When A Contract Is Not A Contract

by **SCOTT M. SANDERS, Esq.**

In my 15 years of practice, probably the most common dispute which has arisen between manufacturer and sales rep is the issue of when modification of a written sales contract becomes valid under the applicable state's law.

How would you like to confer with your principal one morning to find that the 10 percent commission you have been earning has been reduced to five percent without your permission? What if you were told that your actions or verbal statements allowed this to happen? How would your partners, shareholders and employees feel about your huge gaffe? In order to be sure this does not happen to you, read on.

The simple inclusion of a contractual clause stating that a written contract may only be modified by a subsequent written agreement is not always sufficient to prevent modification via oral agreement and/or conduct. Such clauses (which I will refer to as "written modification clauses") are rather standard in rep contracts; but often mean nothing legally.

To make matters more confusing, the states are rather diverse in their handling of this legal issue: most do not give credence to such clauses; some uphold them; and many look at the totality of circumstances. The following analysis is meant only as a sampling of the various ways miscellaneous states treat this area of law.[1]

Alabama/Tennessee/Texas

Little credence is given to written modification clauses by the courts in Alabama, Tennessee and Texas. In one recent opinion by the highest court in the state of Alabama, the general rule followed by these jurisdictions was stated as follows:

"Under Alabama law, a written agreement may be modified by a

1. For an up-to-date and complete analysis of an individual scenario, parties claiming or opposing a contract modification are well advised to seek the advice of counsel familiar with the particular jurisdiction's analysis!

subsequent oral agreement of the parties, unless some statutory provision provides otherwise...." ***This is so even where the contract contains a requirement that all modifications be in writing.*** [Emphasis added by author.]

So much for any attempt in these jurisdictions to limit the ability of your principal or rep to change the terms of your contract through vague oral agreements! It would not seem to be a great rule, as it sometimes makes things clear as mud; but this rule of law is founded upon ancient common law rules, and is still good law in these jurisdictions.[2]

Note — even in jurisdictions following this old rule, contracts which fall within the Statute of Frauds are not allowed to be modified orally. The Statute of Frauds is another ancient rule which requires that contracts, which by the very terms cannot be completed within one year, must be in writing. Consequently, any rep contracts which call for over a one-year appointment, with no allowance for termination before the expiration of one year, cannot be orally modified.[3]

Illinois

Illinois takes a diametrically different view toward oral modifications. In a recent case in this jurisdiction, a federal court applying Illinois law, and noting that the same law applies in Oregon, held that an Oregon commodities broker was forced to live by its written contract with several suppliers of the commodity it was selling to overseas purchasers, notwithstanding the plaintiff broker's allegation that it had entered a series of oral contracts which had been breached by the defendant suppliers subsequent to signing the written contract with the plaintiff.

The court disregarded the alleged oral contracts, and found for the defendant suppliers based upon the plain language of the earlier written contract. In so holding, the court stated:

"[Plaintiff] is thus bound by its written contracts with the defendants, and each of these contracts has an effective integration clause. This means that [Plaintiff] may not...stake its claim on any subsequent oral agreements, because the contracts each provide that their terms cannot be altered or amended except by agreement in writing signed by the duly authorized representatives of the parties...."

It is important to note that the court's decision was based largely on the fact that the parties had entered an "integrated" written contract. An integrated contract is one which states that the contract is meant by the parties to be the entire agreement between them and is complete in and of itself, or words to that effect.[4]

Nonetheless, proof of subsequent oral contracts, in the face of a valid written agreement, was not allowed by the court and the plaintiff's original written contract thus controlled the lawsuit. This type of decision would seem to be better policy in that it makes written contract terms the only binding terms, and thus forces parties to commit subsequent agreements to writing, where there can be no ambiguities and no one gets fooled into thinking their version of the contract will prevail. The only other alternative is to allow parties the "he said-she said" argument and see where the cards fall. Which approach would you, as a contracting party, rather be held to?

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Indiana

Indiana courts treat this issue similarly to Alabama, but add a slightly different analysis, which makes the rule a little more stringent on the party claiming modification. Instead of making a blanket allowance that subsequent oral contracts may act to modify earlier written agreements, the courts in Indiana require that the modification found in the subsequent oral contract be supported by new consideration.

2. In Alabama see, e.g. Cook's Pest Control v. Rebar (2002) 852 So. 2d 730 for full text. In Tennessee see, e.g. Galbreath v. Harris (1991) 811 SW2d 88. In Texas see, e.g. MAR-LAN Industries v. Nelson (1982) 635 SW2d 853.
3. See, e.g. Marlan v. Nelson, cited above, at page 855.
4. See International Marketing, Limited v. Archer-Daniels-Midland Co. (1999) 192 F.3d 724 for more information.

Louisiana and Georgia are states that allow written modification clauses to be completely disregarded, with a slight twist: the courts in these states will look not only at subsequent oral agreements, but also at the conduct of the parties in deciding what their contract terms are.

Unless you are extremely well informed on the law of contracts or possess a law degree, what the heck does "supported by new consideration" mean?

It means that just as in any contract, modifications which change the original terms of a written contract must be accompanied by some valuable term, in favor of the party who is having the written words they agreed to changed, if it is to be held valid![5]

An example would be if a principal orally informed its rep that the original written commission rate of 10 percent was going to be changed to seven percent, due to low margins. It would have to offer some other benefit to the rep (such as an expanded territory) if it wants the modified commission rate to be held valid in court.

At least this requires some give and take on the part of parties attempting to modify written contracts, rather than unilateral, force-it-down-your-throat contract changes for its own benefit.

Louisiana/Georgia

Louisiana and Georgia are states that allow written modification clauses to be completely disregarded, with a slight twist: the courts in these states will look not only at subsequent oral agreements, but also at the conduct of the parties in deciding what their contract terms are. This probably makes for even more confusion than relying strictly on a subsequent oral agreement of the parties, as conduct may not even be intentional while it could bring about a change in contract terms.

For example, the mere fact that a rep negotiates a commission check which was calculated at a rate less than that called for in the parties' written contract could result in a lowering of the contractual commission rate, via conduct, even though the rep might simply have had cash flow reasons for cashing or depositing the check, rather than rejecting it. Not a very certain and concrete policy, but allowed by certain courts to change key contract terms![6]

Ohio

In Ohio, the legislators apparently became very disillusioned with all this convoluted analysis regarding contracts by writing, oral statements, and conduct. They legislated and passed a state law that requires courts in the state to honor written modification clauses.

In Watkins & Sons Pet Supplies v. The Iams Co. (2001) 254 F.3d 607, a sales rep/distributor for the Iams pet food company was terminated after long-term representation pursuant to a written contract which contained a written modification clause. Watkins then filed suit and alleged that defendant Iams made oral promises that if Watkins became an exclusive Iams distributor (thus dropping the other lines he represented) that Iams would make Watkins its exclusive distributor in the state of Michigan.

Unfortunately for Watkins, but fortunately for logical thinking businesspeople, the court rejected his claim for damages and cited the Ohio statute, Ohio Revenue Code 1302.12(B), which states:

"A signed agreement which excludes modification...except by writing cannot be otherwise modified...."

Written modification clauses were thus looked at favorably enough for lawmakers in Ohio to pass a law upholding their validity!

Pennsylvania

The law on the topic in this state is very interesting in that, generally, integrated written contracts with written modification clauses are upheld as valid and binding by the state's courts. However, a very narrow exception

5. See, e.g. U.S. v. Stump Home Specialties Manufacturing, Inc. (1990) 905 F.2d 1117.

6. See, e.g. Taita Chemical v. Westlake Styrene (2001) 246 F. 3d 377, at page 387.

to this rule has been carved out in a line of cases hinging upon an early decision by the Pennsylvania Supreme Court which allowed oral modification of an integrated written contract containing a written modification clause; but only by a much higher level of proof than that normally required in civil matters.[7]

Consequently, courts in Pennsylvania may take liberties to add oral statements as contract terms when by the heightened level of proof stated in the rule, one party attempting to add or clarify terms proves that the oral agreements should be included.

South Carolina

This state follows the basic southern states' approach discussed in the analysis of Alabama, above. However, South Carolina adds one dimension before the courts will disregard written modification clauses: the alleged modification must have occurred before any breach of the contract by the party claiming modification.

The rule was espoused recently in Lee v. Thermal Engineering Corp. (2002) 572 S.E. 2d 298. A sales rep sued his principal after being terminated under a written contract and alleged that oral agreements were made to cover his commissions on engineered products along with non-engineered products, which were the only products the written contract stated were commissionable. Regarding the oral modification, the Court of Appeals stated:

"...by the rules of the common law, it is competent for the parties to a simple contract in writing ***before any breach***...to waive, dissolve, or abandon it, or vary or qualify its terms, and thus make a new one." A written contract may, in the absence of statutory provisions requiring a writing, be modified by a subsequent oral agreement. [Emphasis added by author.]

The court thus awarded the plaintiff rep, who was not accused of any breach, damages for the defendant's failure to compensate him with post-termination commissions on certain sales of engineered products. South Carolina thus created a more sensible version of the Alabama rule by requiring that no breach has first occurred by the party claiming modification before completely disregarding written modification clauses.

Consequently, this allowance will not find its place in a suit where the party claiming modification is found to have breached; but may be allowed in a law suit for damages where the party claiming modification is not alleged to have done wrong; as well as in actions for declaratory relief where one party is suing another for the court to declare what the terms of their contract are.

California/Hawaii/Nevada/ Oregon/Washington/ Montana/Idaho/Arizona

The Ninth Circuit Court of Appeals for the Federal Courts, which controls the law in the federal courts of the above referenced states, is another jurisdiction, like Illinois and Ohio, which upholds the validity of, and enforces, written modification clauses. Parties should check with local counsel, in the particular state, as to the validity of this precedent if the lawsuit is a State Court proceeding.

In a recent opinion concerning the effect of an alleged oral modification of an integrated written contract with a written modification clause, the court ruled in authoritative fashion on upholding such clauses. The Ninth Circuit thus held that:

"Faced with clear, unambiguous written agreements containing integration clauses and no-oral-

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7. See Nicolella v. Palmer (1968) 432 PA 502 which held that where a written contract contains an integration clause and a written modification clause, the party seeking to show subsequent oral modification must prove it by clear, precise and convincing evidence.

modification clauses, and in the absence of language acknowledging any supplemental agreements, we hold that the parol evidence rule bars introduction of evidence of an...oral agreement that directly contradicts a key term of the written contract."

The Ninth Circuit thus spoke loud and clear regarding the invalidity of certain oral agreements where an integrated written contract containing a written modification clause exists.[8]

ABOUT THE AUTHOR:

Scott M. Sanders, of Sanders & Montalto, LLP, became affiliated with MANA in 1990 and has continued to represent MANA members ever since. More members have benefited from his transactional and counseling work than from the firm's litigation services: the firm has prepared and even negotiated contracts for a more favorable principal-agent relationship and is especially attuned to the needs of the individual contractual relationship presented, which vary greatly by product, principal, customer base, and other factors; as well as to the budgetary constraints of most small rep firms.

When required, the firm has litigated breach of contract cases in several state and federal jurisdictions, including California, Texas, Florida, Georgia, Pennsylvania and New York. Sanders has over 94% success rate in this field since 1990, although he has settled a majority of the cases presented over the years without resort to a lawsuit.

The firm has its headquarters in Torrance, California, with satellite offices in Orange County and the San Fernando Valley, California, as well as a newly established New York office in Ulster County. Please feel free to contact Sanders at: (888) 225-3364; or (310) 916-3262; or visit the firm's web site at: www.sandersmontalto.com.

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Final General Warnings

There are two scenarios where contracts based on otherwise illegal oral modifications will be upheld by most courts:

- If the parties begin operating on oral agreements, thus changing written contract terms they originally agreed to, courts in almost all jurisdictions will consider this to be an "executory contract" and will allow the conduct to create a new contract.
- After the breach of a written contract, an accord can be reached orally whereby the parties enter a new contractual relationship, if they so intend, thus discharging the duties under the breached written contract.

Conclusion

Although you may need a legal degree to filter through all the divergent laws regarding modification, the truth is out there. Speak to a qualified attorney in your jurisdiction, or contact MANA for a referral if you are unsure. But by all means, do not just expect that the contract you entered years ago is still in effect, word for word, because you may be in for a big surprise!

Likewise, if events or terms have changed with the passage of time, be sure to prepare and execute a new written agreement which fairly reflects the new terms. If you fail to do this, understand that a judge will gladly frame the terms for you. □

8. For the full text of this case see Pace v. Honolulu Disposal Service (2000) 227 FedRptr 3d 1150.