47 Memorandum 69-32 1/20/69

Subject: Study 47 - Oral modification of a written contract

Resolution Chapter 202 of the Statutes of 1957 authorized the Commission to make a study to determine whether Civil Code Section 1698 should be repealed or revised. The study was described in 1 Cal. L. Revision Comm'n Reports, 1957 Report at 21 (1957) as follows:

> **Topic No. 10: A study to determine whether Civil Code Section 1698 should be repealed or revised.**
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> Section 1698 of the Civil Code, which provides that a contract in writing may be altered by a contract in writing or by an executed oral agreement and not otherwise, might be repealed. It frequently frustrates contractual intent. Moreover, two avoidance techniques have been developed by the courts which considerably limit its effectiveness.[64] One technique is to hold that a subsequent oral agreement modifying a written contract is effective because it is executed, and performance by one party only has been held sufficient to render the agreement executed.[65] The second technique is to hold that the subsequent oral agreement rescinded the original obligations[66] and substituted a new contract, that this is not an "alteration" of the written contract and, therefore, that Section 1698 is not applicable.[67] These techniques are not a satisfactory method of ameliorating the rule, however, because it is necessary to have a lawsuit to determine whether Section 1698 applies in a particular case.
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> If Section 1698 is to be retained, the question arises whether it should apply to all contracts in writing, whether or not required to be written by the statute of frauds or some other statute. It is presently held to apply to all contracts in writing[68] and is thus contrary to the common law rule and probably contrary to the rule in all other states. This interpretation has been criticized by both Williston and Corbin who suggest that the language is the result of an inaccurate attempt to codify the common law rule that contracts required to be in writing can only be modified by a writing.[69]

[64] See Note, 4 HASTINGS L.J. 58 (1952).
[65] D. L. Godbey & Sons Const. Co. v. Deane, 39 Cal.2d 429, 246 P.2d 946 (1952).
[66] Civil Code Section 1689 permits rescission of a contract by mutual assent.
[67] McClure v. Alberti, 190 Cal. 348, 212 Pac. 204 (1923) (rescission of executory written contract by oral agreement); Treadwell v. Nickel, 194 Cal. 243, 228 Pac. 25 (1924) (rescission of written contract by substituted oral contract).
[68] P. A. Smith Co. v. Muller, 201 Cal. 219, 256 Pac. 411 (1927).
[69] 2 CORBIN, CONTRACTS § 301 (1951); 6 WILLISTON, CONTRACTS § 1828 (Rev. ed. 1938).

The Uniform Commerical Code deals with this problem by requiring that a written contract may be altered by an oral agreement unless (1) the modified contract is required by the statute of frauds to be in writing or (2) the original contract requires that any alteration be in writing. This section of the Uniform Commercial Code was modified when the code was enacted in California. The modified version was based on the recommendations of Professors Harold Marsh, Jr., and William D. Warren , who prepared a report for the Senate Fact Finding Committee on Judiciary. This report, which was published in 1961, undertook to analyze the various sections of the Uniform Code which were in controversy and to report in detail thereon. The following extract from their report indicates the reason why the Uniform Commercial Code was modified in California to conform to a considerable extent to Civil Code Section 1698:

This Section [Section 2-209 of the Uniform Code] provides:

"(1) An agreement modifying a contract within this Article needs no consideration to be binding.

"(2) A signed agreement which excludes modification or rescission except by a signed writing cannot be otherwise modified or rescinded, but except as between merchants such a requirement on a form supplied by the merchant must be separately signed by the other party.

"(3) The requirements of the statute of frauds section of this Chapter (Section 12201) must be satisfied if the contract as modified is within its provisions.

"(4) Although an attempt at modification or rescission does not satisfy the requirements of subdivision (2) or (3) it can operate as a waiver.

"(5) A party who has made a waiver affecting an executory portion of the contract may retract the waiver by reasonable notification received by the other party that strict performance will be required of any term waived, unless the retraction would be unjust in view of a material change of position in reliance on the waiver."

Proposed Amendment. The State Bar Committee and the Credit Organizations Committee propose the deletion of this Section. This action would leave CC § 1698 in effect.

Recommendation. It is recommended that this section be amended to read as follows:

"(1) A written contract within this chapter may only be modified by a written agreement or by an oral agreement fully executed by both parties. An agreement modifying a contract within this chapter needs no consideration to be binding.

"(2) Although an attempt at modification or rescission does not satisfy the requirements of subdivision (1), it can operate as a waiver.

"(3) [Subdivision (5) of original section.]"

Discussion. The rule generally prevailing in the United States is that an unsealed contract, even though in writing, can be varied or rescinded by an oral agreement supported by consideration, provided the Statute of Frauds is complied with. 6 Corbin, Contracts (1951) § 1295. This was the California rule until adoption of CC § 1698 in 1872. This section states: "A contract in writing may be altered by a contract in writing, or by an executed oral agreement, and not otherwise."

No attempt will be made to summarize the innumerable cases interpreting CC § 1698. Suffice to say that § 1698 changes the common law rule for modifying a written contract by requiring either a written contract or an executed oral agreement. This rule applies even where the original writing did not come within the Statute of Frauds. The apparent purpose of the California statute is to remove written instruments from attack by means of supposedly less reliable parol evidence. If the oral agreement is executed, this is looked upon as sufficient proof of the modification.

The California courts have at times gone far in interpreting the statute to allow enforcement of oral modifications. In *Godbey & Sons v. Deane*, 39 Cal. 2d 429, 246 P. 2d 946 (1952, the court enforced an oral modification even though executed by only one party to the contract when the oral agreement was supported by new consideration.

Another means employed by some California courts has been to find that the original contract had expired before the oral agreement was made, hence, the oral agreement constituted a new contract not covered by § 1698. See *McKeon* v. *Guisto*, 44 Cal. 2d 152, 280 P. 2d 782 (1955).

This section of the Code changes the common law rule by allowing an agreement modifying a contract to be enforced without consideration. The reason for the change was set out by one writer in these terms: "Frequently, for good business reasons, the parties to a sales contract desire to modify it. Attempts at modification often are frustrated by the so-called 'pre-existing duty' rule of contract law. The pre-existing duty rule provides that neither the performance of a pre-existing duty nor the promise to perform a pre-existing duty is a sufficient consideration for a return promise. Suppose *S* has contracted to sell a quantity of tomatoes to *B* for $1,000. The bottom falls out of the tomato market prior to delivery of the tomatoes to *B*, and *B* asks *S* to reduce the price to $600. *S* thinks it would be good business to do so, and he promises *B* in writing that if *B* will go ahead with performance, *S* will reduce the price to $600. Later, *S* reneges on his promise and sues *B* for $1,000. In most states, the courts would enter a judgment for *S* in the amount of $1,000. They would hold that his promise to reduce the price to $600 was not supported by consideration, because *B's* promise to perform was a promise to perform a pre-existing duty—a promise to render a performance already required by a duty. Most modifications of sales contracts run afoul of the pre-existing duty rule, but there have been growing doubts as to the soundness and social wisdom of that rule, and this has influenced some courts in their actual decisions to evade it. Evasions take the form of rationalizations couched in terms of mutual rescission, waiver and gift. Section 2-209 ends the speciousness of pretending the pre-existing duty rule is consistently in force in states in which able judges long have been evading it, and it brings sense to the law of those states which have steadfastly clung to the pre-existing duty rule." Hawkland, Sales and Bulk Sales under the UCC (ALI 1955) 11.

The Code provision obviously would change the consideration requirement in California law and, in addition, would make an oral agreement an enforceable modification without the requirement that it be executed, unless the contract itself required the modification to be in writing.

California has long had the requirement that written contracts be modified only by another writing or by an executed oral agreement. Although this rule has been disapproved by some of the leading scholars, it has a defensible basis: that parties claiming modification of a contract must be able to prove the change by something other than parol. Opinions may differ on the merits of this rule, but it doubtless has beneficial effects in discouraging false claims of modifications. However, the unwarranted decision which held that "executed" may mean executed on only one side, according to the original terms of the agreement, should be corrected. *Godbey & Sons* v. *Deane, supra.* This type of "execution" obviously furnishes no reliable evidence that the modification was actually agreed upon.

On the other hand, California would do well to follow the lead of this Section in abrogating the consideration requirement of CC § 1698.

The relinquishment of old obligations and taking up of new ones under a modification agreement will normally constitute consideration, but the pre-existing duty cases remain to haunt us. There is no valid reason why two parties to a written contract should not be able to set forth in writing a binding modification of that agreement, even though the pre-existing-duty concept would preclude a holding that consideration in a technical sense was present.

The recommendation regarding subsection (1) constitutes only a minor change in the present California law. The principal change is that a written modification now rendered ineffective by the anachronistic pre-existing-duty doctrine is made enforceable by the recommended amendment. The fully executed oral agreement has never needed consideration to be binding in California under § 1698 and none is required under the recommended amendment. In addition, it is made clear that "executed" means executed on both sides, which, in our opinion, is necessary if this provision is to prevent the enforcement of any oral modifications.

The California rule on the point covered in subsection (2) is set forth in *Miller* v. *Brown*, 136 Cal. App. 2d 762, 289 P.2d 572 (1955): "But under Section 1698 of the Civil Code, an executed oral agreement may alter an agreement in writing, even though, as here, the original contract provides that all changes must be approved in writing. This is so because the executed oral agreement may alter or modify that provision of the contract as well as other portions." Subsection (2) would abrogate this rule and substitute the New York rule allowing parties to provide in a written contract that it can only be modified or rescinded in writing. To insure that a consumer who signs a form contract supplied by a merchant containing such a provision is aware of this clause, he must separately sign the form. Presumably, this means that the clause must be set apart from the remainder of the contract and subscribed by the consumer.

The adoption of the New York rule is unnecessary in view of the requirements of subsection (1) as recommended above. If an oral modification is fully executed on both sides, even a clause in the contract outlawing oral modifications should not permit a party to recover what he has already paid over. In any event, the requirement of a second signature by a consumer is a useless formality.

Subsection (3) of the original section becomes unnecessary in view of the recommended provisions of subsection (1).

Under subsections (2) and (3) [(4) and (5) of the original text], "the party relying upon the contract as altered by the parties' action during performance . . . will be successful if it is shown that nonperformance of the contract as written was induced, caused by, or in reliance upon the other's words and deeds . . . Obviously, a modification agreement can induce the degree of reliance necessary to avoid the rule that the parol modification is invalid." Texas Legislative Council, Analyses of Article 2 (1953) 47-48.

California authorities expressly recognize the doctrine of waiver as an ameliorating factor in cases falling within CC § 1698. In *Panno* v. *Russo*, 82 Cal. App. 2d. 408, 186 P. 2d 452 (1947), the court stated: "It is well settled that the rule against varying the terms of a written instrument by parol or seeking to alter a contract in writing other than by a contract in writing or an executed oral agreement, is subject to the exception that a party to a contract may by conduct or representations waive the performance of a condition thereof or be held estopped by such conduct or representations to deny that he has waived such performance." See also *Bidegary* v. *Ormaca*, 48 Cal. App. 665, 192 Pac. 176 (1920). Since the reason for the rule permitting waiver in contracts within the Statute is to prevent loss through reliance, it follows that the waiver may be retracted before there has been a serious change of position.

Mr. Cook of our legal staff has devoted several months to a study of whether Civil Code Section 1698 should be repealed or revised. However, before an effort is made to prepare a background research study that would be suitable for publication, the staff seeks to obtain the views of the Commission on whether this topic is one that merits study.

There are a number of alternatives:

(1) Make no changes in Section 1698, reporting to the Legislature that the policy embodied in that section was recently reviewed and found generally satisfactory when the Uniform Commerical Code was enacted in California after being modified to conform generally to Civil Code Section 1698.

(2) Retain the substance of Section 1698 but provide that an agreement modifying a contract needs no consideration to be binding. See discussion in Marsh-Warren report.

(3) Repeal Section 1698 on the grounds that it has generated more legislation than it has avoided and has served as a trap for unwary parties to contracts. If this is the choice, the California section of the Uniform Commercial Code probably should be conformed to the official text.

(4) Revise Section 1698 to adopt the substance of the official text of the Uniform Commercial Code provision and revise the California version of the Uniform Commercial Code to conform to the official text.

As to the feasibility of alternatives (3) and (4), see the letter from Professor Marsh (Exhibit I--attached).

Respectfully submitted,

John H. DeMoully
Executive Secretary

UNIVERSITY OF CALIFORNIA, LOS ANGELES

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SCHOOL OF LAW
LOS ANGELES, CALIFORNIA 90024

January 16, 1969

Mr. John H. DeMoully
California Law Revision Commission
School of Law, Stanford University
Stanford, California 94305

Dear John:

In reply to your letter of January 7, 1969 relating to Section 2-209 of the Uniform Commercial Code, my recollection is that the change made in the California statute from the official text was the result of a recommendation made by the State Bar Committee studying the UCC and specifically the subcommittee of that committee which was appointed to review the provisions in Article 2. The comment on this recommendation in our report to the Senate Judiciary Committee was actually prepared by Bill Warren and not by myself, although I concurred in it.

The primary basis for our recommendation as I recall was our belief that requiring the insertion of separate clauses in a contract to be signed separately, as under the New York statute which was essentially copied into the official text of the UCC, is a procedure which has very little to recommend it and merely results in all standard forms incorporating this additional clause. Furthermore, it was our belief that requiring a party to sign or initial a half dozen different printed clauses accomplishes nothing whatever since if he is ready to sign the basic contract he will sign any other number of times that the salesman directs him to. The result is that only where by accident the merchant has failed to get the necessary additional signature does this provision have any meaning, and this does not seem to be a reasonable basis on which to legislate regarding the rights of the parties.

I do not believe that it was any strong feeling about this matter when the code was originally considered, and I would think that there is at least a reasonable chance that no serious opposition would be aroused by a proposal to conform this section into the California code to the official text. However, there is certainly a possibility that the State Bar Committee would again object to the provisions of the official text and also I would imagine a possibility that persons representing retail merchants might finally have become fed up with separate clauses to be signed separately and therefore oppose the change.

My own personal reaction is that the California section is superior but this has to be weighed against the benefits of uniformity, and I would certainly not oppose reverting in this instance to the language of the official text.

Sincerely yours,

Harold

Harold Marsh, Jr.

HM:jr