Be Wary of "Gentlemen's Agreements"

By Melissa Dewey Brumback

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"He's an honest guy."

"I've always done business this way."

"I trust her."

All those statements may be true. Relying on handshake agreements (or, the more old-fashioned "gentlemen's agreements") is a risky business in the construction field. Written contracts are crucial to enforcing binding agreements once the dirt begins to turn. However, a contract is more than a written recital of previously-agreed upon terms. A contract has the ability to change the terms between the parties, often without one of the parties realizing it. And, as Chris Hill, host of Construction Law Musings, has previously noted, the [written] Contract is King.

A written contract often contains a "merger clause" (also called an integration clause). A merger clause is a statement that the contract is a complete statement of the agreement and replaces, or supersedes, prior terms, oral or written representations, or any side agreements. All of those negotiations are deemed merged into the written document, and the written contract has the (rebuttable) presumption that it represents the final agreement between the parties.

An example of such a clause:

> *This Agreement contains the entire agreement of the parties, and supersedes all prior negotiations, agreements and understandings with respect thereto. This Agreement may only be amended by a written document duly executed by all parties.*

The purpose of such a clause is to ensure that the contract is a complete agreement, and that there will be no claims made later of additional terms or that existed. The merger clause effectively takes all those side agreements, representations, and statements and says: "If the terms are not in the contract, we don't care: they don't exist."

While there are certain exceptions to the application of the merger clause (as, for example, when application of the clause would frustrate the parties' true intentions), as a general rule, such a clause will be enforced.

A party entering into a contract which includes this type of language should make sure that all promises and agreements are actually included in the written contract, as otherwise it may be impossible to enforce those unwritten promises.

A corollary to the rule that "contracts are king" is that Warranty Deeds do just that– warrant that the property being sold is free from all encumbrances other than those listed in the deed. A warranty deed supersedes any verbal, unwritten "understandings" about the state of the property being conveyed.

In a recent North Carolina case, the state Court of Appeals applied this rule with a harsh result. In *War Eagle, Inc. v. Belair*, a corporation had **actual notice** of a DENR (Dept of Environment and Natural Resources) buffer violation when it purchased a lot on Lake Norman. It thought the violation was minor and would be minimal to fix. The deed used to convey the property was a Warranty Deed, with no exception for the violation. When the corporation later learned that the violation was more significant than it anticipated, it sued the seller under a breach of warranty deed theory.

The NC Court of Appeals held that the actual knowledge of the violation was not enough to void the covenants contained in the deed. Quoting an earlier case, the Court stated that acceptance of the prior knowledge argument "would render completely meaningless all of the covenants in defendants' deed. If defendants did not mean to be bound by their covenants, they should not have included them in their deed." Thus, the sellers were forced to pay for the complete costs to repair the property to DENR standards, even though the buyer was well aware of the DENR buffer violation when he purchased the property from the seller (and presumably paid a lesser price for the property because of the violation). Harsh justice, indeed!

The moral of the story: never trust anything *but* a carefully drafted, written contract or deed. Or, if you prefer, to borrow from President Ronald Reagan, "Trust but verify." While courts will sometimes look for equitable remedies in cases where parties acted outside of the written agreement, never throw yourself on the mercy of the court. Instead, make sure your contracts and deeds express exactly what the terms are, and the entire and complete understanding between the parties. After all, it is hard to overthrow the King.

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