WHEN THE LEFT HAND FIGHTS THE RIGHT HAND

Avoiding and Resolving Contract Conflicts – Integration Clauses

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Overview

- Contract Interpretation (generally)
- Integration (Merger) Provisions
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  - Complete or Partial Integration
- Subject Matter
- Anti-Reliance
  - “Anti-Sandbagging” Distinguished
Contract Interpretation Generally

• Specific language in a contract controls over general language, and where specific and general provisions conflict, the specific provision ordinarily qualifies the meaning of the general one.
• A contract should be read as a whole and interpreted to reconcile all of its provisions, if possible.
• A court will prefer an interpretation that harmonizes the provisions of a contract as opposed to one that creates an inconsistency or surplusage.
• A court will generally look beyond the four corners of the contract only if the contract is ambiguous, or if the contract expressly makes reference to another contract or instrument.
Integration Clauses Generally

• An integration (or merger) clause in an agreement is one that states that the parties intend the agreement to be the final and exclusive statement of their understanding that may not be contradicted or supplemented without the written consent of the parties.

• Example:

> The Agreement constitutes the entire agreement and understanding between the parties hereto and supersedes any and all prior agreements and understandings, oral or written, relating to the subject matter hereof.

• The effect of integration is to preclude either party from introducing evidence of additional or inconsistent terms outside the four corners of the agreement.

• Ordinarily, the terms of a fully integrated agreement cannot be varied or supplemented by contemporaneous or prior agreements, nor statements made during negotiations.

• However, under certain circumstances, a court may look beyond an integration clause or limit the scope of such a provision.
Integration Clauses: Negotiate with Specificity

- Integration clauses often are found in the “boilerplate” section of contracts and, as such, some parties may give the provisions in such sections inadequate thought and attention.

- A court might grant an integration clause more significance where it is expressly negotiated and added into a document than where it is merely boilerplate language. See Lawrence’s Anderson on the Uniform Commercial Code, Section 2A-202:16

- Courts must weigh the parties’ freedom of contract against concerns that the drafting party is attempting to immunize fraudulent behavior.

- Parties should be hesitant to rely too much on general integration clauses. It is preferable to expressly address issues in the agreement rather than assume that they are swallowed up by the integration clause.
Integration Clauses: Complete v. Partial Integration

• Clauses which state that they are a final expression of the parties’ intentions (i.e., Complete Integration) generally create a presumption of integration.

• Nevertheless, courts may consider extrinsic evidence to determine whether the contract was completely or partially integrated.

• “[I]n determining whether a contract is fully integrated, the court focuses on whether it is carefully and formally drafted, whether it addresses the questions that would naturally arise out of the subject matter, and whether it expresses the final intentions of the parties.” Addy v. Piedmonte, 2009 WL 707641 (Del. Ch. 2009).

• If the agreement is only partially integrated, courts may look at extrinsic evidence to determine the parties’ intent as to scope.
Integration Clauses: Subject Matter

• Parties should consider specifically which agreements and matters are being integrated into the agreement.

• Best practice is to expressly state what agreements (if any) and subject matter are to be integrated.

• Courts will read the entire agreement to determine whether or not a specific matter is integrated under its terms. Courts can interpret integration clauses to either exclude and include certain subject matter:
  
  • “Although the integration clause [...] is broad in scope, it is narrowly focused to ‘the subject matter’ of the Merger Agreement [...], and not the post-acquisition disbursement of proceeds, profits, or other benefits among the alleged Partners.” Grunstein v. Silva, 2009 WL 4698541 at *10 (Del. Ch. 2009).

  • “[T]he argument is that, because the [other agreement] was not referenced elsewhere in the [Stock Purchase Agreement], the integration clause had no effect on it. That argument, however, is unpersuasive. [...] Because the subject matter of [the other agreement] did concern employment, the Stock Purchase Agreement, by way of [the integration clause], superseded [the other agreement] that had not been identified in the Stock Purchase and [was] related [...] to [...] employment.” Ostroff v. Quality Services, 2007 WL 121404 at *10 (Del. Ch. 2007).
Integration Clauses: Anti-Reliance Provisions

• If parties wish to completely shift the burden of statements made outside of an agreement, it is necessary to include specific “anti-reliance” language in the integration clause.

• An anti-reliance provision might read as follows:

   Each of the Parties acknowledges that no other party, nor any agent or attorney of any other party, has made any promise, representation, or warranty whatsoever, and acknowledges that the Party has not executed or authorized the execution of this Agreement in reliance upon any such promise, representation or warranty, that is not expressly contained herein.

• Anti-reliance language may go even further and limit reliance to specific provisions of the contract.

• Nevertheless, Courts may be reluctant to enforce an integration clause, even one containing anti-reliance language, in cases of intentional misrepresentations and fraud.
ABRY Partners V, L.P. v. F & W Acquisition LLC, 891 A.2d 1032 (Del. Ch. 2006)

- Buyer sought to rescind corporate acquisition due to alleged misrepresentations of fact made by Seller that were contained in the Stock Purchase Agreement (the “SPA”).

- The SPA contained an integration clause.

  - Due to existence of the integration clause, the Buyer could not rely on representations made outside of the SPA.

    - “Buyer has accepted that it had promised that the only representations of fact it was relying upon and the only representations of fact made to it were contained within the Agreement itself […]” ABRY Partners, 891 A.2d at 1035.

- Additionally, in this case the integration clause contained anti-reliance language.
ABRY Partners V, L.P. v. F & W Acquisition LLC, cont’d.

• Court of Chancery held that an integration clause, and anti-reliance language contained therein, would not insulate the Seller from liability if the Buyer could prove that Seller intentionally misrepresented facts in the relevant provisions of the SPA or in contemporaneous negotiations.

• Nevertheless, in light of the scope of the integration clause (and the anti-reliance language) the Court placed a very high burden on the Buyer, requiring that the Buyer prove that the “Seller acted with an illicit state of mind” when making the representations (or alleged misrepresentations) at issue.
Integration Clauses: Anti-Reliance Provisions

• Moreover, the Court noted that the absence of an anti-reliance provision in an integration clause might support rescission of the contract based on a claim of fraudulent misrepresentation.

• “[S]tandard integration clauses without explicit anti-reliance representations[] will not relieve a party of its oral and extra-contractual fraudulent representations. The integration clause must contain language that […] can be said to add up to a clear anti-reliance clause by which the plaintiff has contractually promised that it did not rely upon statements outside the contract’s four corners in deciding to sign the contract.” ABRY Partners, 891 A.2d at 1059 (quotations omitted).

• Accordingly, the integration (merger) clause, and anti-reliance language contained therein, must be carefully considered, negotiated and drafted by the parties to the contract.
Anti-Sandbagging Provision - Distinguished

• As distinguished from the “anti-reliance” language discussed above, an “Anti-Sandbagging” provision is one that limits (or eliminates) a party’s remedy for a breach of a representation, warranty or covenant where such party knew of such breach (for example, through facts discovered during diligence) but chose to complete the transaction nonetheless.

• Example:
The Purchaser acknowledges that it has had the opportunity to conduct due diligence and investigation with respect to the Company and the Assets, and in no event shall the Seller have any liability to the Purchaser with respect to a breach of representation, warranty or covenant under this Agreement to the extent that the Purchaser knew of such breach as of the Closing Date.

• In such a case, the outcome will turn on “knowledge” and what was disclosed to the buyer.

• Guardian Eldercare at Brockway LLC v. WRC Highland View Healthcare, No. 199-2011-CD
  • Seller represented and warranted that the assets were in “good condition and working order; were functional for their intended uses; and constituted all of the assets necessary for [Buyer] to conduct the Business” and that the assets contained “no material defects and were in good operating condition and repair.”
  • After closing, Buyer claimed that Seller breached these representations and warranties when it discovered that certain of the assets would require significant investment to correct the defects discovered post-closing.
  • Seller argued that, based upon Buyer’s due diligence investigation, Buyer knew (or should have known) that the assets were in disrepair, notwithstanding Seller’s express representations and warranties to the contrary.
  • Court held that, absent an express provision to the contrary (i.e., an anti-sandbagging provision), a buyer’s due diligence does not affect a seller’s liability for breach of representations and warranties in the context of an asset acquisition.

• While not uncommon, anti-sandbagging provisions can be hotly negotiated and the inclusion of such a provision will depend upon the leverage each party has in the context of the transaction.
Integration Clauses: Conclusion

• Parties should carefully negotiate and consider integration clauses, and not rely on boilerplate language.

• Integration clauses are not an “end-all, be-all” solution. Courts will look at the entire agreement when determining the scope of an integration clause, and this may result in certain subject matter being included or excluded from the integration.

• If complete integration is intended, the parties should ensure that such an intention is clearly articulated in the integration clause.

• Parties should consider whether to include anti-reliance language in the integration clause. Buyers should avoid anti-reliance provisions; Sellers should demand it.

• In the merger and acquisition context, the parties will seek to apportion risk through representations and warranties, and a seller may seek to limit liability through the inclusion of an “anti-sandbagging” provision that will limit a buyer’s remedy if it had knowledge of a breach of a rep or warranty prior to closing, but decided to close nonetheless.