

'Con-Torts': From Breach Of Contract To Tort Claims

Friday, Mar 28, 2008 --- Parties to a contract often attempt to transform an ordinary breach of contract claim into a tort claim of fraudulent or negligent misrepresentation.

These hybrid contract-tort disputes, dubbed “con-tort” claims, are all too familiar in litigation arising out of commercial transactions.

The parties to a contract have a falling out, litigation ensues, and the party alleged to have breached the contract also is charged with committing fraud or otherwise misrepresenting the terms of the deal.

Although con-tort disputes assume a variety of forms, the most common involve allegations of fraudulent inducement, in which the party alleged to have breached the contract also is alleged to have made false representations during contract negotiations that induced the injured party to enter into that contract.

Typically, the alleged pre-contract misrepresentations involve terms that were excluded from the contract that the parties ultimately executed.

Add-on tort claims of this kind should not be shrugged off as just by-products of liberal pleading rules or as retribution by a disgruntled counterparty seeking to cash in on a deal gone bad. Instead, the claims should be taken seriously because they change the tenor, scope, duration, and cost of litigation.

For example, breach of contract cases largely focus on the meaning of the agreement between the parties, and that determination presents a question of law for the court.

That legal determination then inevitably answers the breach question and sets the parameters for damages.

Relative to other types of litigation, contract cases usually present straightforward questions of contract interpretation that are susceptible to early resolution, either on motion or by settlement.

Not so with misrepresentation claims, which are premised on allegations of wrongdoing, bad faith, or on some other improper intent—fact issues whose determination is normally reserved for a jury that may not be seated until two or three years after litigation is initiated.

As a result, a firm charged with misrepresentation may suffer harm to its

reputation or become the target of a government investigation into unfair trade practices or other violations of law.

Accordingly, a relatively small-dollar contract claim can very well mushroom into a high-visibility, high-stakes tort dispute.

One solution to diffusing or otherwise eliminating these types of tort claims can be found in an unlikely place – contract law.

Although the conventional wisdom seems to be that contract and tort remain in hermetically sealed boxes (so that tort claims are not subject to contract defenses), that “wisdom” may not be so conventional after all.

An essential element of a misrepresentation claim – whether it is premised on intentional wrongdoing or negligence – is that the injured party justifiably relied on the false statements alleged to have caused harm.

Con-tort cases live or die at the intersection between what a party claims to have justifiably relied upon in entering the contract and what the contract actually says.

Thus, the crucial question in con-tort litigation is this: Can a party justifiably rely on a representation that does not appear in the contract that the party executed?

The Merger And Integration Clause

The starting point for answering this question is the merger and integration clause. Because certainty of obligation is a necessity in the business world, contracting parties strive to confine their bargain to the representations set forth in the contract, thereby facilitating predictability and advancing the reasonable expectations of the parties.

A properly drafted merger and integration clause furthers these business objectives.

The clause typically provides that all prior agreements between the parties are superseded and merged into the contract executed by the parties, and that modifications to the contract must be accomplished through a writing signed by the parties.

The merger and integration clause thus memorializes in a contract what the parol evidence rule compels as a matter of law: Courts should not re-write a bargain by importing into a fully-integrated contract terms that modify or otherwise contradict the express terms of that contract.

Relying on these principles, some courts have armed merger and integration clauses with a sharp edge, ruling that the clause alone defeats a claim of justifiable reliance.

There are sound contract-based justifications for this rule. A contracting party that agrees that all prior representations are superseded and merged into the signed contract ought not be permitted to say, in effect: “I was not truthful when I agreed to the merger and integration clause, and now I want damages.”

If it were otherwise, contract obligations would drown in a sea of uncertainty, rendering business difficult to conduct and appreciably more expensive.

Equally, with the growing sophistication of businesspeople and the ever-expanding role of counsel in negotiating and drafting contracts, parties particularly well-healed in their business should be held to the terms of the bargain set forth in the four corners of the contract.

The Disclaimer Or No-Reliance Clause

As unassailable as this logic may seem, a merger and integration clause may not be enough to defeat a misrepresentation claim, especially if the clause is too general or is otherwise considered “wimpy.”

In these circumstances, a contract provision that is more directly tied to the specific representations that the injured party claims to have justifiably relied upon is required. Two such clauses have emerged in con-tort law.

The first is the disclaimer clause, in which the breaching party disclaims the specific representations that the injured party claims to have relied upon, or disclaims all representations other than those expressly set forth in the contract (the catch-all).

The other is the no-reliance clause, which typically states that a party is not relying on specified representations or, more broadly, on any representations outside of the contract.

Faced with a disclaimer or no-reliance clause, a con-tort plaintiff will be hard-pressed to credibly claim justifiable reliance on representations that the breaching party denied ever making or that the injured party denied ever accepting.

That justifiable reliance cannot be established in these circumstances confirms that tort law succumbs to the bedrock principle of contract law that all provisions of a contract are to be given effect, and that parties are presumed to mean what they say when they put their names to a contract.

Lessons From Con-Tort Law

Firms should ensure that counsel drafting their agreements pay close attention to the law governing the contracts they draft.

If that law treats merger and integration clauses as dispositive standing alone, then the contract may not need a back-up disclaimer or no-reliance

clause.

However, even if a merger and integration clause is considered dispositive, counsel should ensure that the contract language they choose is substantially similar, or identical to, merger and integration clauses that have withstood court challenges.

Further, if the governing law requires a disclaimer or a no-reliance clause to defeat a misrepresentation claim, then counsel should tailor that clause to cover the disputes that arose during contract negotiations.

So, if a party refuses to make representations about a particular matter (say, future sales or the condition of a business or property), counsel for that party should:

- Include a merger and integration clause.
- Include language that disclaims all representations specific to that issue.
- Impose on the counterparty the obligation to investigate the matter.
- Provide a catch-all clause disclaiming all representations not included in the contract.
- Include in the contract some combination of these four alternatives.

Of course, even the most carefully drafted contract may not deter a party from injecting a misrepresentation claim into an ordinary contract dispute.

But current con-tort law offers valuable guidance that may provide contracting parties some degree of comfort that garden-variety contract disputes will not morph into claims that a contracting party lied when it entered into a contract.

At a minimum, understanding con-tort law and implementing that law through contract language can go a long way towards ensuring that only meritorious misrepresentation claims survive early dismissal.

Counsel should know that contract principles may very well trump tort liability for misrepresentation when parties unmistakably express their intent to confine their bargain to the terms written into the contract and to disclaim all others.

--By Ugo Colella, Katten Muchin Rosenman LLP

Ugo Colella is a litigation partner at Katten Muchin Rosenman in the Washington, D.C. office.

Published for clients as a source of information. The material contained herein is not to be construed as legal advice or opinion.

CIRCULAR 230 DISCLOSURE: Pursuant to Regulations governing practice before the Internal Revenue Service, any tax advice contained herein is not intended or written to be used and cannot be used by a taxpayer for the purpose of avoiding tax penalties that may be imposed on the taxpayer.

©2008 Katten Muchin Rosenman LLP. All rights reserved.

Katten

KattenMuchinRosenman LLP

www.kattenlaw.com

401 S. Tryon Street
Suite 2600
Charlotte, NC 28202-1935
704.444.2000 tel
704.444.2050 fax

525 W. Monroe Street
Chicago, IL 60661-3693
312.902.5200 tel
312.902.1061 fax

5215 N. O'Connor Boulevard
Suite 200
Irving, TX 75039-3732
972.868.9058 tel
972.868.9068 fax

1-3 Frederick's Place
Old Jewry
London EC2R 8AE
+44.20.7776.7620 tel
+44.20.7776.7621 fax

2029 Century Park East
Suite 2600
Los Angeles, CA 90067-3012
310.788.4400 tel
310.788.4471 fax

575 Madison Avenue
New York, NY 10022-2585
212.940.8800 tel
212.940.8776 fax

260 Sheridan Avenue
Suite 450
Palo Alto, CA 94306-2047
650.330.3652 tel
650.321.4746 fax

1025 Thomas Jefferson Street, NW
East Lobby, Suite 700
Washington, DC 20007-5201
202.625.3500 tel
202.298.7570 fax

Katten Muchin Rosenman LLP is a Limited Liability Partnership including Professional Corporations. London Affiliate: Katten Muchin Rosenman Cornish LLP.