "supplement" the terms of a written instrument that on its face is complete and unambiguous). Verex's argument that First Interstate's alleged extrinsic misrepresentations would not vary the terms of the Release is therefore without merit.[3]

B

Verex also contends, however, that "even if the parol evidence rule applies, it is well settled that parol evidence may be admitted to prove fraudulent inducement to enter into a release or contract." We agree. Texas law permits proof of extrinsic representations to show that a contract was induced by fraud, even where the written contract purports to be the whole agreement of the parties and provides that neither party has made extrinsic representations. Consequently, the district court erred by

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[3] Verex also argues that "parol evidence is admissible to explain Verex's reasons for accepting assignment of accounts in lieu of cash consideration[,] and their intentions and understanding that the accounts were viable and the result of First Interstate's comprehensive audit of the Bond Programs." Brief for Verex at 17. However, because Verex does not argue that its "reasons" or its "intentions and understanding" as to those matters would support any of the claims for relief that Verex asserted below, Verex's argument does not persuade us that the district court erred in its ultimate conclusion))that Verex can prove no set of facts which would entitle it to relief. Verex's argument is therefore without merit.

Verex also contends that "parol evidence is admissible to show that consideration has not been paid." Assuming *arguendo* that that is a correct statement of the law in Texas, it is of no benefit to Verex, because Verex, in its complaint, did not allege failure of consideration as a ground for relief. Verex asserted only the four claims for relief already mentioned))fraudulent inducement, negligent misrepresentation, breach of duty as trustee and fiduciary, and breach of contract. Verex's argument premised on failure of consideration is therefore without merit.

dismissing Verex's claim of fraudulent inducement based on the parol evidence rule.

"It is well established that the extrinsic evidence rule ordinarily requires the exclusion of parol[] evidence that would add to, vary, or contradict the unambiguous terms of a written contract. However, it is equally well established that extrinsic evidence is admissible to show fraud[ulent] inducement to enter into a written contract." *Tracy v. Annie's Attic, Inc.*, 840 S.W.2d 527, 532 (Tex. App.)Tyler 1992, writ denied) (citation omitted); *see also F.D.I.C. v. Wallace,* 975 F.2d 227, 229 (5th Cir. 1992) (stating that "Texas grants an exception to" the parol evidence rule "when a party seeks to show fraud in the inducement to enter into a contract"), *cert. denied,* ___ U.S. ___, 113 S. Ct. 2413, 124 L. Ed. 2d 637 (1993). "[F]raud is always provable by any legitimate oral testimony tending to impair the integrity of the written instrument assailed." *Southern Surety Co. v. Adams,* 34 S.W.2d 789, 793 (Tex. 1930). Furthermore, "[a] release, like any other contract, may be avoided if induced by fraud or misrepresentations." *Page v. Baldon,* 437 S.W.2d 625, 629 (Tex. Civ. App.)Dallas 1969, writ ref'd n.r.e.); *see also Lesbrookton, Inc. v. Jackson,* 796 S.W.2d 276, 287 (Tex. App.)Amarillo 1990, writ denied) (stating that "a release is subject to being set aside if it was induced by fraud"); 41 Tex. Jur. 3d *Fraud and Deceit* § 104 (1985) (stating that parol evidence "may be admitted to show that execution of a written release was induced by fraudulent promises made without an intention to perform them"). Pursuant to

the foregoing principles, Verex is entitled to prove by parol evidence that First Interstate fraudulently induced it to enter into the Release.

First Interstate contends, however, that Verex is barred from proving it relied on First Interstate's extrinsic misrepresentations, because of article 6.6 of the Release. Article 6.6 provides that "[e]xcept for the express warranties and representations set forth in this Release," Verex "has not relied on any representations or warranties of any other party . . . in entering into this Release or in making the settlement provided for herein." Believing that "[n]o Texas court has directly addressed the effect of a disclaimer of reliance on representations and warranties clause," First Interstate cites no Texas cases for the proposition that article 6.6 bars Verex from proving its reliance on First Interstate's extrinsic representations. First Interstate relies instead on several decisions applying the law of Georgia and New York. First Interstate's reliance on those decisions is misplaced, since decisions applying Texas law establish that a contractual provision such as article 6.6 is ineffective to bar proof of fraudulent inducement by extrinsic misrepresentations.

In *Dallas Farm Machinery Co. v. Reaves,* 307 S.W.2d 233 (Tex. 1957), the Supreme Court of Texas decided the question "whether parol evidence is admissible, in the face of a `merger' clause in a written contract, to establish that the contract was induced by fraud." *Id.* at 233. The merger clause in *Dallas Farm* provided that the written contract was "understood to be the entire

contract" between the parties. *Id.* at 234. It further provided: "no warranty is made . . . other than herein set forth." *Id.* After explaining that the Texas cases on the effect of such a provision were in conflict, the Texas Supreme Court resolved the conflict by adopting the Massachusetts rule "that a written contract containing a merger clause can be avoided for antecedent fraud or fraud in its inducement and that the parol evidence rule does not stand in the way of proof of such fraud." *Id.* at 239.[4]

First Interstate contends that *Dallas Farm* is not controlling because, unlike the Release at issue here, the contract in *Dallas Farm* did not contain a disclaimer of reliance clause. We disagree. Although the contract in *Dallas Farm* did not disclaim *reliance* on extrinsic representations, it did provide that no warranties were made beyond those contained in the writing. *See Dallas Farm,* 307 S.W.2d at 234. Consequently, proof of parol representations to show fraudulent inducement in that case would have varied the terms of the writing, just as proof of Verex's *reliance* on First

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[4] *See also Plains Cotton Coop. Ass'n v. Wolf,* 553 S.W.2d 800, 805 (Tex. Civ. App.))Amarillo 1977, writ ref'd n.r.e.) ("Misrepresentations justifying rescission can be proven despite the presence of . . . recitations disavowing any oral modification of the contract terms . . . ." (citing *Dallas Farm*)); *Page,* 437 S.W.2d at 629 ("One who seeks to avoid a release procured from him by fraud or misrepresentations may be successful even though . . . the release itself recites that no representations induced its making." (citing *Dallas Farm*)); *cf. Gifford v. Wichita Falls & S. Ry. Co.,* 211 F.2d 494 (5th Cir. 1954) (reversing directed verdict for defendant on claim of fraudulent inducement, in case under the Federal Employers' Liability Act, where written release provided "there has been no representation made by second party, its agents, servants, or employees to induce this settlement except as stated in this agreement and this agreement comprises the full and complete settlement between the parties").

Interstate's parol representations would vary the terms of the writing in this case. *See supra* part II.A. The parol evidence rule))were it to apply))would therefore have the same implications in both cases, despite the difference in contractual language. First Interstate's attempt to distinguish *Dallas Farm* on the basis of that difference is unpersuasive.

Even less persuasive is First Interstate's argument that *Dallas Farm* "is no longer an accurate statement of Texas law." For this proposition First Interstate relies entirely on the Supreme Court's decision in *Town North National Bank v. Broaddus,* 569 S.W.2d 489 (Tex. 1978). First Interstate's reliance on *Town North* is misplaced, because there the Texas Supreme Court did not overrule *Dallas Farm,* and limited its holding))restricting somewhat the admissibility of parol evidence to prove fraudulent inducement))to the context of promissory notes. *See Town North,* 569 S.W.2d at 491. *Dallas Farm* has not been overruled, and it therefore correctly states Texas law on this subject.

First Interstate further argues, however, that "before extrinsic evidence is admissible to prove fraudulent inducement, the proponent [of the extrinsic evidence] must show some sort of trickery, artifice or device in addition to the alleged misrepresentation." First Interstate contends that Verex has not shown First Interstate to have engaged in trick, artifice, or device, and therefore Verex is not entitled to prove fraudulent inducement by way of parol evidence. Because First Interstate

mistakenly relies on the Texas Supreme Court's decision in *Town North National Bank v. Broaddus,* this argument fails.

The court stated in *Town North*: "The question presented is whether, in a suit by one not a holder in due course against the maker of a promissory note, the parol evidence rule prohibits the admission of extrinsic evidence showing that the maker was induced to sign the note by the payee's representation that the maker would not incur liability on the note." *Id.* at 491. The court answered that question by holding that extrinsic evidence is not admissible to show fraud in the inducement of a note unless "there be a showing of some type of trickery, artifice, or device employed by the payee in addition to the showing that the payee represented to the maker he would not be liable on such note." *Id.* at 494.

It is apparent from the language of the Texas Supreme Court's holding in *Town North* that that holding is a narrow one, limited to the factual context which the court there painstakingly described. Furthermore, other courts have recognized the narrowness of the *Town North* ruling. In *F.D.I.C. v. Wallace,* we were referring to *Town North*'s requirement of trickery, artifice or device when we observed: "Texas grants an exception to [the parol evidence rule] when a party seeks to offer parol evidence to show fraud in the inducement to enter into a contract. . . . [H]owever, . . . `the exception is narrower when the contract is a promissory note.'" *Id.*, 975 F.2d at 229. In *Wheeler v. Box,* 671 S.W.2d 75 (Tex. App.))Dallas 1984, no writ), the purchasers of a word processing business successfully prevailed at trial on a claim of fraud in

connection with the purchase of the business. *See id.* at 76. On appeal the defendants argued that under *Town North* "there must be some `trickery' employed to secure the execution of a written agreement before extrinsic evidence to show fraud in its inducement is admissible." *Id.* The Dallas Court of Appeals rejected that argument, observing that *Town North* does "not stand for such a general proposition of law," and that its holding is "much more narrow." *Id.* Because *Wheeler* was a case brought under the Texas Deceptive Trade Practices Act, rather than on a promissory note, the court of appeals refused to apply *Town North*'s requirement of artifice, trickery or device, and held that parol evidence was admissible to prove fraud in the inducement. *Id.* at 77. See also *Coronado Transmission Co. v. O'Shea,* 703 S.W.2d 731, 734 (Tex. App.))Corpus Christi 1985, writ ref'd n.r.e.) ("The rule announced in [*Town North National Bank v.*] *Broaddus* has been construed narrowly to apply to cases involving negotiable promissory notes.").

Despite the boundaries of the *Town North* holding, First Interstate would apply the trickery, artifice and device requirement to this case, which is not a suit on a promissory note. Texas courts have applied that requirement outside the factual context found in *Town North*. *See Wallace,* 975 F.2d at 230 n.5 (noting "a split . . . among the Texas courts of appeals" as to the reach of the trickery requirement (citing cases)). However, First Interstate does not cite, and we have not found, a Texas decision extending the trickery requirement to facts such as those found in

this case. Neither do we conclude that it is our place to extend *Town North*'s trickery requirement to this factual context for the first time, given the explicit limitations of the *Town North* holding and the emphasis which other courts have placed on the narrowness of that ruling. *See City Pub. Serv. Bd. v. General Elec. Co.,* 947 F.2d 747, 748 (5th Cir. 1991) ("[I]t is not for this court))*Erie*-bound to apply state law as state courts would do))to incorporate . . . innovative theories of recovery into Texas law." (citing *Mayo v. Hyatt Corp.,* 898 F.2d 47, 49 (5th Cir. 1990))); *Mitchell v. Random House, Inc.,* 865 F.2d 664, 672 (5th Cir. 1989) ("We will not create this tort for Mississippi."); *Devers v. Mobil Chem. Corp.,* 488 F.2d 258, 260 (5th Cir.) ("While Devers' interpretation of Texas law is not completely foreclosed by the cases, it would most certainly be an expansion of established principles. It is not our function to expand the law of Texas."), *cert. denied,* 417 U.S. 947, 94 S. Ct. 3073, 41 L. Ed. 2d 667 (1974); *but see Wagner,* 658 S.W.2d at 232 (Evans, Chief Justice, concurring) (stating that rule articulated in *Town North* "applies to all written contracts, not merely to promissory notes").

Because proof of parol representations is admissible here to show fraudulent inducement, we cannot say with certainty that Verex can prove no set of facts which would entitle it to relief on that claim. The district court's dismissal of that claim under Rule 12(b)(6) must therefore be reversed.

III

For the reasons stated *supra* in part II.B. we **REVERSE** the district court's dismissal of Verex's claim of fraudulent inducement, and we **REMAND** for further proceedings consistent with this opinion. Verex does not indicate that the arguments rejected *supra* in part II.A. pertain exclusively to any particular claim for relief asserted before the district court. We therefore construe those arguments to attack the district court's order of dismissal as to all of the claims asserted by Verex below. Because we reject those arguments, for the reasons stated in part II.A., we **AFFIRM** the dismissal of all of Verex's claims other than its claim of fraudulent inducement.