#47 1/25/74

First Supplement to Memorandum 74-6

Subject: Study 47 - Oral Modification of Written Contract

We attach further background information concerning oral modification of written contracts.

The yellow sheets are the discussion of this matter from Witkin's Summary of California Law. As you will note from reading the Witkin discussion, there are a number of ways the no-oral-modification rule can be avoided under existing law:

(1) An oral novation, which completely abrogates and extinguishes the old contract, and substitutes a new agreement, is valid. Whether the oral agreement constitutes a modification of the written contract or termination of the written contract and substitution of the oral contract is a question of fact that depends on the intent of the parties at the time of the oral agreement. Accordingly, the enforceability of an oral agreement that is inconsistent with a prior written contract can be determined only through a lawsuit. As a result, Section 1698 has generated a great deal of litigation.

(2) The no-oral-modification rule does not bar the making and enforcement of collateral oral contracts that are not inconsistent with the prior written contract although they deal with the same subject matter. This rule also has been applied where the collateral oral contract attempted to resolve an ambiguity in the written contract.

(3) Where the oral modification is completely performed on both sides, the no-oral-modification rule does not apply. For example, where the parties to a lease agree to reduce the rent and the lessee pays and the lessor accepts the reduced rent, the lessor cannot recover the balance of the rent for the period during which he accepted the reduced rent.

(4) The doctrine of equitable estoppel applies when a party has materially changed his position in reliance on an oral agreement in some way other than by performing pursuant to the agreement.

(5) In some situations, the oral modification may be upheld as a waiver of condition.

(6) Godbey & Sons Constr. Co. v. Deane allows enforcement of oral modifications supported by consideration when performed by one party. The background study (attached to the basic memorandum) takes the view that the Godbey case involved an oral modification that was fully performed by one party, and the performance was, in part, referable to the alleged agreement. The writer takes the view that the Godbey case did not involve enforcement of an oral modification where none of the performing party's performance is referable to the oral modification. Most writers (Witkin included) do not read the Godbey case as one where the performance of the party seeking to enforce the oral modification was referrable or "unequivocally referable" to the modification. You should read the Godbey case. The case is attached (pink sheets).

Considering the state of the law as set out above, it is not surprising that Section 1698 has generated a good deal of litigation. The writer of the article takes the view that the Godbey case has avoided the need for litigation since the rules are now well established. The staff submits that this is not an accurate analysis of the situation; probably the reduced volume of appellate legislation in this area is the result of the fact that most persons view the Godbey decision as holding that full performance of the agreement as modified by the party seeking to enforce the agreement is sufficient. The staff believes that a clear statutory statement of an appropriate rule would be desirable. On the other hand, the Commission may determine that a rule that is so riddled by exceptions is not worthy of retention.

For your information, we also attach a copy of Section 89D of the Restatement of Contracts (2d - tentative draft), dealing with when a promise modifying a duty under an executory contract is enforceable. This should be compared with the Commercial Code provision. Unfortunately the drafters of the Restatement of Contracts (2d) have not yet reached the subject of modification and termination of contracts.

Respectfully submitted,

John H. DeMoully
Executive Secretary

H. Modification or Alteration.

1. [§715] In General.

Modification (or "alteration," as it is called in C.C. 1697 and 1698) is a change in the obligation by a modifying agreement, which requires mutual assent, and must ordinarily be supported by consideration. (*Harvey v. DeGarmo* (1933) 129 C.A. 487, 492, 18 P.2d 971; *American Bldg. etc. Co. v. Ind. Ins. Co.* (1932) 214 C. 608, 615, 7 P.2d 305; 1954 A.S. 429; see 47 Cal. L. Rev. 92; 12 Hastings L. J. 390; 23 Hastings L. J. 1549; 6 Corbin §1293 et seq.; 17 Am.Jur.2d, Contracts §465 et seq.)

There are, however, several exceptions to the requirement of consideration:

First, errors in a contract may be corrected, and omissions supplied, without a new consideration. So where an exclusive agency to sell petroleum products was given to defendant, which did not specify the discount on a new type of gasoline, a modification statifg the discount was binding. In such a situation the consideration for the original contract supports the agreement as modified. (*Texas Co. v. Todd* (1937) 19 C.A.2d 174, 185, 64 P.2d 1180.)

Second, an *executed contract* cannot be attacked for lack of consideration, and the same is true of a modifying agreement. Thus, a modification of a lease by reduction of rent was held binding as to all rent received at the reduced figure, on the theory that the contract was executed as to those payments. (*Julian v. Gold* (1931) 214 C. 74, 79, 3 P.2d 1009; see 20 Cal. L. Rev. 552; 5 So. Cal. L. Rev. 245.)

Third, a *contract not in writing* may be altered *in writing* without a new consideration. (C.C. 1697; see 47 Cal. L. Rev. 92.)

Fourth, a *contract for the sale of goods* may be modified without consideration: "An agreement modifying a contract within this division needs no consideration to be binding." (U.C.C. 2209(1); see 1963 A.S. 337.)

2. Oral Modification of Written Contract.

(a) [§716] Rule Against Modification.

C.C. 1698 provides: "A contract in writing may be altered by a contract in writing, or by an executed oral agreement, and not otherwise." In other words, if the original contract was written, regardless of whether or not it was of a type within the statute of frauds; the modifying agreement must ordinarily comply with two requirements: It must have consideration (supra, §715), and it must be *written.* (*Smith v. Parlier Winery* (1935) 7 C.A.2d 357, 359, 46 P.2d 170; *Harvey v. DeGarmo* (1933) 129 C.A. 487, 492, 18 P.2d 971; *Walther v. Occidental Life Ins. Co.* (1940) 40 C.A.2d 160, 163, 104 P.2d 551; *Battaglia v. Winchester Dried Fruit Co.* (1939) 32 C.A.2d 436, 90 P.2d 111; see 12 Hastings L. J. 391; 23 Hastings L. J. 1549; 15 Williston 3d §1828; 17 A.L.R. 10; 29 A.L.R. 1095; 80 A.L.R. 539; 118 A.L.R. 1511; on the rule

as applied to sales of goods, see U.C.C. 2209(2) [similar to C.C. 1698, supra]; U.C.C. 2209(4) [ineffective modification may operate as waiver]; *Sales*, §37.)

This writing requirement of C.C. 1698 has been criticized as unsound (see 44 Cal. L. Rev. 158; 4 Hastings L. J. 59), and is subject to exceptions (see infra, §§717, 718).

(b) Exception: Executed Oral Agreement.

(1) [§717] Agreement Fully Performed.

C.C. 1698 states that an *executed oral agreement* may alter a written contract. (See *Julian v. Gold* (1931) 214 C. 74, 76, 3 P.2d 1009; *Taylor v. Taylor* (1940) 39 C.A.2d 518, 521, 103 P.2d 575; *Fuller v. Mann* (1932) 119 C.A. 568, 573, 6 P.2d 999; *Estate of Morrison* (1945) 68 C.A.2d 280, 285, 156 P.2d 473; *Keeble v. Brown* (1954) 123 C.A.2d 126, 129, 266 P.2d 569; *Eluschuk v. Chemical Engineers Termite Control* (1966) 246 C.A.2d 463, 469, 471, 54 C.R. 711; 12 Hastings L. J. 391; 13 Stanf. L. Rev. 828; 51 Cal. L. Rev. 1000; 23 Hastings L. J. 1554; U.C.C. 2209, supra, §716.)

Thus, an oral cancellation or rescission is not objectionable, for it is an executed agreement to discharge the contract. (*Treadwell v. Nickel* (1924) 194 C. 243, 258, 228 P. 25; see *Mundt v. Conn. Gen. Life Ins. Co.* (1939) 35 C.A.2d 416, 418, 95 P.2d 966 [property settlement agreement between husband and wife cancelled by oral agreement for reconciliation followed by cohabitation]; *Grant v. The Aerodraulics Co.* (1949) 91 C.A.2d 68, 74, 204 P.2d 683.)

Similarly, an oral *novation*, which completely abrogates and extinguishes the old contract and substitutes a new agreement, is valid. C.C. 1698 has no application to a novation, and an oral novation may extinguish a written agreement. (*Pearsall v. Henry* (1908) 153 C. 314, 95 P. 154, 159; *Klein Norton Co. v. Cohen* (1930) 107 C.A. 325, 331, 290 P. 613; *McKeon v. Giusto* (1955) 44 C.2d 152, 156, 280 P.2d 782; *Bush v. Vernon* (1955) 135 C.A.2d 33, 37, 286 P.2d 903; see 44 Cal. L. Rev. 158; supra, §712.)

(2) [§718] Agreement Performed on One Side.

Ordinarily an executed oral agreement is one fully performed on *both sides*. (See supra, §9.) But in *Godbey & Sons Const. Co. v. Deane* (1952) 39 C.2d 429, 433, 246 P.2d 946, decided on demurrer, defendant under a written contract agreed to pay plaintiff for cement work at a certain rate per cubic foot. Before performance began both parties

thought the payment provision ambiguous, and orally modified it. Plaintiff furnished cement under the modifying agreement but defendant refused to pay the increased amount due. *Held*, the complaint was sufficient; where, as here, there was consideration for the oral modification, execution by the party relying on the modification is enough. (See 40 Cal. L. Rev. 599; 4 Hastings L. J. 59; 23 Hastings L. J. 1559.)

The *Godbey* decision greatly liberalizes the exception to C.C. 1698, and has been criticized as a dangerous undermining of the protection against fraud which the statute was designed to afford. (See dissent, 39 C.2d 434; 40 Cal. L. Rev. 601, 602.) It has also been pointed out that, in the prior cases involving execution on one side only, the modification called for a markedly different kind of performance. In the instant case plaintiff performed the same work; the consideration was merely the substitution of the new obligations of both parties under the modifying agreement; hence the claim of increased compensation would rest entirely on oral evidence. (See 40 Cal. L. Rev. 601.)

Despite these criticisms, the *Godbey* rule has been consistently followed. (See *Healy v. Brewster* (1967) 251 C.A.2d 541, 551, 59 C.R. 752; *Weber v. Jorgensen* (1971) 16 C.A.3d 74, 81, 93 C.R. 668.) But it is inapplicable to contracts for sale of goods: U.C.C. 2209(2) permits modification of a written agreement for the sale of goods by an oral agreement only if it is "fully executed by both parties." (See *Weber v. Jorgensen*, supra, 16 C.A.3d 81.)

(c) [§719] Distinctions.

(1) *Independent Collateral Contract.* An invalid modification must be distinguished from a new and valid *independent contract.* (See *Lacy Mfg. Co. v. Gold Crown Min. Co.* (1942) 52 C.A.2d 568, 577, 126 P.2d 644 [independent contract upheld].) In *Walther v. Occidental Life Ins. Co.* (1940) 40 C.A.2d 160, 104 P.2d 551, the court applied the strict and somewhat questionable test based on the *subject matter.* Plaintiff was employed by written contracts to sell life, accident and health insurance, and later an oral agreement was made authorizing him to sell "group insurance." In denying recovery for commissions under the latter authorization, the court said that group insurance was a form of life insurance and therefore was a subject within the scope of the original contract; consequently the oral agreement was not independent, but an attempted oral modification of the original contract. (40 C.A.2d 164.)

(2) *Waiver of Condition.* In some situations the modification may be upheld as a *waiver of condition.* (See *Bardeen v. Commander Oil Co.* (1940) 40 C.A.2d 341, 347, 104 P.2d 875; supra, §593.) But in *Battaglia v. Winchester Dried Fruit Co.* (1939) 32 C.A.2d 436, 90 P.2d 111, plaintiff seller relied upon an oral agreement to extend time for performance, which was properly held invalid under C.C. 1698. The court rejected the contention that it was a waiver of condition, because no pleading, proof or finding had been made on that theory.

(3) *Estoppel.* A few decisions, viewing C.C. 1698 as a statute of frauds, have held a party estopped by his representations to set up the defense against the other party who relied on them. (See *Wade v. Markwell & Co.* (1953) 118 C.A.2d 410, 421, 258 P.2d 497; *Wagner v. Shapona* (1954) 123 C.A.2d 451, 456, 267 P.2d 378.) 603-604

§ 89D. Modification of Executory Contract

A promise modifying a duty under a contract not fully performed on either side is binding

(a) if the modification is fair and equitable in view of circumstances not anticipated by the parties when the contract was made; or

(b) to the extent provided by statute; or

(c) to the extent that justice requires enforcement in view of material change of position in reliance on the promise.

Comment:

a. Rationale. This Section relates primarily to adjustments in on-going transactions. Like offers and guaranties, such adjustments are ancillary to exchanges and have some of the same presumptive utility. See §§ 76, 89B, 89C. Indeed, paragraph (a) deals with bargains which are without consideration only because of the rule that performance of a legal duty to the promisor is not consideration. See § 76A. This Section is also related to § 88 on waiver of conditions: it may apply to cases in which § 88 is inapplicable because a condition is material to the exchange or risk. As in cases governed by § 88, relation to a bargain tends to satisfy the cautionary and channeling functions of legal formalities. See Comment *c* to § 76. The Statute of Frauds may prevent enforcement in the absence of reliance. See §§ 223–224. Otherwise formal requirements are at a minimum.

b. Performance of legal duty. The rule of § 76A finds its modern justification in cases of promises made by mistake or induced by unfair pressure. Its application to cases where those elements are absent has been much criticized and is avoided if paragraph (a) of this Section is applicable. The limitation to a modification which is "fair and equitable" goes beyond absence of coercion and requires an objectively demonstrable reason for seeking a modification. Compare Uniform Commercial Code § 2–209 Comment. The reason for modification must rest in circumstances not "anticipated" as part of the context in which the contract was made, but a frustrating event may be unanticipated for this purpose if it was not adequately covered, even though it was foreseen as a remote possibility. When such a reason is present, the relative financial strength of the parties, the formality with which the modification is made, the extent to which it is performed or relied on and other circumstances may be relevant to show or negate imposition or unfair surprise.

The same result called for by paragraph (a) is sometimes reached on the ground that the original contract was "rescinded" by mutual agreement and that new promises were then made which furnished consideration for each other. That theory is rejected here because it is fictitious when the "rescission" and new agreement are simultaneous, and because if logically carried out it might uphold unfair and inequitable modifications.

Illustrations:

1. By a written contract A agrees to excavate a cellar for B for a stated price. Solid rock is unexpectedly encountered and A so notifies B. A and B then orally agree that A will remove the rock at a unit price which is reasonable but nine times that used in computing the original price, and A completes the job. B is bound to pay the increased amount.

2. A contracts with B to supply for $300 a laundry chute for a building B has contracted to build for the Government for $150,000. Later A discovers that he made an error as to the type of material to be used and should have bid $1,200. A offers to supply the chute for $1000, eliminating overhead and profit. After ascertaining that other suppliers would charge more, B agrees. The new agreement is binding.

3. A is employed by B as a designer of coats at $90 a week for a year beginning November 1 under a written contract executed September 1. A is offered $115 a week by another employer and so informs B. A and B then agree that A will be paid $100 a week and in October execute a new written contract to that effect, simultaneously tearing up the prior contract. The new contract is binding.

4. A contracts to manufacture and sell to B 2,000 steel roofs for corn cribs at $60. Before A begins manufacture a threat of a nationwide steel strike raises the cost of steel about $10 per roof, and A and B agree orally to increase the price to $70 per roof. A thereafter manufactures and delivers 1700 of the roofs, and B pays for 1,500 of them at the increased price without protest, increasing the selling price of the corn cribs by $10. The new agreement is binding.

5. A contracts to manufacture and sell to B 100,000 castings for lawn mowers at 50 cents each. After partial delivery and after B has contracted to sell a substantial number of lawn mowers at a fixed price, A notifies B that

increased metal costs require that the price be increased to 75 cents. Substitute castings are available at 55 cents, but only after several months delay. B protests but is forced to agree to the new price to keep its plant in operation. The modification is not binding.

c. Statutes. Uniform Commercial Code § 2–209 dispenses with the requirement of consideration for an agreement modifying a contract for the sale of goods. Under that section the original contract can provide against oral modification, and the requirements of the Statute of Frauds must be met if the contract as modified is within its provisions; but an ineffective modification can operate as a waiver. The Comment indicates that extortion of a modification without legitimate commercial reason is ineffective as a violation of the duty of good faith imposed by the Code. A similar limitation may be applicable under statutes which give effect to a signed writing as a substitute for the seal, or under statutes which give effect to acceptance by the promisee of the modified performance. In some States statutes or constitutional provisions flatly forbid the payment of extra compensation to Government contractors.

d. Reliance. Paragraph (c) states the application of § 90 to modification of an executory contract in language adapted from Uniform Commercial Code § 2–209. Even though the promise is not binding when made, it may become binding in whole or in part by reason of action or forbearance by the promisee or third persons in reliance on it. In some cases the result can be viewed as based either on estoppel to contradict a representation of fact or on reliance on a promise. Ordinarily reliance by the promisee is reasonably foreseeable and makes the modification binding with respect to performance by the promisee under it and any return performance owed by the promisor. But as under § 88 the original terms can be reinstated for the future by reasonable notification received by the promisee unless reinstatement would be unjust in view of a change of position on his part. Compare Uniform Commercial Code § 2–209(5).

Illustrations:

6. A defaults in payment of a premium on a life insurance policy issued by B, an insurance company. Pursuant to the terms of the policy, B notifies A of the lapse of the policy and undertakes to continue the insurance until a specified future date, but by mistake specifies a date two months later than the insured would be entitled to under the policy. On inquiry by A two years later, B repeats the mistake, offering A an option to take a cash payment. A fails

to do so, and dies one month before the specified date. B is bound to pay the insurance.

7. A is the lessee of an apartment house under a 99-year lease from B at a rent of $10,000 per year. Because of war conditions many of the apartments become vacant, and in order to enable A to stay in business B agrees to reduce the rent to $5,000. The reduced rent is paid for five years. The war being over, the apartments are then fully rented, and B notifies A that the full rent called for by the lease must be paid. A is bound to pay the full rent only from a reasonable time after the receipt of the notification.

8. A contracts with B to carry a shipment of fish under refrigeration. During the short first leg of the voyage the refrigeration equipment on the ship breaks down, and A offers either to continue under ventilation or to hold the cargo at the first port for later shipment. B agrees to shipment under ventilation but later changes his mind. A receives notification of the change before he has changed his position. A is bound to ship under refrigeration.

REPORTER'S NOTE

The section is new. See Fuller, Consideration and Form, 41 Colum.L.Rev. 799, 818 (1941); Patterson, An Apology for Consideration, 58 Colum.L.Rev. 929, 936–938 (1958); 1 Williston, Contracts §§ 130–130A (3d ed. 1957); 1A Corbin, Contracts §§ 182–186 (1963).

Comment b. See Note, 12 A.L.R.2d 78 (1950). Illustration 1 is based on Robert G. Watkins & Son, Inc. v. Carrig, 91 N.H. 459, 21 A.2d 591 (1941); cf. Pittsburgh Testing Laboratory v. Farnsworth & Chambers, Inc., 251 F.2d 77 (10th Cir. 1958); see United States v. I. B. Miller, Inc., 81 F.2d 8 (2d Cir. 1936); Notes, 25 A.L.R. 1450 (1923), 55 A.L.R. 1333 (1928), 138 A.L.R. 136 (1942). Compare Illustration 8 to § 76 of the original Restatement. Illustration 2 is based on Lange v. United States, 120 F.2d 886 (4th Cir. 1941). Illustration 3 is based on Schwartzreich v. Bauman-Basch, Inc., 231 N.Y. 196, 131 N.E. 887 (1921), cf. De Pova v. Camden Forge Co., 254 F.2d 248 (3d Cir. 1958), cert. denied 358 U.S. 816. Illustration 4 is based on Siebring Mfg. Co. v. Carlson Hybrid Corn Co., 246 Iowa 923, 70 N.W.2d 149 (1955); cf. M. W. Zack Co. v. R. D. Werner Co., 222 F.2d 634 (6th Cir. 1955); San Gabriel Valley Ready-Mixt v. Casillas, 142 Cal.App.2d 137, 298 P.2d 76 (1956); Swartz v. Lieberman, 323 Mass. 109, 80 N.E.2d 5 (1948). Illustration 5 is based on Rexite Casting Co. v. Midwest Mower Corp., 267 S.W.2d 327 (Mo. App.1954).

Comment c. See Uniform Written Obligations Act, 33 Pa. St. § 6 (Purdon 1957); Mass.G.L. c. 4, § 9A; New York General Obligations Law § 5–1103; Notes, 47 Colum.L.Rev. 431, 442–443 (1947), 46 Mich.L.Rev. 58, 61–65

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(1947). For a constitutional prohibition of additional compensation for Government contractors, see McGovern v. New York, 234 N.Y. 377, 138 N.E. 26 (1923); Kizior v. St. Joseph, 329 S.W.2d 605 (Mo.1959).

Comment d. See Fuller, The Reliance Interest in Contract Damages, 46 Yale L.J. 52, 401–406 (1936-1937). Illustration 6 is based on Hetchler v. American Life Ins. Co., 266 Mich. 608, 254 N.W. 221 (1934). Illustration 7 is based on Central London Property Trust, Ltd. v. High Trees House, Ltd., [1947] K.B. 130; cf. Tool Metal Co. v. Tungsten Electric Co., [1955] 2 All Eng.R. 657 (H.L.); McKenzie v. Harrison, 120 N.Y. 260, 24 N.E. 458 (1890); Liebreich v. Tyler State Bank & Trust Co., 100 S.W.2d 152 (Tex. Civ.App.1936) (depression), 50 Harv.L.Rev. 1314. But cf. Levine v. Blumenthal, 117 N.J.L. 23, 186 Atl. 457 (1936), affirmed 117 N.J.L. 426, 189 Atl. 54. Illustration 8 is based on Atlantic Fish Co. v. Dollar S.S. Line, 205 Cal. 65, 269 Pac. 926 (1928).