Use of Terms and Conditions in Purchase Agreements: *Merger Clauses*

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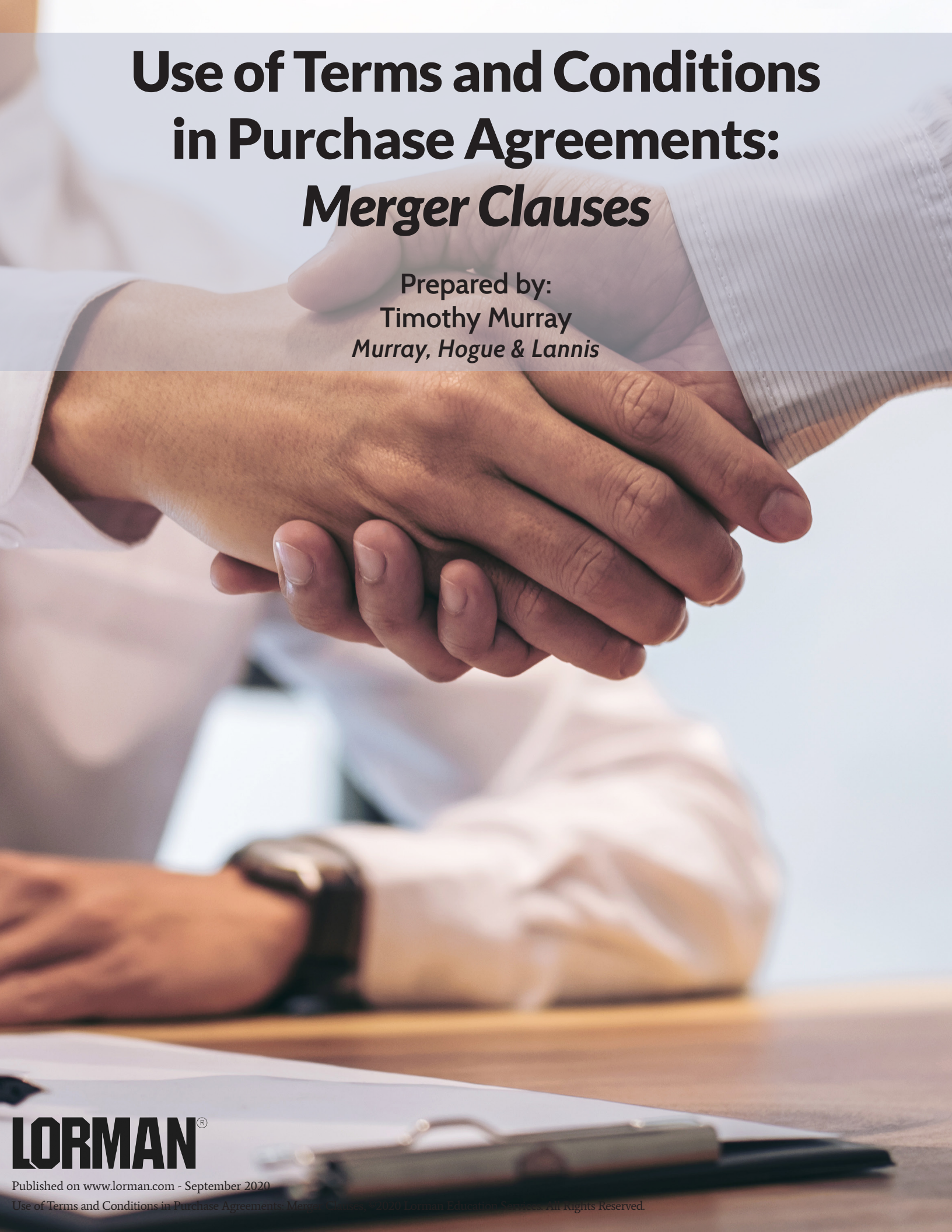

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MERGER CLAUSES

Merger clauses are overlooked and misunderstood, which can expose our clients to staggering risk.

The Dreaded Parol Evidence Rule In a Nutshell

To discuss merger clauses, we have to talk about the parol evidence rule, which hovers over every contract we enter into.

Despite its name—the "parol evidence rule"—it's not a rule of evidence but of substantive law. The purpose behind the parol evidence rule "is to prevent parties to a written contract from seeking to vary its terms by reference to side agreements, or tentative agreements reached in preliminary negotiations."[1] The parol evidence rule is not a rule of interpretation. Rather, it defines the subject matter of interpretation."[2]

Integration: Partial or Complete?

If the parties intend their writing as a final expression of one or more terms of an agreement, the agreement *integrated*. There are two kinds of "integration":

- A *partially integrated* agreement is intended by the parties as a final expression of some but not all terms of their agreement. It discharges prior or contemporaneous agreements that contradict the subsequent writing. It does not discharge prior or contemporaneous agreements that contain consistent additional terms that do not contradict the writing.

- A *completely integrated* agreement is intended by the parties as a complete and exclusive statement of the terms of the agreement. It, too, discharges any prior or contemporaneous agreements that contradict the writing, but it also discharges any prior or contemporaneous agreements that are

[1] Herzog Contracting Corp. v. McGowen Corp., 976 F.2d 1062, 1070 (7th Cir. 1992) (Posner, J.).
[2] John E. Murray and Timothy Murray, Corbin on Contracts Desk Edition § 24.04 (Matthew Bender 2017).

> within the scope of the agreement, even consistent additional terms that don't contradict the writing.[3]

For both partially and completely integrated agreements, prior or contemporaneous oral agreements that ***contradict*** the terms of the subsequent written contract are inadmissible.

Where there is no contradiction between the prior oral agreement and the subsequent written contract, determining whether the prior oral agreement is admissible hinges on whether the written contract is completely or partially integrated. How do courts make this determination? There are various tests to decide whether a writing is partially or completely integrated--the dominant one is the "natural omission" test: would reasonable parties in this situation naturally and normally include the terms of the prior oral agreement in the written contract? If so, the written agreement is completely integrated, and the prior oral agreement is inadmissible. If not, the written agreement is partially integrated, and the prior oral agreement is admissible.[4]

How do so-called "merger" clauses fit into all this? Merger clauses are contractual provisions stating, one way or another, "that there are no representations, promises or agreements between the parties except those found in the writing."[5]

A merger clause can automatically transform a *partially* integrated agreement into a *completely* integrated agreement.

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[3] See, e.g., Restatement (Second) of Contracts §§210, 213, 215, and 216 (Am. Law Inst. 1981).

[4] See, e.g., John E. Murray and Timothy Murray, Corbin on Contracts Desk Edition § 25.06[4] (Matthew Bender 2017). See also, Restatement (Second) of Contracts § 216 (Am. Law Inst. 1981).

> A written contract is integrated if it represents a final and complete expression of the parties agreement. Kehr Packages v. Fidelity Bank, N.A., 710 A.2d 1169, 1173 (Pa. Super. Ct. 1998) (citing Lenzi v. Hahnemann University, 445 Pa. Super. 187, 664 A.2d 1375, 1379 (Pa. Super. 1995)). A contract is partially integrated 'if the writing omits a consistent additional agreed term which . . . in the circumstances might naturally be omitted from the writing.'" Id. The issue of whether the contract is integrated is a question of law. Lenzi v. Hahnemann Univ.., 445 Pa. Super. 187, 664 A.2d 1375, 1379 (Pa. Super. Ct. 1995).

NWI Orthodontics P.C. v. Bell (In re Bell), 498 B.R. 463, 480 (Bankr. E.D. Pa. 2013).

[5] Restatement (Second) of Contracts, cmt. e (Am. Law Inst. 1981). A merger clause states "that the writing constitutes the sole and exclusive repository of the parties' agreement and somewhat redundantly [adds that the parties] do not intend to be bound by any other agreement, understanding or negotiation of whatsoever kind or nature." John E. Murray, Murray on Contracts § 85 (5th ed. 2011).

Including a merger clause in the contract is "likely to conclude the issue whether the agreement is completely integrated."[6] This means that with a merger clause, "[c]onsistent additional terms may then be excluded even though their omission [from the written agreement] would have been natural in the absence of such a clause."[7] As one court put it: "The purpose of a merger clause is to require the full application of the parol evidence rule in order to bar the introduction of extrinsic evidence to alter, vary or contradict the terms of the writing . . .."[8]

DRAFTING TIPS:

• ***There is no excuse not to have a merger clause.*** Failing to have a merger clause can open the door to the admission of all manner of evidence about side agreements and extra-contractual promises that your client likely intended to omit from the contract. Courts sometimes justify the admission of evidence about side agreements by noting that the written contract lacks a merger clause—that might be difficult to explain to a client.

It is a blunder that is easily avoided. Always include a merger clause.

• ***Use the language recognized by the courts***. In the merger clause, just say that the agreement is "completely integrated."[9] Courts recognize this language even if the style-mavens don't like it. This is not an English essay contest. Do *not* characterize the writing as merely containing the "entire" or the "final" agreement of the parties.[10] State: **"The parties intend this statement of their agreement to constitute the complete, exclusive, and fully integrated statement of their agreement. As such, it is the sole expression of their agreement, and they are not bound by any other agreements of whatsoever kind or nature."**

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[6] Restatement (Second) of Contracts, cmt. e (Am. Law Inst. 1981).
[7] Id.
[8] Jarecki v. Shung Moo Louie, 95 N.Y.2d 665, 669, 745 N.E.2d 1006, 1009 (2001) (citation omitted).
[9] "[T]he contract drafter is wise to recite that the agreement is completely integrated if it is meant to be so regarded." David G. Epstein, Adam L. Tate, and William Yaris, Fifty: Shades of Grey - Uncertainty About Extrinsic Evidence and Parol Evidence After All These UCC Years, 45 Ariz. St. L.J. 925, 933 (2013).
[10] Middletown Concrete Prods. v. Black Clawson Co., 802 F. Supp. 1135 (D. Del. 1992); Gem Corrugated Box Corp. v. National Kraft Container Corp., 427 F.2d 499, 503 (2d Cir. 1970).

• ***Drafting in case merger clauses are not conclusive under the applicable law***. Some courts hold merger clauses to be conclusive[11] or "generally conclusive,"[12] while other courts say they are not conclusive but may be a significant factor on the question of integration depending on the facts.[13] According to the Restatement (Second) of Contracts: such clauses are "likely to conclude the issue whether the agreement is completely integrated."[14]

The parol evidence is a rule of substantive law, so the parties should be free to designate in their choice of law provision a state that makes merger clauses conclusive (provided that the choice of that state's law is otherwise enforceable).[15]

• ***Don't rely solely on cookie-cutter merger clauses to make your writings fully integrated***. Where possible, the parties should not *solely* rely on a merger clause. If the parties have other contracts or other dealings related to or within the scope of the agreement at issue, if possible, the contract should reference them and explicitly state that the agreement does not alter any rights or obligations except to the extent expressly stated in the agreement. The goal is to exclude any evidence of alleged side agreements. Don't rely on a one-size-fits-all merger clause.[16]

• ***Drafting merger clauses to exclude fraud***. Generally, evidence of fraud is admissible even in if the contract has a

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[11] E.g., "[T]he parties' insertion of the merger clause into the settlement agreement is conclusive evidence of their intent to create a fully integrated contract." Bonner v. City of New Haven, 2018 Conn. Super. LEXIS 1285, *11 (2018). Benvenuti Oil Co. v. Foss Consultants, Inc., 64 Conn. App. 723, 781 A.2d 435 (2001)(conclusive, so long as parties are of equal bargaining power). See also, Custom Pack Sols., Inc. v. Great Lakes Healthcare Purchasing Network, Inc., 2018 Mich. App. LEXIS 333 (2018); Green Acres Mall, L.L.C. v Sevenfold Enters., LLC, 32 Misc. 3d 1231(A), 936 N.Y.S.2d 58 (2011).

[12] IIG Wireless, Inc. v. Yi, 22 Cal. App. 5th 630, 640, 231 Cal. Rptr. 3d 771, 783 (2018).

[13] Bonfire, LLC v. Zacharia, 251 F. Supp. 3d 47, 2017 U.S. Dist. LEXIS 62175 (D.D. C. 2017). Amplatz v. AGA Med. Corp., 2012 Minn. Dist. LEXIS 200 (2012)(merger clause a "significant" factor). "[T]he force accorded to an integration clause is dependent upon the facts. Corbin § 25.8[A] at 70 (observing that an integration clause 'should be given weight based on the circumstances under which it was adopted, including the complexity and sophistication of the contract and the parties' . . . ." Jacobson v. Hofgard, 168 F. Supp. 3d 187, 202 (D.D.C. 2016).

[14] Restatement (Second) of Contracts, § 216, cmt. e (Am. Law Inst. 1981).

[15] The choice of law provision "includes application of the parol evidence rule, which is a rule of substantive law." Ng v. Schram, 2013 U.S. Dist. LEXIS 141046, *20 (S.D. N.Y. 2013).

[16] Courts are naturally more skeptical of boilerplate provisions than of terms specifically drafted for the present transaction. The chief architect of the Uniform Commercial Code, Karl Llewellyn, said that "there is no assent at all" to such terms. Karl Llewellyn, The Common Law Tradition: Deciding Appeals 370 (1960).

completely integrated agreement with a garden-variety merger clause. But if the contract contains an anti-reliance clause stating "that the parties to the contract did not rely upon statements or representations not contained within the document itself,"[17] most—but not all—jurisdictions that have ruled on the issue hold that claims of fraud in the inducement are barred.[18]

• ***Seeking complete integration in international contracts***. Unless the parties have agreed to opt out of CISG (per Article 6), it applies to contracts for the sale of goods made by parties with their principal places of business in different CISG countries.

There is no parol evidence rule under the CISG. In addressing how a court should determine the intent or understanding of a reasonable person, Article 8 provides that "due consideration is to be given to all relevant circumstances of the case including the negotiations, any practices which the parties have established between themselves, usages and any subsequent conduct of the parties." Such "negotiations" can include any prior promises, agreements, or understandings—so all of these could be admissible into evidence.

It is not altogether clear whether a merger clause makes a contract completely integrated under the CISG. There is authority that the extrinsic evidence should not be excluded unless the parties actually intended the merger clause to have that effect. To make that determination, evidence of all relevant facts and surrounding circumstances must be examined.[19]

PUTTING IT ALL TOGETHER

To draft a merger clause, here is a start:

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[17] Billington v. Ginn-LA Pine Island, Ltd., LLLP, 192 So. 3d 77, 80 (Fla. App. 2016).
[18] Id. The Billington case contains an excellent discussion of anti-reliance clauses.
[19] Cedar Petrochemicals, Inc. v. Dongbu Hannong Chem. Co., 2011 U.S. Dist. LEXIS 110716 (S.D. N.Y. 2011).

To opt out of the CISG, the parties cannot rely on an ordinary choice of law provision that states, for example, that the law of a particular state in the United States shall apply—that's because the law in the United States includes CISG, so to opt out of CISG, it is necessary to choose the law of a jurisdiction and then expressly add that the parties also agree to opt out of the CISG.See, e.g., John E. Murray and Timothy Murray, Corbin on Contracts Desk Edition § 83.02[4] (Matthew Bender 2017).

> The parties intend this statement of their agreement to constitute the complete, exclusive, and fully integrated statement of their agreement. As such, it is the sole expression of their agreement, and they are not bound by any other agreements of whatsoever kind or nature. The parties also intend that this agreement may not be supplemented, explained, or interpreted by any evidence of trade usage or course of dealing. In entering this agreement, the parties did not rely upon oral or written statements or representations not contained within the document itself.

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NO ORAL MODIFICATION AND ANTI-WAIVER CLAUSES

Clauses purporting to forbid oral modifications generally can't be relied upon to preclude oral modifications. Contracts can keep most *pre*-formation understandings from having contractual significance, but post-formation understandings are much more difficult to control in the document. "Even where the contract specifically states that no non-written modification will be recognized, the parties may yet alter their agreement. . . . The pen may be more precise in permanently recording what is to be done, but it may not still the tongues which bespeak an improvement in or modification of what has been written."[20]

Anti-waiver provisions are subject to the same sorts of considerations. One court explained: "[A]n 'anti-waiver' clause, like any other term in the contract, is itself subject to waiver or modification by course of performance."[21]

For contracts for the sale of goods, many courts hold that pursuant to U.C.C. § 2-209(3), the statute of frauds requires any

[20] Wagner v. Graziano Constr. Co., 390 Pa. 445, 448 (1957).
[21] Westinghouse Credit Corp. v. Shelton, 645 F.2d 869 (10th Cir. 1981).

modification to be in writing, even those that did not need to be in writing at the time of contract formation.

There can be *post*-formation warranties:

> The precise time when words of description or affirmation are made or samples are shown is not material. The sole question is whether the language or samples or models are fairly to be regarded as part of the contract. If language is used after the closing of the deal (as when the buyer when taking delivery asks and receives an additional assurance), the warranty becomes a modification, and need not be supported by consideration if it is otherwise reasonable and in order. (Section 2-209).[22]

***DRAFTING TIP*:** If the contract's no oral modification clause states that certain specified agents shall have no power to vary the contract or to waive the performance of conditions, this will make it much more difficult for oral modifications to be legally operative. Such a provision "is notice that these agents have no such power when the contract is made. Therefore, a party who wishes to rely upon a subsequent waiver by the specified agent must show that in some way he acquired such a power after the contract was made."[23]

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[22] U.C.C. § 2-313 cmt. 7.
[23] Corbin on Contracts § 40.13.