#79 10/21/77

Memorandum 77-72

Subject: Study 79 - Parol Evidence Rule (Approval of Recommendation for Printing)

Attached to this memorandum are two copies of the staff draft of the recommendation relating to the parol evidence rule, revised in accordance with the Commission's decisions at the October 1977 meeting. The Comment to Section 1856 of the Code of Civil Procedure has been reorganized and rewritten; the staff has not, however, added to the Comment examples of the operation of the rule (as was suggested by the Commission) because the Comment already seems unduly long and because, as the section and Comment are rewritten, the operation of the rule seems sufficiently clear. Please mark any editorial suggestions you may have on one of the copies to return to the staff at the November meeting.

At the October meeting, the Commission requested a memorandum outlining the division of responsibilities between judge and jury in a parol evidence case. This is attached as Exhibit 1 (pink). The principles outlined in the memorandum are preserved in the attached draft of the parol evidence recommendation.

At the October meeting, the Commission also requested a memorandum on course of performance in interpreting contracts. This is attached as Exhibit 2 (yellow) and was prepared by Carrie Carter, a Stanford law student. As the memorandum indicates, California general contract law accepts course of performance as the best evidence of the intent of the parties to the contract. To give the same effect to course of performance that the Uniform Commercial Code gives will not change existing California law.

Finally, the staff renews its suggestion that Civil Code Sections 1625, 1638, and 1639 be repealed. These provisions are set out as Exhibit 3 (green). They are clearly at odds with the cases interpreting them and with the parol evidence rule. Leaving them on the books and amending or repealing them by implication is not satisfactory and can only serve to confuse things.

Respectfully submitted,

Nathaniel Sterling
Assistant Executive Secretary

EXHIBIT 1

Functions of Judge and Jury in Parol Evidence Case

For the purposes of this discussion, parol evidence cases will be classified as those involving collateral agreements and those involving interpretation of the agreement.

Where parol evidence is offered to show a collateral agreement that contradicts, explains, or supplements the terms of a written agreement, the critical question governing its admissibility under the parol evidence rule is whether the written agreement is "integrated," that is, whether it is intended by the parties as final, complete, and exclusive.

> Whether or not the writing constitutes an integrated agreement is a question of law for the court. The language of the writing is an important consideration, particularly where it recites that all understandings of the parties are contained therein; these are the so-called words of "integration." But the determination may not be made from the writing alone; the proffered collateral parol agreement itself must be considered, as well as the circumstances surrounding the transaction, and its subject matter, nature and object. [Brawthen v. H & R Block, Inc., 28 Cal. App.3d 131, 137, 104 Cal. Rptr. 486, ___ (1972) (citations omitted).]

The trial court is invested with a degree of discretion in ruling upon the admissibility of such extrinsic evidence.

> The matters to which the court must address itself in determining whether the evidence of an oral agreement should go to the jury are such questions as (1) whether the written agreement appears to state a complete agreement; (2) whether the alleged oral agreement directly contradicts the writing; (3) whether the oral agreement might naturally be made as a separate agreement; (4) whether the jury might be misled by the introduction of the parol testimony. [Brawthen v. H & R Block, Inc., 52 Cal. App.3d 139, 146, 124 Cal. Rptr. 845, ___ (1975) (citation omitted).]

Where the trial is by jury, the proceedings on the integration issue will be heard out of their presence. If integration of the writing is not established as a matter of law, and the parol evidence is admitted, then the related questions of credibility of witnesses, and the parties' intent, ordinarily become questions of fact for the jury.

Where parol evidence is offered to interpret the terms of a written agreement, the critical question governing its admissibility is not

whether the writing appears to the court to be plain and unambiguous on its face, but whether the offered evidence is relevant to prove a meaning to which the language of the instrument is reasonably susceptible. Rational interpretation requires a preliminary consideration by the court of all credible evidence offered to prove the intention of the parties. Such evidence includes testimony as to the circumstances surrounding the making of the agreement including the object, nature, and subject matter of the writing so that the court can place itself in the same situation in which the parties found themselves at the time of contracting. If the court decides, after considering this evidence, that the language of a contract, in the light of all the circumstances, is fairly susceptible of either one of the two interpretations contended for, extrinsic evidence relevant to prove either of such meanings is admissible, and goes to the jury. Pacific Gas & E. Co. v. G.W. Thomas Drayage, etc. Co., 60 Cal.2d 33, 442 P.2d 641, 69 Cal. Rptr. 561 (1968).

While the jury may be allowed to hear parol evidence of a collateral agreement or involving interpretation of the contract, the jury's resolution of the factual questions of the bargain of the parties does not affect the court's authority to judge the effect of the bargain as a matter of law. Tahoe Nat'l Bank v. Phillips, 4 Cal.3d 11, 480 P.2d 320, 92 Cal. Rptr. 704 (1971); Estate of Cohen, 4 Cal.3d 41, 480 P.2d 300, 92 Cal. Rptr. 684 (1971).

EXHIBIT 2

October 17, 1977

Course of Performance or Practical Construction in California Common Law

By: Carrie Carter

In interpreting contracts, the intent of the parties is given great weight. This means that contracts are interpreted in light of the conduct of the parties where that conduct expresses the parties' intent. Especially important in interpreting ambiguities in the contract is the course of performance by the parties when they were performing harmoniously under the contract before a dispute arose. This is a general principle of contract law, and it appears in the California Commercial Code (Section 2208) and in California common law. The rule is that the course of the parties' performance before a dispute arose is given great weight in interpreting ambiguities in a written contract. 1 B. Witkin, Summary of California Law Contracts § 161, at 449 (8th ed. 1973). Course of performance will define ambiguous contract terms; it will not override express and unambiguous terms of a written contract.

An early California case enunciating the doctrine of practical construction is Mitau v. Roddan, 149 Cal. 1, 84 P. 145 (1906). This case dealt with a hops supply contract. There was a question as to whether the buyer had a right of inspection before purchase where the contract was silent on the right of inspection. The court found that, while both parties were performing harmoniously under the contract, the buyer had a right of inspection. This evidence of the practical construction put on the contract by the parties themselves was decisive:

> And in all cases where the terms of their contract, or the language they employ, raises a question of doubtful construction, and it appears that the parties themselves have practically interpreted their contract, the courts will follow that practical contruction. It is to be assumed that parties to a contract best know what was meant by its terms and are least liable to be mistaken as to its intention; that each party is alert to his own interests, and to insistence on his rights, and that whatever is done by the parties contemporaneously with the execution of the contract is done under its terms as they understood and intended it should be. Parties

> are far less liable to have been mistaken as to the intention of their contract during the period while harmonious and practical construction reflects that intention than they are when subsequent differences have impelled them to resort to law, when one of them then seeks a construction at variance with the practical construction they have placed upon it. The law, however, recognizes the practical construction of the contract as the best evidence of what was intended by its provisions. In its execution, every executory contract requires more or less of a practical construction to be given it by the parties, and when this has been given, the law, in any subsequent litigation which involves the construction of the contract, adopts the practical construction of the parties as the true construction and as the safest rule to be applied in the solution of the difficulty. [84 P. 150.]

In Rosenberg v. Geo. A. Moore & Co., 194 Cal. 392, 229 P. 34 (1924), the parties were performing under a series of rag supply contracts. There was no express provision for the return of unsatisfactory rags to the vendor, but the court found that returns had been effected under early contracts in the series and would, therefore, be available under the later contracts.

Tanner v. Title Insurance & Trust Co., 20 Cal.2d 814, 129 P.2d 383 (1942), dealt with the interpretation of a community oil lease, where some parties to the lease had surrendered lots within the original lease. The court gave decisive weight to the fact that those parties had continued to receive royalties after the surrender and that the party now raising the challenges to payment of the royalties had not protested those payments. The rule was not stated as a matter of waiver, but the focus instead was on the interpretation of the contract.

An oft-cited case is Universal Sales Corp. v. California Press Mfg. Co., 20 Cal.2d 751, 128 P.2d 665 (1942). This dealt with a contract between a supplier and a purchaser of a prototype pellet press. The question was whether a provision for royalties to the purchaser-user on later sales of the machine applied to sales of a different press. Since the royalty provision was ambiguous as to its application to different new machines, developed from the prototype, the Supreme Court looked to the trial court's findings as to the parties' performance prior to the dispute: The parties had collaborated in improving the performance of the prototype, with continuing cooperative development of the new machine. This collaborative effort, along with a 17-year fixed term for

royalties, indicated an intent to extend the royalty provision to cover sales of future developments of the pellet press.

A more recent case which is also cited quite often is Crestview Cemetary Ass'n v. Dieden, 54 Cal.2d 744, 8 Cal. Rptr. 427, 356 P.2d 171 (1960). In that case, the issue was whether an attorney's fee for obtaining a zoning change was earned when the change was obtained but later repealed. Again, the parties' conduct after the zone change was obtained was decisive in determining what the attorney's task under the contract was to be.

The cases above are cited often, but there are many other California cases enunciating the same point: Davies Machinery Co. v. Pine Mountain Club, Inc., 39 Cal. App.3d 18, 113 Cal. Rptr. 784 (5th Dist. 1974) (that that the purchase agreement had not become a lease agreement); Stilson v. Moulton-Niguel Water Dist., 21 Cal. App.3d 928, 98 Cal. Rptr. 914 (4th Dist. 1971) (course of performance under contruction contract did not establish agency relationship for purposes of tort liability); Crawford v. Continental Gas Co., 261 Cal. App.2d 98, 67 Cal. Rptr. 641 (1st Dist. 1968) (when insurance policyholder made quarterly payments for many years, he could not claim that he thought the quarterly payment amount was an annual premium); Sierad v. Lilly, 204 Cal. App.2d 770, 22 Cal. Rptr. 580 (4th Dist. 1962) (past practices examined to see if commercial building lease included adjacent parking spaces); Standard Iron Works v. Globe Jewelry & Loan, Inc., 164 Cal. App.2d 108, 330 P.2d 271 (4th Dist. 1958) (where parties acted as if constuction contract was for three-story building, an ambiguous contract was interpreted accordingly).

See also Balian v. Rainey, 115 Cal. App.2d 10, 251 P.2d 731 (2d Dist. 1952) (doctrine of practical construction used in interpreting partnership agreement); Kohn v. Kohn, 95 Cal. App.2d 708, 214 P.2d 71 (1st Dist. 1950) (interpreting a marital property settlement); Lemm v. Stillwater Land & Cattle Co., 217 Cal. 474, 19 P.2d 785 (1933) (interpreting assignment of a purchase money note); Keith v. Electrical Engineering Co., 136 Cal. 178, 68 P. 598 (1902) (in interpreting royalty agreement, defendant manufacturer's original payment practices were found important in construing ambiguous term).

These cases are wide-ranging as to the types of contracts to which the doctrine is applied and outline no limitations on the application of this doctrine. Along with the UCC section (set out below) applicable to sales contracts, these cases seem to cover the field of contracts.

§ 2208. [Course of Performance or Practical Construction]

(1) Where the contract for sale involves repeated occasions for performance by either party with knowledge of the nature of the performance and opportunity for objection to it by the other, any course of performance accepted or acquiesced in without objection shall be relevant to determine the meaning of the agreement.

(2) The express terms of the agreement and any such course of performance, as well as any course of dealing and usage of trade, shall be construed whenever reasonable as consistent with each other; but when such construction is unreasonable, express terms shall control course of performance and course of performance shall control both course of dealing and usage of trade (Section 1205).

(3) Subject to the provisions of the next section on modification and waiver, such course of performance shall be relevant to show a waiver or modification of any term inconsistent with such course of performance.

EXHIBIT 3

Civil Code § 1625

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.

Civil Code § 1638

1638. The language of a contract is to govern its interpretation, if the language is clear and explicit, and does not involve an absurdity.

Civil Code § 1639

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.