LEGALIZING FRAUD IN MICHIGAN CONTRACT LAW

I. INTRODUCTION

In 1998, the Michigan Court of Appeals decided a case that dramatically changed the parol evidence rule in Michigan.[1] In *UAW-GM Human Resource Center v. KSL Recreation Corporation* (*KSL*), the court reinterpreted the parol evidence rule to hold that because of an express merger clause, evidence of an alleged collateral agreement was inadmissible to change the terms of the contract.[2] Even evidence of fraud was barred in this case.[3] The parol evidence rule bars admission of written or oral evidence that would contradict the terms of the integrated agreement.[4] In most states, however, there is an exception to allow evidence that suggests fraud.[5] The majority opinion in *KSL* sharply limits this exception.

Although at first this may not seem like an earth-shattering decision, an analysis of the understood purpose of the parol evidence rule and the meaning of the parol evidence rule before and after this decision will show that the court of appeals has effectively eliminated the fraud exception to the rule, thus making it much easier for parties to fraudulently induce others to enter contracts. This Note will first explore the history in Michigan of fraud in the inducement, particularly its application in the context of the economic loss doctrine in *Huron Tool & Engineering v. Precision Consulting Services, Inc.*[6] Next, a comparison of the laws of other states, particularly Montana, whose parol evidence rule is similar to Michigan's, and New York, whose parol evidence rule is dissimilar, will illustrate the significance of the majority's decision. Finally, an analysis of how courts have subsequently applied the *KSL* majority opinion will demonstrate that the parol evidence doctrine in

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1. UAW-GM Human Res. Ctr. v. KSL Recreation Corp., 228 Mich. App. 486 (1998). The majority opinion was authored by Judge Steven Markman, who is now a Justice of the Michigan Supreme Court.

2. *Id.* at 502.

3. *Id.*

4. Howard Yale Lederman, *Freedom to Defraud: Making Michigan Safe for Fraud*, 87 MICH. B.J. 19, 20 (2008). "Parol evidence rule" is really a misnomer because the rule is not a rule of evidence, but rather one of contract law. Ralph C. Anzivino, *The Fraud in the Inducement Exception to the Economic Loss Doctrine*, 90 MARQ. L. REV. 921, 938 (2007) (citing RESTATEMENT (SECOND) OF CONTRACTS § 213 cmt. 1 (1981)).

5. *KSL Recreation Corp.*, 228 Mich. App. at 493 (citing NAG Enters., Inc. v. All State Indus., Inc., 407 Mich. 407, 410-11 (1979)).

6. Huron Tool & Eng'g Co. v. Precision Consulting Servs., Inc., 209 Mich. App. 365, 368 (1995).

Michigan is now unclear and hence difficult to apply. Because the majority opinion makes it easier for parties to get away with fraud, the *KSL* decision is extremely problematic and should be reconsidered so as to re-broaden the exception for fraud in Michigan contract law.

II. BACKGROUND

A. UAW-GM Human Resource Center v. KSL Recreation Corporation: Practically Eliminating the Exception for Fraud

In the case at issue in this Note, plaintiff UAW-GM Human Resource Center (UAW) contracted with Carol Management Corporation (CMC) to rent space in the Doral Resort and Country Club for a convention.[7] The contract was formed in December 1993, and the convention was to take place in October 1994.[8] The contract included a merger clause, which stated that the written agreement represented "'a merger of all proposals, negotiations and representations with reference to the subject matter and provisions.'"[9] In December 1993, the defendant KSL Recreation Corporation (KSL) purchased the resort from CMC.[10] Upon taking control of the resort, KSL replaced all unionized employees at the resort with non-union employees.[11] While the contract did not require that the resort's employees be unionized, UAW alleged that it had an oral agreement that the resort employees would be union-represented.[12] UAW claimed that it signed the contract in reliance on this promise.[13] Upon learning in June 1994 that the union-represented employees had been replaced by nonunionized employees, UAW cancelled the contract and demanded return of its deposit.[14] When KSL refused to refund the deposit, UAW sued.[15] The defendants claimed that evidence of the oral agreement regarding unionized workers was inadmissible because of the merger clause,[16] plaintiffs contended that the defendants' representations during contract formation were knowingly false and therefore constituted fraud, triggering the exception to the parol

7. *KSL Recreation Corp.*, 228 Mich. App. at 488.
8. *Id.*
9. *Id.*
10. *Id.* at 489.
11. *Id.*
12. *Id.* at 488.
13. *KSL Recreation Corp.*, 228 Mich. App. at 488.
14. *Id.* at 489.
15. *Id.*
16. *Id.* at 490-91.

evidence rule.[17] The court of appeals majority concluded that parol evidence demonstrating fraud is not admissible when there is an express merger clause, unless that evidence shows that the fraud invalidates the merger clause itself.[18] The majority's interpretation and application of the parol evidence rule to the facts of this case is the topic of the remainder of this Note.

B. The Parol Evidence Rule

The first step to understanding the magnitude of the majority's opinion is to understand the parol evidence rule, an already confusing rule.[19] According to Michigan's parol evidence rule, "parol evidence of contract negotiations, or of prior or contemporaneous agreements that contradict or vary the written contract, is not admissible to vary the terms of a contract which is clear and unambiguous."[20] The purpose of the rule is to give stability to written contracts.[21] Essentially, there is a two-step process to determine whether extrinsic evidence—which could take the form of oral negotiations, subsequent modification or prior written documents, among other things—, is admissible.[22] First, the court must determine whether the writing is an integration or "final expression of one or more terms of an agreement."[23] If it is not an integration, the parol evidence rule does not apply, and there is no reason to exclude the evidence.[24] If the court determines that the writing is a full integration, the second step is to determine whether the agreement is a partial or

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17. *Id.* at 490-91, 504.

18. *Id.* at 502.

19. Regarding the parol evidence rule, Professor Wellman has noted, "'few things in our law are darker' . . . 'nor fuller of subtle difficulties.'" Vincent A. Wellman, *Essay: The Unfortunate Quest for Magic in Contract Drafting*, 52 WAYNE L. REV. 1101, 1121-22 (2006) (quoting James B. Thayer, *The "Parol Evidence" Rule*, 6 HARV. L. REV. 325, 325 (1893)).

20. *KSL Recreation Corp.*, 228 Mich. App. at 492 (quoting Schmude Oil Co. v. Omar Operating Co., 184 Mich. App. 574, 580 (1990) (internal quotation marks omitted)). It is important to note that this rule assumes that a contract is a complete integration. The language used in Michigan case law varies slightly from that in the RESTATEMENT (SECOND) OF CONTRACTS, but has the same effect. For the Restatement scheme, see RESTATEMENT (SECOND) OF CONTRACTS §§ 209-10, 215-16 (2008).

21. *KSL Recreation Corp.*, 228 Mich. App. at 492 (citing 4 WILLISTON, CONTRACTS § 631). The quote continues, "for otherwise either party might avoid his obligation by testifying that a contemporaneous oral agreement released him from the duties that had simultaneously assumed in writing." *Id. See* Lederman, *supra* note 4, at 20.

22. *See* E. ALLAN FARNSWORTH, ET AL., CONTRACTS: CASES AND MATERIALS 365-66 (2008).

23. RESTATEMENT (SECOND) OF CONTRACTS § 209(1) (2008).

24. *Id.* § 213.

complete integration.[25] If the written document has been "adopted by the parties as a complete and exclusive statement of the terms of the agreement," then it is a complete integration.[26] Anything less than a complete integration is a partially integrated agreement.[27] The *KSL* decision takes a slightly different approach in that the Court of Appeals majority concluded that the presence of a merger clause is conclusive, therefore signifying that the written document is a complete integration.[28]

Whether the agreement is completely or partially integrated will determine which additional terms, if any, are admissible as evidence to alter the terms of the written agreement.[29] If the agreement is completely integrated, no additional terms are admissible.[30] If, on the other hand, the agreement is partially integrated, then consistent additional terms are admissible, but additional terms that contradict the terms of the written agreement are not admissible.[31]

An important point in the analysis of parol evidence is the presence of a merger clause.[32] Such a provision often states "that there are no representations, promises or agreements between the parties except those found in the writing . . . and if agreed to [are] likely to conclude the issue whether the agreement is completely integrated."[33] Therefore, if a written agreement contains a merger clause, this generally points to the

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25. *Id.* § 210.

26. *Id.* § 210(1).

27. *Id.* § 210(2).

28. *KSL Recreation Corp.*, 228 Mich. App. at 502. *See* Wellman, *supra* note 19, at 1121. In this article, Professor Wellman notes that the court treated the merger clause as if it were "magic." *Id.*

29. RESTATEMENT (SECOND) OF CONTRACTS § 213 (2008).

30. *Id.* § 215. However, as the Restatement observes, a series of exceptions have traditionally been recognized. *See id.* § 214(d) ("Agreements and negotiations prior to or contemporaneous with the adoption of a writing are admissible to establish . . . illegality, fraud, duress, mistake, lack of consideration, or other invalidating clause.").

31. *Id.* § 216. The Uniform Commercial Code has a slightly different scheme than the Restatement, but only applies when the contract is for the sale of goods. U.C.C. §§ 2-101, 2-202 (1977). Because the contract at issue in *KSL* was not for the sale of goods, the U.C.C. was not relevant to the majority's analysis and therefore will not be discussed further in this Note.

32. "An integration or merger clause is 'a contractual provision stating that the contract represents the parties' complete and final agreement and supersedes all informal understandings and oral agreements relating to the subject matter of the contract.'" Anzivino, *supra* note 4, at 938 (quoting BLACK'S LAW DICTIONARY 824 (8th ed. 2004)).

33. RESTATEMENT (SECOND) OF CONTRACTS § 216 cmt. e (2008). For a more detailed analysis and explanation of merger clauses, see Wellman, *supra* note 19. Howard Yale Lederman also notes, "[t]he purpose of an integration clause is to invoke the parol evidence rule." Lederman, *supra* note 4, at 20 (quoting Dwight J. Davis & Courtland L. Reichman, *Understanding the Value of Integration Clauses*, 18 FRANCHISE L.J. 135, 136 (1999) (internal quotations omitted)).

conclusion that the written document is a complete integration.[34] When such a clause is present in a written agreement, additional terms, whether consistent or contradictory, are rarely admissible.[35]

C. Fraud in the Inducement: An Exception to the Parol Evidence Rule

Michigan recognizes four exceptions to the parol evidence rule when fraud is potentially involved,[36] one of which is that parol evidence that would otherwise be inadmissible to alter the terms of a written agreement is admissible to demonstrate that there was indeed fraud.[37] However, in *NAG Enterprises, Inc. v. All State Industries, Inc.*,[38] the case in which the Michigan Supreme Court identified these four exceptions, the contract at issue did not contain a merger clause, unlike the contract at issue in *UAW-GM v. KSL*.[39] Therefore, before *KSL*, it was not clear whether the exceptions applied in the presence of a merger clause. This conflict will be discussed in further detail below.

There are two types of fraud in the context of contract law: fraud in the inducement and fraud in the factum.[40] If one party fraudulently misrepresents an element of the contract, such as the quality of goods in a contract for the sale of goods, that is said to be fraud in the inducement.[41] The effect of a finding of fraud in the inducement is that

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34. The majority opinion goes beyond this proposition by holding that the presence of a merger clause is "conclusive" that the agreement is a final integration. *KSL Recreation Corp.*, 228 Mich. App. at 502. However, in subsequent cases, the Michigan Court of Appeals has examined the language of the merger clause at issue in order to determine its effect. *See, e.g.*, Bradley Inv. V, L.L.C. v. Sutherby, No. 278390, 2008 WL 4958786, at *4 (Mich. Ct. App. Nov. 20, 2008) (taking into consideration "the location of the [merger clause] in the context of the agreement"); Stout v. Withrow, No. 271632, 2008 WL 400695, at *8 (Mich. Ct. App. Feb. 14, 2008) (comparing the language of the merger clause at issue to the merger clause in the *KSL* contract); Brondyk v. Midwestern United Life Ins. Co., No. 252859, 2005 WL 1846467, at *2 (Mich. Ct. App. Aug. 4, 2005) (looking at "[t]he plain language of [the] integration clause[]" to determine the parties' intent).

35. RESTATEMENT (SECOND) OF CONTRACTS § 216 cmt. e.

36. *KSL Recreation Corp.*, 228 Mich. App. at 493 (citing *NAG Enters., Inc.*, 407 Mich. at 410-11).

37. *Id.* The other three exceptions are "(1) that the writing was a sham, not intended to create legal relations, . . . (3) that the parties did not integrate their agreement or assent to it as the final embodiment of their understanding, [and] (4) that the agreement was only partially integrated because essential elements were not reduced to writing." *Id.*

38. NAG Enters., Inc. v. All State Indus., Inc., 407 Mich. 407 (1979).

39. *KSL Recreation Corp.*, 228 Mich. App. at 493.

40. 1 E. ALLAN FARNSWORTH, FARNSWORTH ON CONTRACTS 446 (2d ed. 1998).

41. *Id.* Professor Anzivino defines fraud in the inducement as "when a misrepresentation leads another to enter into a transaction with a false impression of the risks, duties, or obligations involved." Ralph C. Anzivino, *supra* note 4, at 933 (quoting

the "contract [is] voidable at the instance of the recipient."[42] If, on the other hand, the fraud is regarding the written document itself, such as lying about its legal validity, that fraud is called fraud in the factum.[43] The effect of fraud in the factum is that "there is no contract at all[,]" so long as the other party did not know or have reason to know of the fraud.[44] The fraud alleged in *KSL* was fraud in the inducement because it did not question the legal validity of the document, but rather the alleged fraud was regarding one element of the contract—whether the employees would be unionized.[45]

Farnsworth identifies four elements required to prove fraud in the inducement: (1) "an assertion that is not in accord with the facts";[46] (2) "the assertion must be either fraudulent or material";[47] (3) "the assertion must be relied on by the recipient in manifesting assent";[48] and (4) "the reliance of the recipient must be justified."[49] In *KSL*, the majority stated that because there was a merger clause, it was "unreasonable for plaintiff's agent to rely on any representations not included in the letter of agreement" and therefore the fourth element of fraud in the inducement was not satisfied.[50] The court went on to hold that where there is a merger clause, no parol evidence is admissible except to show that the merger clause itself was fraudulently assented to, or where the

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BLACK'S LAW DICTIONARY 686 (8th ed. 2004) (internal quotation marks omitted)). According to the Michigan Court of Appeals, "[f]raud in the inducement occurs where a party materially misrepresents future conduct under circumstances in which the assertions may reasonably be expected to be relied upon and are relied upon." Samuel D. Begola Servs., Inc. v. Wild Bros., 210 Mich. App. 636, 639 (1995).

42. FARNSWORTH, *supra* note 40, at 446.

43. *Id.*

44. *Id.*

45. *KSL Recreation Corp.*, 228 Mich. App. at 504. Specifically, plaintiffs alleged that agreeing to provide unionized employees and failing to disclose that the sale of the hotel was pending amounted to fraud in the inducement; both the affirmative misrepresentation and the failure to disclose were made in order to induce the plaintiff to sign the contract, and the person who made the statements knew that they were false. *Id.*

46. FARNSWORTH, *supra* note 40, at 447.

47. *Id.* at 448. In addition to practically eliminating the exception for fraud in the inducement, the court also narrowed this prong of the requirements to show fraud. The *KSL* court stated:

> [T]he plaintiff must not only show an incorporated precontract agreement or representation, but must also show that the defendant induced him or her to suppose that the contract incorporated the agreement or representation, or 'to execute an incomplete writing, while describing it as complete, the written provision may be voidable on the ground of fraud.

Lederman, *supra* note 4, at 21 (quoting *KSL Recreation Corp.*, 228 Mich. App. at 503).

48. FARNSWORTH, *supra* note 40, at 448.

49. *Id.*

50. *KSL Recreation Corp.*, 228 Mich. App. at 504.

"agreement is obviously incomplete 'on its face.'"[51] Specifically, the court stated, "a contract with a merger clause nullifies all antecedent claims . . . includ[ing] any collateral agreements that were allegedly an inducement for entering into the contract."[52] The effect of this holding is to give an extreme amount of weight to the presence of the merger clause and eliminate almost any exception to the parol evidence rule for fraud in the inducement when such a merger clause is present.[53]

D. Huron Tool & Engineering Company v. Precision Consulting Services, Inc.*: Fraud in the Inducement and the Economic Loss Doctrine*

Prior to *KSL*, the Court of Appeals had recognized fraud in the inducement in the economic loss context in *Huron Tool v. Precision Consulting*.[54] According to Michigan's economic loss doctrine, where a purchaser has remedies in both contract and tort, his remedies are limited to contract only insofar as his losses are only economic.[55] This doctrine is applicable when there are potential remedies in both contract and tort law.[56] When such is the case, the economic loss doctrine limits recovery to that enabled by contract law only when the losses are purely economic. The facts of *Huron Tool* pose the conflict that arises when the recovery would be limited to Article Two's remedies under the economic loss doctrine, but because the U.C.C. statute of limitations had expired, the plaintiff is unable to recover at all.[57] States have created exceptions to the economic loss doctrine that allow for recovery in a situation where the defendant defrauded the plaintiff, and still give the plaintiff an opportunity to recover. There are three different ways states treat fraud in the economic loss context: they either do not permit any type of fraud as

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51. *Id.* at 502 (quoting 3 CORBIN CONTRACTS, § 578 at 411).

52. *Id.*

53. Lederman, *supra* note 4, at 21 ("[T]he Court almost abrogated the fraud exception.").

54. *Id.* at 20. For a more detailed explanation of the economic loss doctrine see generally Vincent A. Wellman, *Assessing the Economic Loss Doctrine in Michigan: Making Sense Out of the Development of Law*, 54 WAYNE L. REV. 791 (2008).

55. *Huron Tool & Eng'g Co.*, 209 Mich. App. at 368-69 (quoting Neibarger v. Universal Coop., Inc., 439 Mich. 512 (1992)). *See also* Gary M. Victor, *The Economic Loss Doctrine and Consumers*, 89 MICH. B.J. 23 (2010). Professor Wellman identifies the rationale behind this rule as "harmoniz[ing] all of the law relating to products liability." Wellman, *supra* note 54, at 801.

56. Victor, *supra* note 55, at 23. Victor elaborates, however, that frequently the conflict is such that there is no option between contract and tort law. Rather, no remedy is available in contract law (because the statute of limitations has passed), therefore the options are recovery under tort law or no recovery at all. *Id.*

57. *Id.* at 23-24.

an exception to economic loss, they allow any type of fraud to be an exception, or they allow a narrow exception for fraud in the inducement.[58] Because of the decision in *Huron Tool*, Michigan is now among those states that allow a narrow exception for fraud in the inducement.[59]

In *Huron Tool*, the plaintiffs contracted to purchase a computer software system from the defendants in 1986.[60] Because this was a contract for the sale of goods, the transaction was governed by the Uniform Commercial Code (U.C.C.).[61] After delivery of the system, defendants performed some modifications and other work for plaintiffs, for which plaintiffs paid separately and independent of the contract.[62] Plaintiffs brought a suit because of defects in the system.[63] They alleged breach of contract and warranty, as well as fraud and misrepresentation.[64] The trial court ordered summary judgment for the defendants because the U.C.C. statute of limitations had expired.[65] On appeal, plaintiffs argued that they could bring their fraud claims independently of their contractual claims, but defendants argued that the economic loss doctrine would bar bringing such independent claims.[66] In analyzing whether the fraud claims could be brought independent of the breach of contract claims, thus escaping the U.C.C. statute of limitations, the court concluded that while the economic loss doctrine would generally preclude independent causes of action of a contract, the court would allow an exception for

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58. *Id.* (citing Anzivino, *supra* note 4, at 931-33). Professor Anzivino identifies three rationales for the narrowest approach as stated by the Wisconsin Supreme Court: (1) it keeps tort and contract law distinct, (2) it "promotes and protects . . . freedom to contract," and (3) it encourages the buyer, the party with the most risk, to insure against fraud. Anzivino, *supra* note 4, at 931-34 (citing Kaloti Enters., Inc. v. Kellogg Sales Co., 283 Wis. 2d 555, ¶¶ 46, 48, 50 (2005)).

59. *Huron Tool & Eng'g Co.*, 209 Mich. App. at 367. Wisconsin, Florida and "arguably" Michigan are the only states with this narrow exception. Anzivino, *supra* note 4, at 933. Professor Anzivino does not conclusively state that Michigan has adopted the rule because the Michigan Supreme Court has not ruled on the issue. *KSL* is still the leading case in Michigan on the topic to date. Professor Anzivino also states that five other states that will likely adopt this narrow exception are Arizona, Delaware, Kentucky, Missouri, and Pennsylvania. *Id.* at 934 n.74.

60. *Huron Tool & Eng'g Co.*, 209 Mich. App. at 367.

61. *Id.*; U.C.C. § 2-102. There is an argument to be made that the contract at issue in *Huron Tool & Engineering Co.* is not governed by the U.C.C. because the creation of a computer system should constitute "services," not the sale of goods, but this is beyond the scope of this Note. Victor, *supra* note 55, at 25; Wellman, *supra* note 54, at 814.

62. *Huron Tool & Eng'g Co.*, 209 Mich. App. at 367.

63. *Id.*

64. *Id.*

65. *Id.* at 368.

66. *Id.*

fraud in the inducement.[67] However, because the plaintiffs had not pled fraud in the inducement, they were not entitled to bring that cause of action.[68]

In carving out the exception to the economic loss doctrine for fraud in the inducement, Judge Michael J. Kelly, the author of the opinion, analyzed the distinction between fraud in the inducement and other types of fraud, examined the underlying rationale of the economic loss doctrine, and the necessity for an exception for fraud. Regarding the different types of fraud, the court noted that fraud in the inducement is a pre-contractual action and is therefore a tort.[69] Other types of fraud, on the other hand, are generally related to performance of the terms of the contract, and therefore the remedy for such action is contractual in nature.[70] From this analysis, it appears that fraud in the inducement falls outside the scope of the economic loss doctrine because the action is pre-contractual, and therefore not governed by the contract law that governs the performance of the terms of the contract.

Regarding the underlying purpose of the economic loss doctrine, the *Huron Tool* court noted that it guarantees a separation between contract and tort law, and it is designed to ensure that "tort remedies [do not] simply engulf the contractual remedies[.]"[71] When these two rationales are viewed together, it is clear that where there is fraud in the inducement, there is a separate tort action from the terms of the contract, and because there is no contractual claim in such a situation, any remedy for that action has no chance of encompassing a contractual claim. In such a case, tort law is the only available remedy and therefore an exception for fraud in the economic loss doctrine is necessary.

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67. *Id.* In *Huron Tool*, the court cited Neibarger v. Universal Coop., Inc., 439 Mich. 512 (1992) as the leading case in Michigan on the economic loss doctrine. In analyzing that case, the *Huron Tool* court distinguished the facts in front of it from those in *Neibarger* because the latter case involved an unintentional tort (negligence), while *Huron Tool* involved an intentional tort (fraud). Other than making this distinction, however, the court did not make clear under what circumstances the exception to the economic loss doctrine applied, other than fraud in the inducement. For this reason, this appears to be a very narrow exception to the economic loss doctrine. *Huron Tool & Eng'g Co.*, 209 Mich. App. at 369-71; *see* Victor, *supra* note 55, at 25.

68. *Huron Tool & Eng'g Co.*, 209 Mich. App. at 368.

69. *Id.* at 371-73.

70. *Id.* at 373. The court cited a New Jersey Federal District Court decision, *Public Service Enter. Grp., Inc. v. Philadelphia Elec. Co.*, 722 F. Supp. 184, 201 (D. N.J. 1989), as the source of this analysis. *Id.*

71. *Id.* at 371 (quoting Williams Elec. Co., Inc. v. Honeywell, Inc., 772 F. Supp. 1225, 1237-38 (N.D. Fla. 1991)).

E. Fraud in the Inducement and the Parol Evidence Rule in KSL Recreation Corp.

The necessity for an exception for fraud in the inducement in the context of the economic loss doctrine challenges the majority's decision in *KSL*. The majority narrowed even further what is already a narrow exception. Whereas in the economic loss context, there is an exception for any type of fraud in the inducement, the *KSL* court eliminated such an exception in the context of contract law when there is a merger clause present. Therefore, evidence of fraud in the inducement is only admissible as an exception to the parol evidence rule in the event that there is no merger clause. This is going to be an extremely narrow set of cases and the practical effects of this limitation, while reducing the amount of litigation in the court, can be potentially detrimental to parties contracting in Michigan.

III. ANALYSIS

A. The Effect of KSL Recreation Corp. *on Michigan Contract Law*

An analysis of how courts have subsequently applied *KSL* will illustrate the detrimental effect of the holding. According to the *KSL* court, any party can fraudulently induce another to sign a contract and it will not be held liable for making a fraudulent statement as long as the contract contains a merger clause. The only part of the fraud in the inducement exception that remains intact is when the fraud directly relates to the merger clause itself.[72] The practical effects of this conclusion are absolutely astounding. Therefore, one can fraudulently make an oral promise in order to induce a party to the contract to sign it, and as long as the promise does not touch the merger clause itself, the merger clause will bar any evidence of such action in court.[73] By

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72. This exception also applies when the fraud relates to the validity of the entire contract. The majority opinion has also left intact a narrow exception for contracts that are not complete "on [their] face," but does not address exactly what this means, and therefore it is not entirely clear how much of this exception actually remains. *See KSL Recreation Corp.*, 228 Mich. App. at 495.

73. It seems nearly impossible to imagine a practical situation in which the fraud would go to the merger clause itself. Perhaps if the defrauding party stated, "do not read the paragraph on page X, it does not mean anything" referring to the merger clause, then that would constitute fraud of the merger clause itself, but such a situation does not seem very likely. In *Hamade v. Sunoco, Inc.*, the court of appeals stated that in order to succeed on a fraud in the inducement claim in the presence of a merger clause, the plaintiff would have to:

eliminating the fraud in the inducement exception to the parol evidence rule for all instances except where the fraud touches the merger clause itself, the majority has created an environment where encouraging parties to defraud others into entering a contract is permissible.[74] Presumably the court's intent for such a narrow exception is to keep the level of litigation down in Michigan courts, but when that goal is pursued at the expense of justice, Michigan judges may have to rethink their priorities.

An analysis of how courts have subsequently applied the *KSL* holding illustrates the effects of the decision. In *Hamade v. Sunoco, Inc.*,[75] the court concluded that the plaintiffs failed to show that the alleged fraud invalidated the merger clause.[76] In that case, plaintiff Hamade had purchased a Sunoco station from its previous owner and entered into a dealer supply franchise agreement with Sunoco.[77] During negotiations of a new agreement,[78] Sunoco's representative Jeff Byard stated to Hamade that Hamade need not worry about Sunoco opening another station along the same line of traffic as Hamade's station when Hamade expressed an interest in including a provision in the agreement that would prevent Sunoco from opening another such station.[79] However, in 2000, Sunoco approved a new station located only one mile from Hamade's station.[80] Hamade brought a lawsuit alleging that

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> [S]how not only that he requested the inclusion of a clause guaranteeing him an exclusive territory, but also that, as a result of Sunoco's fraudulent representations, he was induced to forget about the inclusion of that term and sign an agreement that omitted it while describing itself as the parties' entire agreement.

Hamade v. Sunoco, Inc., 271 Mich. App. 145, 170 (2006). The likelihood of such a scenario actually happening seems nearly impossible.

74. Professor Anzivino notes, "[t]he narrow fraud in the inducement exception is against public policy because it permits a deceitful person to accomplish indirectly that which the person could not accomplish directly through the party's contract." Anzivino, *supra* note 4, at 939.

75. 271 Mich. App. 145 (2006).

76. *Id.* at 171.

77. *Id.* at 149.

78. Specifically, Hamade entered an agreement in 1986 when he purchased the station. *Id.* That agreement ended in 1989, at which point Hamade entered a subsequent agreement. *Id.* This new agreement expired in 1992, at which point Hamade obtained extensions, which lasted until 1997. *Id.* In 1997, Sunoco required Hamade to make certain improvements to the station before they would agree to a new dealer supply franchise agreement. *Id.* After Hamade made the requested changes to the station, he entered the negotiations that are the focus of the issues of this case. *Id.*

79. *Id.* at 149-50.

80. *Id.* at 150. Hamade also brought a breach of contract claim, alleging that Sunoco delivered inferior fuel that caused damage to his customers' engines. *Id.* Hamade alleged that the bad fuel issue, in addition to the new location, have resulted in a loss of business at his station. *Id.*

opening this new station constituted a breach of contract.[81] As can be expected given the topic and substance of this Note, the contract contained a merger clause,[82] and therefore the trial court concluded that evidence of the oral agreement between Hamade and Byard was inadmissible.[83] On appeal, the court of appeals applied *KSL* and concluded that the fraud did not invalidate the integration clause, and therefore it did not fit the narrow exception to the parol evidence rule.[84] For these reasons, the court concluded that plaintiff's breach of contract claims must fail.[85]

In *Tocco v. Tocco*,[86] on the other hand, the federal district court applied the *KSL* holding and concluded that the fraud in that case invalided the merger clause itself.[87] In that case, plaintiff Sam Tocco ("Grandfather") brought a lawsuit against Sam Anthony Tocco ("Grandson"), the plaintiff's grandson, alleging multiple claims, including that the grandson fraudulently induced him to enter into a contract for the sale of a cemetery.[88] The grandson allegedly indicated that the grandfather would receive $4,400,000 in exchange for the property, when in reality the grandfather actually received very little

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81. *Id.*

82. The merger clause stated:

> *NOTE TO DEALER:* BEFORE SIGNING IN THE SPACE PROVIDED BELOW YOU SHOULD CAREFULLY READ ALL PARTS OF THIS AGREEMENT, WHICH IS A BINDING LEGAL DOCUMENT CONTAINING SEVERAL PARTS AND ATTACHMENTS (INCLUDING ALL ADDENDA, AMENDMENTS, SCHEDULES AND DOCUMENTS INCORPORATED HEREIN). THIS IS THE ENTIRE AGREEMENT BETWEEN COMPANY AND DEALER, AND MERGES AND SUPERCEDES ALL PRIOR AGREEMENTS, UNDERSTANDINGS, REPRESENTATIONS AND WARRANTIES (ORAL OR WRITTEN, EXPRESS OR IMPLIED) CONCERNING DEALER'S OPERATION OF A FRANCHISE AT THE PREMISES. NO MODIFICATIONS OR UNDERSTANDING CONCERNING THIS AGREEMENT SHALL BE BINDING UNLESS IN WRITING AND SIGNED BY COMPANY'S AUTHORIZED REPRESENTATIVE.

Hamade, 271 Mich. App. at 168.

83. *Id.* at 166.

84. *Id.* at 171. Prior to drawing this conclusion, the court of appeals also noted that *KSL* allows an exception when the contract is incomplete on its face, but concluded that the contract at issue was complete on its face, and therefore evidence of this oral agreement was inadmissible to fill the gaps. *Id.*

85. *Id.*

86. 409 F. Supp. 2d 816 (E.D. Mich. 2005).

87. *Id.* at 828.

88. *Id.* at 817-18. It should be noted that the plaintiff in this case was seeking a preliminary injunction, which is analyzed under a slightly different standard than a court order, but for the purposes of this Note, the analysis is still entirely relevant.

consideration.[89] The court determined that, despite the presence of a merger clause, these misrepresentations amounted to fraud in the inducement.[90] The court further concluded that the fraud in the inducement in this case negated the merger clause itself.[91] Although the court considered other factors, it is unclear as to how the fraud in the inducement in this case differed significantly from that in *KSL*. In both cases, one party misrepresented an element of the contract in order to induce the other party to sign the agreement.

These cases illustrate the problems presented by *KSL*. *KSL* practically eliminated the exception to the parol evidence rule for fraud, and courts, such as *Tocco*, have taken to interpreting the holding in a way so as to protect parties from fraud where it does not seem that they would actually be protected under the exception.[92] In these two cases, at issue was an oral agreement of a contract term that was not included in the original written agreement. Why one court concluded that the fraudulent misrepresentation invalidated the merger clause itself while the other court concluded that the fraud did not invalidate the merger clause is an example of the problems faced by courts applying the *KSL* decision.

B. Comparison to Other States: Montana and New York

Looking at the way the Montana Supreme Court has handled the parol evidence rule and fraud will shed further light on the extremity of the *KSL* decision. In *Sherrod, Inc. v. Morrison-Knudson Company*,[93] Sherrod subcontracted to perform earth-moving work for Morrison-Knudson, the general contractor of a housing construction project.[94] Sherrod claimed that a representative from Morrison-Knudson orally stated that there were 25,000 cubic yards of excavation work, and Sherrod made its bid, which was accepted, according to that number.[95] Sherrod signed a contract, but contended in court that Morrison-Knudson's officers knew that there was more than 25,000 cubic yards of

89. *Id.* at 827. Plaintiffs put forth evidence showing that in exchange for the sale of the cemetery, Grandfather received "very little cash and . . . promissory notes with essentially no security." *Id.*

90. *Id.*

91. *Id.* at 828.

92. *See also Bradley Inv. V, L.L.C.*, No. 278390, 2008 WL 4958786, at *4, in which the Michigan Court of Appeals distinguished *KSL* by looking at the language and placement of the merger clause and concluded that the merger clause did not apply to the entire agreement, therefore extrinsic evidence of fraud was properly admitted.

93. 815 P.2d 1135 (Mont. 1991).

94. *Id.* at 1135.

95. *Id.* at 1136.

earth to be moved because they refused to pay for the work already completed unless they signed.[96] The contract contained a "no oral modification clause."[97] After they began work, Sherrod realized that the amount of excavation work far exceeded the stated amount.[98] Sherrod did most of the work and was paid the contract amount less a portion for work that was not completed.[99]

The Montana Supreme Court invoked the parol evidence rule in its analysis of this case. The Montana parol evidence rule states that "[t]he execution of a contract in writing, whether the law requires it to be written or not, supersedes all the oral negotiations or stipulations concerning its matter which preceded or accompanied the execution of the instrument."[100] Montana law does recognize an exception to this rule for fraud, but only when the fraud is not related directly to the subject of the contract.[101] When the fraud is related to the subject of the contract (particularly, as here, where the oral statement directly contradicts a term of the contract), the parol evidence rule applies and such evidence is inadmissible to alter the terms of the written document.[102] The court therefore concluded that the evidence of the oral statement was inadmissible to alter the terms of the written contract.[103]

Clearly Montana has taken a different route with their exception for fraud than Michigan has. Whereas Michigan only allows evidence of fraud that touches the merger clause itself, Montana allows evidence of any fraud that is unrelated to the subject of the contract. Because the *KSL* contract did not speak to whether or not the employees would be unionized, presumably under the Montana law, the evidence of the oral agreement would be admissible. An analysis of Montana's law illustrates

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96. *Id.*

97. *Id.* The language of that clause provided:

> No verbal agreement with any agent either before or after the execution of this Subcontract shall affect or modify any of the terms or obligations herein contained and this contract shall be conclusively considered as containing and expressing all of the terms and conditions agreed upon by the parties hereto. No changes . . . shall be valid . . . unless reduced to writing and signed by the parties hereto.

Id. Thus, the quoted clause appears to be a "no oral modification clause," or "NOM" clause, rather than a merger clause. A NOM clause does not speak to whether or not the written document is a complete integration, but rather only that any modifications to the written document must be in writing. BLACK'S LAW DICTIONARY 1035 (8th ed. 2008).

98. *Sherrod, Inc.*, 815 P.2d at 1136.

99. *Id.*

100. *Id.* (quoting MONT. CODE ANN. § 28-2-904 (1979)).

101. *Id.* at 1137 (citing MONT. CODE ANN. § 28-2-905(2) (1979)).

102. *Id.* (citing Cont'l Oil Co. v. Bell, 94 Mont. 123, 133 (1933)).

103. *Id.*

exactly how narrow Michigan courts have tailored the fraud in the inducement exception to the parol evidence rule. Therefore, Montana's exception to the parol evidence rule for fraud in the inducement is much broader than Michigan's.

The leading New York case on the issue of the parol evidence rule is *Hicks v. Bush*.[104] In that case, the court identified the New York parol evidence rule as allowing oral evidence to prove the legal effectiveness of a written document as long as the evidence does not contradict the terms of the written document.[105] Essentially, any parol evidence is admissible as long as it is not contradictory to the terms of the agreement. This is extremely lenient compared to the Michigan parol evidence rule, which does not allow admission of any parol evidence, except in extremely narrow circumstances, such as when there is fraud of the merger clause. This rule is lenient enough that it hardly requires an exception for fraud in the inducement because any fraudulent statement made in order to induce another to enter into a contractual relationship would be admissible to alter the terms of the written document, as long as the oral statement did not contradict the terms of the agreement. Under this rule, KSL's promise to UAW-GM that the employees at the resort would be unionized would be certainly admissible because nothing in the contract spoke of whether or not the employees would be unionized, and therefore the oral agreement would not be contradictory.

Compared to Montana and New York, Michigan's law regarding the admissibility of parol evidence in the presence of a merger clause is extremely narrow. While New York has a very broad parol evidence rule, even Montana's, which is very similar to Michigan's rule, would still allow more evidence in the instance of fraud than would the Michigan rule. Although Michigan's rule may keep unnecessary litigation out of the court system, it effectively keeps out almost all litigation, even that involving people with legitimate claims that courts should be able to redress.

C. Application of KSL Recreation Corp. *in Other Michigan Cases*

Courts in subsequent Michigan cases have noticed significant problems with the *KSL* decision that hinder its applicability. First, the *KSL* majority never discussed the actual language of the merger

104. 10 N.Y.2d 488 (1962).

105. *Id.* at 491 (citing Saltzman v. Barson, 239 N.Y. 332, 337 (1925)).

clause.[106] In *Star Insurance Company v. United Commercial Insurance Agency*,[107] the court examined the scope of a merger clause, which the *KSL* majority did not address.[108]

In *Stout v. Withrow*,[109] the Michigan Court of Appeals distinguished the facts from those of *KSL* primarily based on the specific language of the merger clause.[110] The merger clause stated that the written document "merged only 'other agreements, oral or otherwise[.]'"[111] The merger clause at issue in *KSL*, on the other hand, stated that it "constituted 'a merger of all proposals, negotiations, and representations with reference to the subject matter and provisions.'"[112] The court in *Stout* distinguished "representations" as referred to in the *KSL* merger clause from "agreements" as referred to in the *Stout* merger clause.[113] Because the *KSL* court concluded that "when the parties include an integration clause in their written contract, it is conclusive and parol evidence is not admissible to show that the agreement is not integrated[,]" it would appear that any integration clause would prevent admission of parol evidence.[114] However, the court's analysis in *Stout* was clearly not comporting with the spirit (or the literal words) of the *KSL* decision.[115]

Second, an issue arises where the parties include a merger clause without intent or by accident and, as a result, the written document is

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106. Stout v. Withrow, No. 271632 2008 WL 400695, at *8 (Mich. Ct. App. Feb. 14, 2008). While this is an unreported opinion, it illustrates one of the major problems with the majority's analysis in *KSL*, and therefore should not be overlooked.

107. 392 F. Supp. 2d 927 (E.D. Mich. 2005)

108. *Id.* at 929. While this is a federal district court case and not a Michigan state court case, the analysis is still highly relevant for the point of this Note.

109. *Stout*, 2008 WL 400695, at *8.

110. *Id.*

111. *Id.*

112. *KSL Recreation Corp.*, 228 Mich. App. at 488.

113. *Stout*, 2008 WL 400695, at *8.

114. *KSL Recreation Corp.*, 228 Mich. App. at 502. *See also* Wellman, *supra* note 19, at 1123 (stating that "it appears that the majority's conclusion is predicated on the mere fact that the contract included some such clause.").

115. According to Lederman, it is the majority in *KSL*, not the *Stout* court, that misinterprets the merger clause. He states that in including the merger clause in their written document, the parties did not intend to nullify any other understandings or agreements, but rather to "contract in accordance with their understandings and agreements and preserve their rights to sue for fraud." Lederman, *supra* note 4, at 21. The *KSL* majority concludes on the understanding that a merger clause vitiates any precontractual agreements made by the parties, but the fact that other exceptions to the parol evidence rule exist at all suggests that such a conclusion is an inaccurate interpretation of a merger clause. Furthermore, considering how New York courts interpret the parol evidence rule in light of this interpretation would never comport with common sense.

clearly incomplete on its face.[116] When such a problem occurs, according to *KSL*, any parol evidence would be inadmissible to alter the terms of the contract, even though the written document obviously does not fully display the true intentions of the signing parties.[117]

These two issues suggest that there is a problem with the *KSL* analysis and conclusion. While it is commonly understood that the parol evidence rule seeks to instill stability in written documents,[118] the *KSL* majority interprets the rule too narrowly and effectively precludes parties with valid legal claims from litigation. A better solution might have been for the *KSL* court to conclude that the presence of a merger clause creates a rebuttable *presumption* that the contract is completely integrated, instead of precluding all parol evidence. Without overruling *KSL*, courts could clarify its impact by delineating factors that point toward whether a contract is a complete integration. The fact that a contract contains a merger clause should only be one such factor and not the sole factor governing the decision. Another factor the courts might consider is the language of the merger clause itself. It is important to consider what the parties actually intended by including a merger clause before concluding for them what the merger clause means. Based on *KSL*, however, the take away for parties is to be extremely careful when signing contracts containing merger clauses in Michigan.[119]

IV. CONCLUSION

The *UAW-GM Human Resource Center v. KSL Recreation Corporation* holding puts Michigan in an extreme place regarding the exception to the parol evidence rule for fraud. The decision practically eliminates any such exception, making it far easier for parties to get away with fraudulently inducing other parties into signing contracts.

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116. It is quite possible to imagine parties using a form contract or drafting a contract based on a previously used contract that contained a merger clause, but failing to include all the terms of the contract and not removing that merger clause.

117. Wellman, *supra* note 19, at 1125.

118. *KSL Recreation Corp.*, 228 Mich. App. at 492 ("The practical justification for the rule lies in the stability that it gives to written contracts; for otherwise either party might avoid his obligation by testifying that a contemporaneous oral agreement released him from the duties that he had simultaneously assumed in writing." (internal quotation marks omitted)); Lederman, *supra* note 4, at 20.

119. See Thomas M. Schehr, *Commercial Transactions and Contracts*, 45 WAYNE L. REV. 517, 555-56 (1999) for the proposition that "[t]he making of a contract depends not on the agreement of two minds in one intention, but on the agreement of two sets of external signs—not on the parties' having meant the same thing but on their having said the same thing." (quoting Oliver Wendell Holmes, *The Path of the Law*, COLLECTED LEGAL PAPERS, 167, 178 (1920) (internal quotation marks omitted)).

Although it is unlikely because the conservatives have recently cemented their control of the Michigan Supreme Court, the court should reexamine the *KSL* decision and consider re-broadening the exception to the parol evidence rule for fraud.

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