



More and more plaintiffs are using a fraud-in-the-inducement theory to turn ordinary breach-of-contract allegations into tort claims. A recent seventh circuit decision, while not all good news for prospective defendants, gives them a new way to fight back.

Using No-Reliance Clauses to Prevent Fraud-in-the-Inducement Claims

By Joseph Wylie

Commercial litigators are familiar with the situation: a plaintiff in what looks like a plain-vanilla breach-of-contract case argues that the contract includes terms that do not appear within the four corners of the document.

For instance, the plaintiff may assert that the defendant made warranties about the subject matter of the contract. The plaintiff attempts to introduce parol evidence to demonstrate that the written agreement does not include all terms of the contract agreed to. Usually, this parol evidence amounts to a claim that the defendant offered or agreed to some term or condition that was not included in the final written agreement.

Luckily for the defendant, the written agreement contains an integration clause. The parol evidence is deemed inadmissible, and the terms of the contract are limited to what appears in the written agreement.

But more and more plaintiffs in otherwise ordinary breach-of-contract cases include fraud-in-the-inducement allegations to avoid the terms of their written agreements. Superficially, these claims seem to be the same as those supporting parol evidence claims: the defendant is alleged to have agreed to some term or made some representation not included in the final agreement. But instead of arguing that this alleged extrinsic agreement should be con-

sidered part of the contract, the fraud-in-the-inducement plaintiff argues that the alleged extrinsic agreement constitutes a fraudulent misrepresentation on which he or she relied.

Regardless of the merits of fraud-in-the-inducement claims, they complicate even the most basic disputes over commercial transactions. Assuming that the plaintiff can survive a motion to dismiss (not a difficult task for creative lawyers, even though fraud-in-the-inducement must be pled with

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particularity), these claims can allow intrusive discovery into matters far afield from the transaction at issue.

For instance, a claim of fraud may open the door for a plaintiff to seek discovery into any contractual relationship between the defendant and third parties to show some pattern of deception. And these claims may ultimately allow plaintiffs to put evidence of alleged extrinsic agreements before a jury, increasing the likelihood of a verdict against the defendant.

This article looks at case law governing fraud in the inducement, and especially at a recent seventh circuit decision authored by Judge Posner. While the ruling arguably undermines the effectiveness of integration clauses, it also makes no-reliance clauses a more powerful tool for combating fraud-in-the-inducement claims.

Integration or Merger Clauses: Partial Protection

A common challenge to fraud-in-the-inducement claims is to point to an integration or merger clause¹ in the written agreement between the plaintiff and defendant. In Illinois, at least until recently, such challenges frequently succeeded. However, a pair of recent federal cases has made victory less certain.

Illinois Cases

In *Barille v Sears Roebuck & Co.*,² the first district held that where a contract contains a merger or integration clause, the parties to that contract cannot pursue fraud claims based on agreements or representations not included in that agreement.

The plaintiff in *Barille*, a former participant in Allstate's "Neighborhood Office Agent" ("NOA") program, sued on a variety of theories, including breach of contract, common-law fraud, and consumer fraud.³ The plaintiff's fraud claim was based on allegations that Allstate had made representations to the plaintiff about the costs of the NOA program, the location of her office, the future revenues that she could expect, and other aspects of her participation in the NOA program. The plaintiff alleged that she was fraudulently induced into entering into the NOA agreement.⁴

The first district held that the integration clause in the NOA agreement insulated the defendants from any fraudulent inducement claims:

In the present case, the element of justifiable reliance is absent. It is well settled under the doctrine of merger and the parol evidence rule that a written agreement which is complete on its face supercedes all prior agreements on the same subject matter and bars the introduction of evidence concerning any prior term or agreement on that subject matter....This particularly applies when the contract, as here, contains an unambiguous merger or integration clause.⁵

The integration clause in the NOA agreement at issue in *Barille* explicitly excluded any terms or conditions not included in the agreement. The contract provided as follows:

You and the Company acknowledge that each has read the Employment Agreement and the Addendum, understands it and agrees to be bound by its terms, that it is the complete and exclusive statement of the agreement between you and the Company, and that it supercedes all proposals, oral or written, and all other communication between you and the Company relating to the subject matter of this Agreement.⁶

This language on its face would appear to preclude any claims based on representations made before the contract was executed.

At least one other Illinois court considering the same question has reached the opposite conclusion, although without extensive reasoning or comment. Ten years before *Barille*, the second district held in *Salkeld v V.R. Business Brokers*⁷ that a merger clause in an agreement did not preclude a party to that agreement from bringing a fraud claim based on representations not included in the agreement.

The plaintiff in *Salkeld* entered into an agreement by which the plaintiff was to distribute a product provided by the defendants. The plaintiff brought causes of action based on common-law fraud, consumer fraud, and violations of the Franchise Disclosure Act, alleging that the defendants made false representations concerning intellectual property rights, projected future earnings, lack of competition for the product, and other matters.⁸

The trial court held that the "plaintiff had no right to rely on any of the [allegedly fraudulent] representations, in

that by signing the contract, plaintiff 'agreed that all these things were merged in the contract.'" The second district reversed, stating that "[w]e do not believe that the ends of justice will be served by allowing the merger clause in the agreement to mask the allegations of fraudu-

***Vigortone* increases the likelihood that courts applying Illinois law will dismiss fraud-in-the-inducement claims where the underlying contract contains a no-reliance clause.**

lent misrepresentation in plaintiff's amended complaint."¹⁰

The *Salkeld* appellate court did not offer any more detailed analysis supporting its position. It does not appear that any reported Illinois cases have followed *Salkeld*, and with the exception of a single federal case (discussed below), *Salkeld* has not been followed at the federal level.

Federal Developments

Federal courts historically have held that under Illinois law, merger or integration clauses preclude fraud-in-the-inducement claims based on pre-agreement representations. Recent decisions, however, call into question that line of cases.

Federal courts applying Illinois law have, at least until recently, followed

1. An "integration clause" provides that a contract is the final and complete expression of the agreement between the parties; a "merger clause" provides that all prior agreements of the parties have been merged into the written document. *Black's Law Dictionary* 809, 989 (West 6th Ed 1990). In practice, contracts often contain elements of merger and integration clauses in the same clause, and courts rarely distinguish between the two.

2. 289 Ill App 3d 171, 682 NE2d 118 (1st D 1997).

3. *Id.* at 173, 682 NE2d at 120.

4. *Id.* at 176, 682 NE2d at 122.

5. *Id.* at 177, 682 NE2d at 123 (citations omitted). The consumer fraud claim was not subject to dismissal on this basis because justifiable reliance is not an element of that cause of action. However, the consumer fraud claim was dismissed on other grounds.

6. *Id.*

7. 192 Ill App 3d 663, 548 NE2d 1151 (2d D 1989).

8. *Id.* at 673, 548 NE2d at 1157.

9. *Id.*

10. *Id.* at 674, 548 NE2d at 1157-58.

Barille (either by directly citing that decision or by applying the same logic). For instance, in *Worldcom Network Servs, Inc v UMG Communications Groups, Inc*,¹¹ the court dismissed an Illinois common-law fraud claim based on the existence of an integration clause in a contract between the parties. The court, citing *Barille*, held that the counterclaimant "was reasonably entitled to rely on the language of the [agreement] but it could not reasonably rely on any earlier promises made by [the counterdefendant] that were not reflected within the agreement."¹²

As the majority noted in *Vigortone*, representations in a contract could strip integration or no-reliance clauses of their effect.

Similarly, in *Properties Unlimited, Inc Realtors v Cendant Mobility Services*,¹³ the court dismissed an Illinois common-law fraud claim because the plaintiff had entered into an agreement with the defendant containing a merger clause. Without citing *Barille*, the court held that "a party cannot justifiably rely on allegedly false inducements to enter into an agreement if the subject matter of the representations has been integrated into an unambiguous contract provision."¹⁴

The first federal court deviation from *Barille* appears to have been *Tricontinental Industries Ltd v Anixter*.¹⁵ The plaintiff in *Tricontinental* brought federal securities law and state common-law fraud claims against executives of a company to which the plaintiff had sold its assets in exchange for stock. The court held that the mere presence of a merger clause in a contract did not justify dismissal of the common-law fraud claim.

The court explicitly rejected *Barille* as "appl[ying] contract principles of merger and the parol evidence rule, which govern the legal interpretation of a contract, to the fact-intensive inquiry of reasonable reliance on a fraudulent statement."¹⁶ The *Tricontinental* court relied on the fourth district case *Carlile v Snap-on Tools*,¹⁷ which held that "[f]raud, even in the inducement, may justify consideration of

prior understandings which would be otherwise excluded under the parol evidence rule."¹⁸ Note that the agreement at issue in *Carlile* apparently did not contain a merger or integration clause.

Without citing *Tricontinental*, the seventh circuit in *Vigortone AG Products, Inc v PM AG Products, Inc*¹⁹ recently adopted much the same reasoning. In *Vigortone*, the purchaser of a corporation sued the seller on contract and fraud grounds for alleged misrepresentations made during purchase negotiations. The district court allowed both theories to be presented to a jury, resulting in damage awards on both theories.

The seventh circuit, in an opinion by Judge Posner, held that merger or integration clauses do not preclude a party to a contract from bringing fraud-in-the-inducement claims. Judge Posner downplayed the reasoning in *Barille* and noted that *Barille* and *Salkeld* reach opposite conclusions.²⁰

In resolving what Judge Posner characterized as an unresolved question of Illinois law, the seventh circuit looked to what it characterized as the majority rule that merger or integration clauses do not bar fraud claims. The seventh circuit explained that this rule is based on the distinction between contract and tort law:

[F]raud is a tort, and the parol evidence rule is not a doctrine of tort law and so an integration clause does not bar a claim of fraud based on statements not contained in the contract. Doctrine aside, all an integration clause does is limit the evidence available to the parties should a dispute arise over the meaning of the contract. It has nothing to do with whether the contract was induced, or its price jacked up, by fraud.²¹

The seventh circuit then held that when confronted with an uncertain question of state law, "the best guess is that the state's highest court, should it ever be presented with the issues, will line up with the majority of the states."²²

The seventh circuit also looked to the fact that the contract in *Vigortone* contained a warranty that the defendant knew of "no fact which adversely affects or in the future is likely to adversely affect the Purchased Assets." The court

found that this clause "makes it implausible to suppose that the integration clause was meant to reach representations designed actively to conceal the existence of an undisclosed fact likely to harm" the plaintiff.²³ (The court did not explain how a clause entitling a party to contract damages for a breach of warranty implied that the parties agreed to allow tort damages for fraud.)

This line of reasoning from *Vigortone* ignores one of the bases on which the *Barille* court relied. In *Barille*, the first district based its decision not only on the parol evidence rule, but on its judgment that an integration or merger clause renders any reliance on statements not contained in the agreement at issue to be unreasonable. *Barille* therefore was based not on a contract doctrine, but on the plaintiff's failure to allege an element (justifiable reliance) of the tort of fraud.²⁴ And in fact, in *Vigortone* the seventh circuit went on to find that the plaintiff's reliance on alleged misrepresentations was not justified based on the plaintiff's due diligence efforts (but not on the existence of the integration clause in the purchase contract).²⁵

No-Reliance Clauses: Closing the Loophole

Although *Vigortone* argues against the use of integration or merger clauses to prevent fraud-in-the-inducement claims, the same case illustrates another

11. 1998 WL 341830 (ND Ill 1998).

12. *Id.* at *4.

13. 2002 WL 1147460 (ND Ill 2002).

14. *Id.* at *2.

15. 215 F Supp 2d 942 (ND Ill 2002).

16. *Id.* at 950.

17. 271 Ill App 3d 833, 648 NE2d 317 (4th D 1995).

18. *Id.* at 841, 648 NE2d at 323.

19. 316 F3d 641 (7th Cir 2002).

20. *Id.* at 644.

21. *Id.*

22. *Id.*

23. *Id.* at 645.

24. An unreported district court case recently addressed the logic behind *Barille*. In *Sequel Capital, LLC v Rothman*, 2003 WL 22757758 (ND Ill 2003), the court held that an integration clause in a contract did not preclude the plaintiff from attempting to demonstrate justifiable reliance in an action based on §10b-5 of the Securities Exchange Act of 1934. *Id.* at *14-16. The court in *Sequel* distinguished *Rissman v Rissman*, 213 F3d 381 (7th Cir 2000), in which a no-reliance clause was held to preclude a §10b-5 claim, on grounds that the integration clause in *Sequel* was much narrower than the no-reliance clause present in *Rissman*. The *Sequel* court then applied this logic to a common-law fraud action brought along with the §10b-5 claim. The decision assumes that state-law claims are subject to the same analysis as federal claims; no Illinois cases are cited. *Id.* at *18.

25. *Vigortone* at 645-47.

means to achieve the same goal: the no-reliance clause. Specifically, the seventh circuit held that although merger or integration clauses do not preclude fraud-in-the-inducement claims, the presence of so-called "no-reliance clauses" in a contract would preclude such claims.

These clauses, which state in some form "that neither party has relied on any representations made by the other,"²⁶ are sufficient in the eyes of the seventh circuit to preclude fraud suits. The court reasoned that "[s]ince reliance is an element of fraud, the [no-reliance] clause, if upheld – and why should it not be upheld, at least when the contract is between sophisticated commercial enterprises – precludes a fraud suit."²⁷

It is unclear how Illinois case law will develop in light of the seventh circuit's decision in *Vigortone*. Although the case is not binding on Illinois courts, a very real possibility is that they will cite it as persuasive authority and that *Vigortone*'s prediction with respect to the Illinois Supreme Court's view of this matter will become a self-fulfilling prophesy.

In addition, the seventh circuit described the rule it adopted in *Vigortone* as the "general rule,"²⁸ suggesting that a court outside Illinois might draw the same distinction as did the seventh circuit between integration or merger clauses on the one hand and no-reliance clauses on the other. In fact, case law on this issue appears to be split. While a 50-state survey is beyond the scope of this article, at least some states follow the "general rule" enunciated in *Vigortone*,²⁹ while others follow the logic of *Barille*.³⁰

Practical Implications: Drafting Agreements

In drafting agreements, lawyers should strongly consider including no-reliance clauses. On one hand, a party agreeing to such a clause in essence agrees in advance to waive any causes of action it may have for fraud. That party would, under the logic of *Vigortone* and like cases, be limited to contract remedies. On the other hand, including a no-reliance clause in a contract provides the parties with greater confidence that any disputes will be resolved as a contract rather than a tort claim.

Parties considering inserting a no-reliance clause in a contract should make sure that they do not create an inadvertent ambiguity between the non-reliance clause and explicit contractual represen-

tations or warranties. As noted in *Vigortone* itself, representations in a contract could strip merger or integration clauses, or no-reliance clauses, of their effect.

In *Vigortone*, the seventh circuit noted a party's representation in the contract that it knew of "no fact which adversely affects or in the future is likely to adversely affect" the value of the contract's subject matter.³¹ The court used this representation as evidence that the merger clause was not intended to release the parties from tort liability for pre-contract representations.

Similar "material adverse effect" clauses in a contract may be used to argue that a merger or integration clause in a contract was meant to limit interpretation of the contract but not to prevent tort claims. If a party to the contract insists on a material adverse effect clause, a reasonable compromise may be to include an election-of-remedies clause that specifies that a party is limited to contract or other specified damages in the event of a breach of a specific warranty or representation.

On the other hand, disclaimers of representations or warranties can prevent fraud-in-the-inducement claims directed to the subject matter of the disclaimer. Even in states that allow fraud claims despite "boiler-plate" merger or integration clauses, specific disclaimers may insulate prospective defendants.³² For instance, the parties can include clauses that provide that they have not relied on any pre-contract representations about enumerated subject matters.

The possibility of a conflict of laws on this issue may also drive choice-of-law decisions. Although there appears to be a conflict among Illinois districts over whether merger or integration clauses bar fraud claims, the law of some other states is relatively clear that such clauses do not bar fraud claims.

In fact, at least one jurisdiction, California, does not even grant no-reliance clauses the effect suggested by *Vigortone*.³³ Therefore, a contract that provides that Illinois law governs disputes between the parties might help limit causes of action to contract claims.

Practical Implications: Litigating Fraud-in-the-Inducement Claims

Regardless of its persuasive aspect, *Vigortone* is not binding on Illinois courts. At least in principle, Illinois courts other than those in the first and

second districts are still faced with a choice between following *Barille* or *Salkeld*. Litigators in Illinois therefore may still seek to have fraud-in-the-inducement claims dismissed in cases involving contracts with merger or integration clauses.

More importantly, even if courts accept the logic of *Vigortone*, that case did not hold that a merger or integration clause is irrelevant in fraud cases. True, courts following *Vigortone* may not accept a merger or integration clause as *per se* evidence that the claimant's reliance on representations outside of the four corners was unreasonable. On the other hand, such clauses, taken together with other evidence in motion practice or at trial, may help show that such reliance was unreasonable.

For instance, one court has noted that even in a jurisdiction in which merger clauses do not automatically justify dismissal of fraud claims, "[a] merger clause freely negotiated by similarly sophisticated parties as part of the bargain in an arm's-length transaction has a different effect than a provision in a standard form contract which cannot be negotiated and cannot serve as the basis of the parties' bargain."³⁴ In other words, the merger clause, along with evidence relating to the negotiation of that clause, may justify dismissal of a fraud claim.

Finally, *Vigortone* almost certainly increases the likelihood that courts applying Illinois law will dismiss fraud-in-the-inducement claims where the underlying contract contains a no-reliance clause. One important caveat, hinted at in *Vigortone*, is that in cases in which the parties are in an unequal bargaining position or are of differing levels of sophistication, such contracts may be subject

26. *Id.* at 644.

27. *Id.* at 645.

28. *Id.* at 644.

29. See, for example, *Wilson v Equitable Life Assur Soc of the US*, 622 So 2d 25, 27 (Fla D Ct App 1993); *Stanley v Bray Terminals, Inc.*, 197 FRD 224 (ND NY 2000).

30. See, for example, *Ainsworth v Perreault*, 254 Ga App 470, 563 SE2d 135 (Ga Ct App 2002); *Redwend Ltd Partnership v Edwards*, 354 SC 459, 581 SE2d 496 (SC Ct App 2003).

31. *Vigortone* at 645.

32. See, for example, *Dallas Aerospace, Inc v CIS Air Corp*, 2002 WL 31453789 (SD NY 2002) (under New York law, "a party cannot justifiably rely on a representation that has been explicitly disclaimed in the agreement.") (citations omitted) (emphasis in original).

33. See *Wang v Massey Chevrolet*, 97 Cal App 4th 856, 118 Cal Rptr 2d 770 (2002).

34. *Ikon Office Solutions, Inc v Eifert*, 125 SW 3d 113, 126, 2003 WL 21782347, *12 (Tex Ct App 2003).

to attack as contracts of adhesion. Although Illinois courts generally enforce such contracts, they are often interpreted against the drafter.³⁵ A court might allow a fraud claim to proceed despite a no-reliance clause in the case of a contract of adhesion.

Conclusion

Parties to a contract often include integration or merger clauses to control the

scope of their agreement. Fraud-in-the-inducement claims threaten that certainty and can expand a party's obligations and potential liability under a contract. Although merger and integration clauses historically have insulated parties from fraud-in-the-inducement claims under Illinois law, recent federal decisions threaten to negate those clauses' effectiveness.

Thanks to a recent seventh circuit decision, however, no-reliance clauses

could offer the certainty previously provided by merger and integration clauses. With this in mind, parties drafting agreements under Illinois law should take a hard look at inserting no-reliance clauses alongside their merger and integration clauses. ■

35. See, for example, *Abbott v Amoco Oil Co*, 249 Ill App 3d 774, 781, 619 NE2d 789, 795 (2d D 1993) (noting that "generally, burdensome clauses in adhesion contracts should be construed against the more powerful party").