#79 6/24/77

Memorandum 77-42

Subject: Study 79 - Parol Evidence Rule

Background

At the June 1977 meeting, the Commission requested the staff to prepare a memorandum investigating the possibility of codifying Commercial Code Section 2202 as a general contract provision. Commercial Code Section 2202 provides:

> 2202. Terms with respect to which the confirmatory memoranda of the parties agree or which are otherwise set forth in a writing intended by the parties as a final expression of their agreement with respect to such terms as are included therein may not be contradicted by evidence of any prior agreement or of a contemporaneous oral agreement but may be explained or supplemented
>
> (a) By course of dealing or usage of trade (section 1205) or by course of performance (Section 2208); and
>
> (b) By evidence of consistent additional terms unless the court finds the writing to have been intended also as a complete and exclusive statement of the terms of the agreement.

Analysis of UCC Rule

Section 2202 is not the best-drafted statement of the parol evidence rule we have seen. For clarity and purposes of analysis, we will recast it as follows:

> The terms of an agreement set forth in a writing that is intended by the parties as a final expression of their agreement with respect to those terms:
>
> (a) May not be contradicted by either of the following:
>
> (1) Evidence of any prior agreement.
>
> (2) Evidence of a contemporaneous oral agreement.
>
> (b) May be explained or supplemented by either of the following:
>
> (1) Course of dealing, usage of trade, or course of performance.
>
> (2) Evidence of consistent additional terms, unless the court finds the writing to have been intended also as a complee and exclusive statement of the terms of the agreement.

As thus recast, a number of aspects of the UCC rule become immediately apparent.

Consistent additional terms. The most obvious aspect is its liberalization of the traditional parol evidence rule by providing that the fact that an agreement is intended as final with respect to some of its terms does not preclude evidence of other terms. The Official Comment makes this clear--"This section definitely rejects any assumption that because a writing has been worked out which is final on some matters, it is to be taken as including all the matters agreed upon." In fact, the UCC permits evidence of consistent additional terms except where the court finds that, in addition to being intended as final, the writing is also intended as a complete and exclusive statement of the terms. The Official Comment supplements this subjective rule with the objective note that, "If the additional terms are such that, if agreed upon, they would certainly have been included in the document in the view of the court, then evidence of their alleged making must be kept from the trier of fact."

Contradictory contemporaneous written agreement. A second aspect of the UCC rule is that, while it does not generally permit evidence of a prior or contemporaneous collateral agreement that contradicts the terms of a writing, it does permit evidence of a contemporaneous written agreement. This liberalization seems appropriate but does not help the consumer much, who frequently attempts to rely on a contemporaneous oral agreement.

Interpretation. Another aspect of the UCC rule is that it deals with questions of interpretation as well as with parol evidence problems. It permits evidence to "explain" as well as to supplement the final terms of an agreement. It permits such evidence without the necessity of a court finding that the language is ambiguous. The Official Comment notes this point, stating that the section "definitely rejects the requirement that a condition precedent to the admissibility" of this type of evidence "is an original determination by the court that the language used is ambiguous."

Court determination of issues. Another aspect worth noting at this time is that, whether the court or jury makes the finding that the terms of an agreement are intended as "final," is not clear. The court is specifically assigned only the issue of whether the writing is "complete

and exclusive." The staff has been unable to find a case in point either in California or in other jurisdictions that have adopted the UCC. At least one commentator believes finality is a question for the court:

> The Code does not say that this question is for the judge, but if "completeness and exclusivity" is for the judge, then whether a writing is a final written expression as to the terms it does include would be for the judge, for the greater ordinarily includes the lesser. [J. White & R. Summers, Handbook of the Law Under the Uniform Commercial Code § 2-9 at pp. 67-68 (1972).]

Course of dealing and usage of trade. A final aspect of the UCC rule is that it makes explicit that the terms of a writing may be both supplemented (parol evidence) and explained (interpretation) by course of dealing, usage of trade, and course of performance. While these evidentiary facts are not "collateral agreements" as such, they arguably fall within the ban of the parol evidence rule since they are extrinsic evidence of the intent of the parties. These factors have been used as aids to interpretation by the California courts, sometimes on rather slim statutory authority. See discussion in 1 B. Witkin, Summary of the California Law, Contracts §§ 527, 534 (8th ed. 1973).

Comparison of UCC Rule With Existing California Law

The foregoing analysis reveals that the UCC rule is remarkably close to existing California law, as laid out in Justice Jefferson's benchbook statement attached to Memorandum 77-39. This is not surprising since Chief Justice Traynor in Masterson v. Sine, 68 Cal.2d 222, 436 P.2d 561, 65 Cal. Rptr. 545 (1968), draws upon Commercial Code Section 2202. See 68 Cal.2d at 228.

Under both Commercial Code Section 2202 and California law generally, whether the agreement is integrated is a question for the judge to determine; if the agreement is integrated, there can be no evidence of a collateral agreement; if the agreement is not integrated, there can be evidence of a collateral agreement that does not contradict the writing; and, regardless of integration, evidence may be introduced to resolve ambiguities. The main differences between Commercial Code Section 2202 and California law generally are (1) that the UCC makes clear that the

parol evidence rule does not exclude a contradictory written agreement that is contemporaneous with the writing, and (2) the UCC makes explicit that course of dealing, usage of trade, and course of performance may be used both to supplement and explain the terms of the agreement.

Problems in Adopting UCC Rule

There are a number of obstacles to adopting Commercial Code Section 2202 as a rule of general contract law. The Commercial Code provision uses specially defined terminology, makes internal references to other provisions of the Commercial Code, and is interrelated with other provisions of the Commercial Code (such as Section 1103, which preserves the law of fraud and mistake, and Section 2316, which provides for exclusion or modification of warranties). The Commercial Code provision is not found wholly in the statute since an important part of its meaning resides in the Official Comment; it was for this reason that the New York Law Revision Commission, in its study of the Uniform Commercial Code, recommended codification of language based on Comment 3 in the rule. The draftsmanship of the UCC provision lacks clarity and is confusing. The UCC provision fails to make clear that the doctrine of reformation and other principles of contract law and contract interpretation are preserved.

These obstacles are not insuperable; they merely mean that we could not incorporate the UCC provision by reference or duplicate it. We would have to redraft the provision to make one that is comparable but adequate as a general principle of contract law. This would amount to something close to a codification of existing California law.

Conclusion

While the staff sees a number of problems in adopting the UCC version of the parol evidence rule, we believe the problems are manageable. The attached draft of a tentative recommendation relating to the parol evidence rule represents the staff's effort to adapt the UCC provision. The staff believes we should obtain permission to include Professor Sweet's article as a background study since it effectively discusses the reasons for the parol evidence rule and the policies behind its liberalization.

In this connection, the Commission may be interested to learn that we have been in communication with the Law Commission of England which has a tentative recommendation to repeal the parol evidence rule; they report that the reaction so far has been favorable.

Respectfully submitted,

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#79 6/27/77

STAFF DRAFT

TENTATIVE RECOMMENDATION

relating to

THE PAROL EVIDENCE RULE

The California version of the parol evidence rule appears in several places in the statutes.[1] Code of Civil Procedure Section 1856, which is the basic statutory formulation of the rule, provides:

> 1856. When the terms of an agreement have been reduced to writing by the parties, it is to be considered as containing all those terms, and therefore there can be between the parties and their representatives, or successors in interest, no evidence of the terms of the agreement other than the contents of the writing, except in the following cases:
>
> 1. Where a mistake or imperfection of the writing is put in issue by the pleadings;
>
> 2. Where the validity of the agreement is the fact is dispute.
>
> But this section does not exclude other evidence of the circumstances under which the agreement was made or to which it relates, as defined in Section 1860, or to explain an intrinsic ambiguity, or to establish illegality or fraud. The term agreement includes deeds and wills, as well as contracts between parties.

This rule serves a variety of purposes and policies, with the intent to encourage parties to reduce their agreements to writing. A written agreement minimizes the opportunity for failing memories or perjury, enhances certainty in commercial dealings, and minimizes court time in resolving disputes.[2]

The California statements of the parol evidence rule, enacted in 1872, have not proved adequate, however. In some situations, strict application of the rule would frustrate the clear intention of the parties. For this reason, the cases have continually eroded the rule,

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1. Civil Code §§ 1625, 1639; Code Civ. Proc. § 1856; Com. Code § 2202.

2. See discussion in Sweet, Contract Making and Parol Evidence: Diagnosis and Treatment of a Sick Rule, 53 Cornell L. Rev. 1036, 1047-51 (1968) (attached as a background study).

resulting in a maze of conflicting tests and exceptions.[3] As the parol evidence rule exists in California today, it bears little resemblance to the statutory statements of the rule.

The existing California parol evidence rule may be summarized as follows.[4] The rule makes inadmissible evidence of prior or contemporaneous oral and written agreements that would vary, add to, or contradict the terms of a written instrument that the parties intend to be integrated--i.e., to supersede all other prior or contemporaneous negotiations and understandings, and to constitute the final, complete, and exclusive embodiment of their agreement.[5] The rule does not make inadmissible collateral evidence that would supplement (but not contradict) the terms of a written instrument if it is shown that the written instrument was not intended by the parties to constitute an integrated agreement.[6] The rule does not make inadmissible extrinsic evidence offered to interpret or explain the meaning of a written instrument, whether or not integrated.[7] The question of integration is one for the court rather than the jury.[8] The rule does not make inadmissible extrinsic evidence offered to prove that a written instrument is invalid or unenforceable because of mistake, fraud, lack of consideration, illegality, and the like.[9]

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3. See discussion in Sweet, id. at 1037-44.

4. For a more detailed analysis, see B. Jefferson, The Parol Evidence Rule, in California Evidence Benchbook at 565-86 (1972).

5. Weisenburg v. Thomas, 9 Cal. App.3d 961, 89 Cal. Rptr. 113 (1970); Exchequer Acceptance Corp. v. Alexander, 271 Cal. App.2d 1, 76 Cal. Rptr. 328 (1969).

6. Masterson v. Sine, 68 Cal.2d 222, 436 P.2d 561, 65 Cal. Rptr. 545 (1968); Birsner v. Bolles, 20 Cal. App.3d 635, 97 Cal. Rptr. 846 (1971).

7. Delta Dynamics, Inc. v. Arioto, 69 Cal.2d 525, 446 P.2d 785, 72 Cal. Rptr. 785 (1968); P. G. & E. v. G. W. Thomas Drayage & Rigging Co., 69 Cal.2d 33, 442 P.2d 641, 69 Cal. Rptr. 561 (1968).

8. Brawthen v. H. & R. Block, Inc., 28 Cal. App.3d 131, 104 Cal. Rptr. 486 (1972).

9. Coast Bank v. Holmes, 19 Cal. App.3d 581, 97 Cal. Rptr. 30 (1971); B. Witkin, California Evidence §§ 737-747 (2d ed. 1972, 1977 Supp.)

The statute should at least accurately state the law.[10] An inaccurate statutory statement of the parol evidence rule is not only misleading, it also requires a search through the reports and treatises to find the law. The Law Revision Commission recommends that California's parol evidence rule statutes be revised to conform to existing law.[11]

The Commission further recommends that the Uniform Commercial Code serve as the basis for the statutory restatement of the parol evidence rule. Commercial Code Section 2202 provides:

> 2202. Terms with respect to which the confirmatory memoranda of the parties agree or which are otherwise set forth in a writing intended by the parties as a final expression of their agreement with respect to such terms as are included therein may not be contradicted by evidence of any prior agreement or of a contemporaneous oral agreement but may be explained or supplemented:
>
> (a) By course of dealings or usage of trade (Section 1205) or by course of performance (Section 2208); and
>
> (b) By evidence of consistent additional terms unless the court finds the writing to have been intended also as a complete and exclusive statement of the terms of the agreement.
>
> Official Comment
>
> 1. This section definitely rejects:
>
> (a) Any assumption that because a writing has been worked out which is final on some matters, it is to be taken as including all the matters agreed upon;
>
> (b) The premise that the language used has the meaning attributable to such language by rules of construction existing in the law rather than the meaning which arises out of the commercial context in which it was used; and
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> (c) The requirement that a condition precedent to the admissibility of the type of evidence specified in paragraph (a) is an original determination by the court that the language used is ambiguous.

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10. See Note, Chief Justice Traynor and the Parol Evidence Rule, 22 Stanford L. Rev. 547, 563 (1970): "It is time for the California state legislature to step in and rid the California Codes of the confusion for which they have become legendary. The provisions concerning parol evidence should either be rewritten or amended to conform to Chief Justice Traynor's three opinions."

11. See Sweet, Contract Making and Parol Evidence: Diagnosis and Treatment of a Sick Rule, 53 Cornell L. Rev. 1036, 1061-63 (1968) (attached as a background study).

2. Paragraph (a) makes admissible evidence of course of dealing, usage of trade and course of performance to explain or supplement the terms of any writing stating the agreement of the parties in order that the true understanding of the parties as to the agreement may be reached. Such writings are to be read on the assumption that the course of prior dealings between the parties and the usages of trade were taken for granted when the document was phrased. Unless carefully negated they have become an element of the meaning of the words used. Similarly, the course of actual performance by the parties is considered the best indication of what they intended the writing to mean.

3. Under paragraph (b) consistent additional terms, not reduced to writing, may be proved unless the court finds that the writing was intended by both parties as a complete and exclusive statement of all the terms. If the additional terms are such that, if agreed upon, they would certainly have been included in the document in the view of the court, then evidence of their alleged making must be kept from the trier of fact.

Use of the Uniform Commercial Code will assure a uniform parol evidence rule applicable both to contracts for the sale of goods and to contracts and conveyances generally. Use of the Uniform Commercial Code will also result in minimal disturbance of existing law since the leading California cases have drawn upon the Uniform Commercial Code in their formulation of the parol evidence rule.[12]

The Uniform Commercial Code parol evidence rule differs from existing general contract law in two aspects. The Uniform Commercial Code rule makes clear that the parol evidence rule does not preclude a contradictory written agreement that is contemporaneous with the writing.[13] The Uniform Commercial Code makes explicit that course of dealing, usage of trade, and course of performance may be used both to supplement and explain the terms of the agreement.[14] The Commission believes these would be beneficial changes in the general law and recommends their adoption.

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12. See, e.g., Masterson v. Sine, 68 Cal.2d 222, 228-29, 436 P.2d 561, ___, 65 Cal. Rptr 545, ___ (1968). See discussion in Note, The Parol Evidence Rule: Is it Necessary? 44 N.Y.U. L. Rev. 972, 977-82 (1969).

13. Under existing law, where there are several writings between the same parties that are parts of substantially one transaction, they are to be taken together. See, e.g., s. Jon Kreedman & Co. v. Meyer Bros. Parking-Western Corp., 58 Cal. App.3d 173, 180, 130 Cal. Rptr. 41, ___ (1976). See discussion in 1 B. Witkin, Summary of California Law, Contracts § 525 (8th ed. 1973).

14. Course of dealing, usage of trade, and course of performance have been used as aids to interpretation by the California courts on occasion. See discussion in 1 B. Witkin, Summary of California Law, Contracts §§ 527, 534 (8th ed. 1973).

The Commission's tentative recommendation would be effectuated by enactment of the following measure:

An act to amend Sections 1625 and 1639 of the Civil Code and to amend Section 1856 of the Code of Civil Procedure.

The people of the State of California do enact as follows:

Civil Code § 1625 (amended)

SECTION 1. Section 1625 of the Civil Code is amended to read:

1625. The execution of a contract in writing, whether the law requires it to be written or not, supersedes all the negotiations or stipulations concerning its matter which preceded or accompanied the execution of the ~~instrument.~~ instrument to the extent provided in Section 1856 of the Code of Civil Procedure.

Comment. Section 1625 is amended to refer to the statutory restatement of the parol evidence rule in Code of Civil Procedure Section 1865. For the law applicable to contracts for the sale of goods, see Commercial Code Section 2202.

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Civil Code § 1639 (amended)

SEC. 2. Section 1639 of the Civil Code is amended to read:

1639. When a contract is reduced to writing, the intention of the parties is to be ascertained from the writing alone, if possible; subject, however, to the other provisions of this ~~Title.~~ title and to Section 1856 of the Code of Civil Procedure.

Comment. Section 1639 is amended to refer to the statutory restatement of the parol evidence rule in Code of Civil Procedure Section 1865. For the law applicable to contracts for the sale of goods, see Commercial Code Section 2202.

Code of Civil Procedure § 1856 (amended)

SEC. 3. Section 1856 of the Code of Civil Procedure is amended to read:

1856. ~~When~~ (a) This section applies when the terms of an agreement have been reduced to writing by the parties, ~~it is to be considered as containing all those terms, and therefore there can be between the parties and their representatives, or successors in interest, no evidence of the terms of the agreement other than the contents of the writing, except in the following cases:~~ and the court determines that the terms of the agreement are intended by the parties as the final expression of their agreement with respect to those terms.

(b) The terms of the agreement:

(1) May not be contradicted either by evidence of a prior oral or written agreement or by evidence of a contemporaneous oral agreement.

(2) May be explained or supplemented by evidence of consistent additional terms, unless the court determines either that the writing is intended as a complete and exclusive statement of the terms of the agreement or that the additional terms are such that, if agreed upon, they would certainly have been included in the writing.

(3) May be explained or supplemented by course of dealing or usage of trade (as provided in Section 1205 of the Commercial Code) or by course of performance (as provided in Section 2208 of the Commercial Code).

(c) Notwithstanding any other provision of this section:

(1) This section does not apply

~~1.~~ ~~Where~~ where a mistake or imperfection of the writing is put in issue by the ~~pleadings;~~

~~2.~~ ~~Where~~ pleadings, or where the validity of the agreement is the fact in dispute.

~~But this~~ (2) This section does not exclude other evidence of the circumstances under which the agreement was made or to which it relates, as defined in Section 1860, or to explain an extrinsic ~~ambiguity,~~ ambiguity or otherwise interpret the terms of the agreement, or to establish illegality or fraud. ~~The~~

(d) As used in this section, the term agreement includes deeds and wills, as well as contracts between parties.

Comment. Section 1856 is amended to restate the substance of the parol evidence rule for contracts and other written instruments. For the law applicable to contracts for the sale of goods, see Commercial Code Section 2202.

Subdivision (a) is comparable to the first part of the introductory portion of Commercial Code Section 2202. It makes clear that the issue of finality of the terms of an agreement is a matter for court determination.

Subdivision (b)(1) is comparable to the second part of the introductory portion of Commercial Code Section 2202 and codifies prior law. See, e.g., American Nat'l Ins. Co. v. Continental Parking Corp., 42 Cal. App.3d 260, 116 Cal. Rptr. 80 (1974) (hearing denied). It makes clear that evidence of a contemporaneous written agreement that contradicts the terms of the agreement is not precluded by the parol evidence rule. Cf. Civil Code § 1642 (several contracts relating to the same matters, between the same parties, and made as parts of substantially one transaction, are to be taken together).

Subdivision (b)(2) is comparable to subdivision (b) of Commercial Code Section 2202 but elevates Comment 3 of the Official Comments to statutory status. It definitely rejects any assumption that, because a writing has been worked out which is final on some matters, it is to be taken as including all the matters agreed upon. This codifies prior law. See, e.g., Masterson v. Sine, 68 Cal.2d 222, 436 P.2d 561, 65 Cal. Rptr. 545 (1968). Subdivision (b)(2) also codifies the rule that the issue of completeness and exclusivity is a matter for court determination. See, e.g., Brawthen v. H. & R. Block, Inc., 28 Cal. App.3d 131, 104 Cal. Rptr. 486 (1972).

Subdivision (b)(3) is comparable to subdivision (a) of Commercial Code Sectin 2202. It definitely rejects (1) the premise that the language used has the meaning attributable to such language by rules of construction existing in the law rather than the meaning which arises out of the commercial context in which it was used and (2) the requirement that a condition precedent to the admissibility of the type of evidence specified in the subdivision is an original determination by the court that the language used is ambiguous. Subdivision (b)(3) makes

admissible evidence of course of dealing, usage of trade, and course of performance to explain or supplement the terms of any writing stating the agreement of the parties in order that the true understanding of the parties as to the agreement may be reached. Such writings are to be read on the assumption that the course of prior dealings between the parties and the usages of trade were taken for granted when the document was phrased. Unless carefully negated, they have become an element of the meaning of the words used. Similarly, the course of actual performance by the parties is considered the best indication of what they intended the writing to mean.

Subdivision (c) is amended to make clear that the restatement of the parol evidence rule in this section does not affect the admissibility of extrinsic evidence offered to interpret or explain the meaning of the terms of a written agreement, regardless whether the writing is intended by the parties as a final, complete, and exclusive statement of those terms. This continues prior law. See, e.g., P. G. & E. v. G. W. Thomas Drayage & Rigging Co., 69 Cal.2d 33, 442 P.2d 641, 69 Cal. Rptr. 561 (1968).