Chapter 6: Identifying and Interpreting the Terms of an Agreement

A. Introduction

1. Definitions

a. What is a fully integrated agreement? See RESTATEMENT OF CONTRACTS (2D) §213(2).

b. What is a partially integrated agreement? See RESTATEMENT OF CONTRACTS (2D) §213(1).

c. Note that the determination that a writing is integrated (in full, or partially) is a *conclusion*, not a legal argument.

2. Scope of Application: To the extent it applies, the parol evidence rule excludes evidence of prior and contemporaneous oral agreements as well as prior written agreements.

3. Merger Clause: A writing will sometimes include a clause that asserts that the writing expresses the complete agreement between the parties. Such a clause, called a merger clause, if given effect will cause the writing to be treated as fully integrated.

B. Parol Evidence Rule

1. Four Corners and Its Progeny

a. Hypo: Five individuals start a corporation, and they cause the corporation to borrow from a bank. The corporation's note includes a place for guarantors to sign, and four of the five incorporators sign. When the corporation cannot pay on the note, the bank sues the four guarantors. They allege that they agreed with the bank that they would sign as guarantors only if all five incorporators guaranteed repayment. Thus, they argue that there was an agreement that none of the guarantees would be effective until all five signed the note. Does the parol evidence rule permit evidence of this condition on enforceability of the guarantees? Yes: lack of delivery (as well as any other argument that the contract was never intended to become effective) can always br proven.

b. *Mitchill v. Lath* (p. 542): The Laths sold their farm to Ms. Mitchill, and they allegedly agreed to remove an unattractive ice house from adjoining property. However, this alleged promise was not contained in the writing otherwise describing the transaction. The court held that the alleged collateral promise could not be proved because it was a promise the parties ordinarily would be expected to have put in the writing. The court further suggested that the promise might contradict the terms of the writing. Assuming it does not contradict the writing, is the court saying that the writing is fully or partially integrated?

c. *Masterson v. Sine* (p. 546): Dallas and Rebecca Masterson sold their ranch to Medora and Lu Sine. Medora is Dallas's sister. The deed provides that the grantors (the Mastersons) have the right to repurchase the ranch any time within 10 years for the price paid by the Sine's, plus depreciated value of any improvements. Dallas has since become bankrupt, and the bankruptcy trustee seeks to exercise the option for the benefit of Dallas's creditors. The Sines seek to prove that the repurchase the parties had agreed that the repurchase option was to be personal to the Mastersons so that the property would not leave the family. *Held*, the parol evidence rule does not bar evidence of the alleged contemporaneous oral agreement such oral agreement is not one that "would certainly" have included in the writing. The court observed that the repurchase option had been written by hand in an otherwise printed document, and it would have been difficult to write the conditions imposed

on the option in the space available. In addition, the court observed that the parties likely did not know of the parol evidence rule so that they did not know of the importance of placing the entire agreement in writing. The dissent argues that allowing the parties to prove a condition on the otherwise unconditional promise permits the parties to contradict the writing; that is, a promise lacking words of limitation is understood to be unconditional. Note that the court says at p. 548: "Evidence of oral collateral agreements should be excluded only when the fact finder is likely to be misled. The rule must therefore be based on the credibility of the evidence." Does this say the parol evidence rule applies only if the court does not believe the collateral agreement was made? If so, does the parol evidence rule have any meaning.]

2. Merger Clauses

a. *UAW-GM Human Resource Center v. KSL recreation Corp.* (p. 553):

i. Assuming that the plaintiff is correct that the parties discussed the importance of union representation, does that necessarily mean that the defendant promised to continue such representation? Might this be precisely the kind of circumstance to which the parol evidence rule was intended to speak?

ii. The court says that there is a fraud exception to the parol exception rule but that it does not apply in this case. What type of fraud can be proven despite the merger clause? See p. 556. Surely fraud in the execution, but what else? If the party is told that a writing is not required, could promissory estoppel apply?

iii. The dissent says that "The cardinal rule in the interpretation of contracts is to ascertain the intention of the parties." (at 558) Which parties? Those who negotiate the contract, those who will perform the contract, or those who will be sued if the contract is breached? And does this statement account for the possibility of error? If courts cannot infallibly determine the proper intent, are some possible errors better than others? If so, which errors might be considered better? See Note 4 (p. 560).

iv. Some contracts are more likely than others to require the cooperation of multiple parties. For example, a contract made by a corporation often will require the performance by many corporate employees. In such circumstances is there a reason why a court should be less willing to admit parol evidence. Or consider legislation in which (a) many people must vote on the law but will not negotiate face to face and then perhaps millions of people will be required to conform their behavior to the statute. Should a court interpret a statute in accordance with the language or the intention of the legislators?

b. Notes: Should a merger clause be effective? Suppose you represent an insurance company who wishes to settle an injury claim. It is the position of your client that the injury was not caused by the negligence of the hospital you represent; it is uncontested that the child is severely injured. Your client is willing to pay actual hospital costs, but no more, to settle the claim. How do you write the settlement agreement to ensure that the victim's family will not accept the settlement and then sue for more, alleging that the settlement was only a partial payment? See especially *Trident Center* below.

3. The UCC Parol Evidence Rule in U.C.C. §2-202: Note that course of dealing (§1-205(1)), usage of trade (§1-205(2)), and course of performance (§2-208) can clarify *even a fully integrated contract.*

C. Interpretation of Contract Language

1. Plain Meaning and Contextual Meaning in Common Law Interpretation

a. *W.W.W. Assocs. v. Giancontieri* (p. 569):

i. A contract for the purchase and sale of real estate includes a reciprocal cancellation provision in the event that certain litigation affecting the property does

not conclude by a specific date. The writing also includes a merger clause. The buyer argues that the provision was intended to protect only the buyer and so cannot be exercised by the seller (who exercised the clause and refunded the down payment). *Held*, the unambiguous language of the clause coupled with the merger clause precludes evidence that the cancellation clause could not be exercised by the seller as well as by the buyer. "[W]hen parties set down their agreement in a clear, complete document, their writing should as a rule be enforced according to its terms." (p. 571) The court concludes the extrinsic evidence cannot be introduced to create an ambiguity where there is none but, presumably, only to resolve an ambiguity apparent on the face of the document.

ii. Note the bad faith argument discussed on page 572. What is the argument? That the seller violated its implicit obligation to defend the litigation but instead took no action to end the litigation so it would be able to avoid the contract. Why did this argument fail? No admissible evidence in support of the argument (hearsay generally is inadmissible).

b. *In re Soper's Estate* (Note 2 at 573): Ira Soper disappeared from Kentucky in 1921, leaving Adeline Soper, his wife of 10 years. He moved to Minneapolis and purported to marry Gertrude Whitby with whom he lived until his death. Prior to his death, Ira formed a corporation with Karstens. They agreed upon an insurance buyout plan providing that when one shareholder died, his shares would be transferred to the other, and the wife of the deceased shareholder would receive the insurance proceeds. At issue is whether the insurance proceeds payable upon the death of Ira should be paid to Adeline or Gertrude. *Held*, that the circumstances of the buyout indicate that Ira wanted the proceeds to be payable to Gertrude even though Adeline was Ira's legal spouse.

i. Suppose this case did not concern a corporate buyout plan but simply the terms of a will. Should interpretation of a will be essentially textual or contextual? Suppose the will was written laving everything to "my wife" and then Soper committed suicide. Should it matter if a note was left?

(A) The note reads: "I abandoned my wife. I hope she can forgive me."

(B) The note reads: "I have abandoned my wife. I hope she can forgive me.

ii. Why should interpretation of a will turn on the decedent's intention, expressed or unexpressed, while interpretation of a contract generally turns only on expressed intentions? Should interpretation of legislation be textual or contextual?

c. Hypo: Two shareholders agree upon a similar insurance buyout plan, this time with the proceeds to be payable to the deceased shareholder's children. After the death of one of the shareholders, it is determined that the deceased shareholder had fathered a child out of wedlock. Assume that the deceased shareholder was unaware of this child. Should the newly-discovered child share in the insurance proceeds?

d. *Raffles v. Wichelhaus* (Note 1 at 572): Each party reasonably understood "Peerless" to have a different meaning. Can *Giancontieri* be reconciled with this case? See Restatement (Second) of Contracts §201 (at 24-25). Can this provision be explained as based on an allocation of blame?

e. *Pacific Gas & Electric Co. v. G.W. Thomas Dryage & Rigging Co.* (p. 574): Defendant agreed to install heavy equipment in plaintiff's plant. As part of the agreement, defendant agreed to "indemnify" plaintiff "against all loss, damage, expense and liability resulting from . . . injury to property, arising out of or in any way connected with the performance of this contract." During performance of the contract, plaintiff's plant was injured.

Plaintiff seeks recovery from defendant under the indemnity agreement, and defendant asserts that this agreement was intended to apply only to injury to third parties. At issue is whether the defendant may prove by extrinsic evidence that the indemnity clause was intended to be so limited. *Held*, that extrinsic evidence may be offered to prove that a provision in the contract is ambiguous or that it means other than what nonparties might expect it to mean.

i. Does this holding leave anything of the parol evidence rule?

ii. How would you prove that a term, unambiguous on its face, means other than what it seems to say?

f. *Trident Center v. Connecticut General Life Insurance Co.* (p. 577): A loan agreement provided that the loan could not be prepaid for 10 years. Thereafter, prepayment was permitted with a sliding scale prepayment penalty. If the debtor defaulted on any of its obligations, the lender could accelerate the debt and add a 10% prepayment penalty. Alternatively, the lender could collect all income from the underlying property and apply that income against the debt. At issue is whether the debtor may prove by extrinsic evidence that the parties intended that the debtor could prepay the loan during the first 10 years by paying the then-outstanding balance plus a 10% prepayment penalty. *Held*, the debtor may introduce extrinsic evidence to prove that the parties intention was other than that expressed in the writing. Citing *Pacific Gas*, the federal court, deciding the case under California law, wrote: "This case therefore presents the question whether parties in California can ever draft a contract that is proof to parol evidence. Somewhat surprisingly, the answer is no."

g. Note the discussion in Note 6 (p. 583) in favor of a largely textual approach in some circumstances and a more contextual approach in others.

2. Interpreting Ambiguous Contracts: The Importance of the Burden of Proof

a. *Frigaliment Importing Co. v. B.N.S. Int'l Sales Corp.* (p. 585):

i. If the parties attributed materially different meanings to the word "chicken," why was there a contract? How is *Raffles v. Wichelhaus* different?

ii. Does the court's analysis of the argument in the last full paragraph on page 586 need any qualification?

iii. Look at the final paragraph on pages 585-86. What is the buyer's argument (that the court rejects)?

b. Might this case be resolved by reference to an "information-generating" rule? That is, if a party does not suggest that a general term be limited, it does not care about further divisions and so leaves discretion in the party who gets to make the choice?

b. Hypos

i. Shortly before exam period, you walk into the university bookstore to buy bluebooks. They say that they are sold out, but that they will have some by Thursday, the morning of your first exam. You pre-pay and leave. When you return on Thursday, you discover they sell only the small size bluebooks and you need the large ones. Has the bookstore breached your contract?

ii. The law school places an order with a commercial office supplier for 10,000 bluebooks. When they arrive, they are the small ones. Law schools around the country use the large ones. Can the law school refuse to accept the delivery? Does it matter whether the agreement is in writing?

iii. You read an advertisement in Tennis magazine for a specific pair of shoes. The advertisement includes the phrase "satisfaction guaranteed." The ad also provides that shipping and handling costs are nonrefundable. You order the shoes, and when they arrive, the receipt says that a 20% restocking fee is imposed on all nondefective returns. You decide to return the shoes. Must you pay the restocking charge?

iv. Suppose the advertisement is run in a magazine targeted to tennis professionals. Assume further that a restocking fee is standard in the industry. The advertisement says at the top: "Wholesale to the tennis industry. Ask about our specials for teaching pros." Different result?

c. The tension between textual and contextual approaches to interpretation arises in a variety of settings beyond traditional contract. One problem with using a contextual approach to contract interpretation is that while context might reveal the understanding of one of the parties, it might also prejudice the other party who relied more strongly on the specific language the agreed upon writing. Thus, the more parties there are to a contract, the more contextual analysis should become suspect because there are more parties who may have relied on the express wording of the written document. From this, it seems that the case for contextual analysis is strongest in interpreting a will, because a will is a one-party document in which no party other than the testator has a legally recognizable interest in the property subject to the will. Conversely, the case for contextual interpretation is weakest in the case of legislation, where many legislators vote on the words of a proposed law but do not necessarily agree on contextual materials (such as hearing testimony or other legislative history).

3. Interpretation in the UCC:

a. Section 2-202. Final Written Expression: Parol Evidence or Extrinsic Evidence. Terms with respect to which the confirmatory memoranda of the parties agree or which are otherwise set forth in 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 a contemporaneous oral agreement but may be explained or supplemented (a) by course of dealing or usage of trade (Section 1-205) or by course of performance (Section 2-208); 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.

b. See especially Official Comment 3 (at 140).

c. *Columbia Nitrogen Corp. v. Royster Co.* (p. 595): Royster agreed to sell and Columbia agreed to buy a minimum of 31,000 tons of phosphate per year for three years at a price per ton with an escalation clause based on Royster's cost of production. The market price of phosphate plunged, and Columbia ordered less than a tenth of the minimum quantity. Columbia seeks to introduce evidence of prior deals (where the positions of buyer and seller were reversed) in which one of the parties took substantially less of a good than called for in the contract.

i. Extrinsic evidence of prior course of dealings should be admitted even if the contract seems unambiguous on its face, but only to explain or supplement the writing. (p. 598)

ii. Extrinsic evidence should be excluded if it contradicts the writing: "the test of admissibility is . . . whether the proffered evidence of course of dealing and trade usage reasonably can be construed as consistent with the express terms of the agreement." (p. 598) This court says that a term which allows for a reduction in quantity does not contradict the express terms of the contract. Would the same be true of an oral agreement providing that the price could be raised or lowered? What if, in the past, the parties had often adjusted price to account for changes in market conditions? If you wanted to write a contract that would not permit a party to rely on trade usage or course of dealings, what would you write? Would such a provision by more persuasive as to trade usage or course of dealings? Note the discussion of Schwartz & Scott in Note 3 (p. 605-06).

iii. The writing does not include a provision expressly excluding the proffered evidence. (p. 598) To be sure, the writing excluded evidence of oral agreements (see p. 599), but the court says that evidence of trade usage and course of dealings is not covered by that provision.

iv. The contract provides for damages if the buyer refuses to pay for delivered phosphate but does directly speak to rejected deliveries. (p. 598) The court says that the UCC usual contract remedies cannot be applied until it is determined whether there has been a breach ("default") under the terms of the contract.

d. *Southern Concrete Services v. Mableton Contractors, Inc*. (p. 600): Buyer requested substantially less concrete than specified in the agreement (12,542 cubic years as compared with "approximately 70,000 cubic yards"). The buyer argues that it should be permitted to introduce evidence of both trade usage and mutual understandings. Does the UCC permit parol evidence not based on trade usage or course of dealings? See p. 603.

i. This court rejects most of what was said in *Royster*. In particular, it treats evidence limiting quantity as a contradictory term. See p. 603-04.

ii. If a party wishes to exclude parol evidence, what does this court say that it should do? Include a merger clause; see page 604.

e. Summary: The difference between (a) resolving an ambiguity and (b) adding additional terms sometimes can be clear. For example, in *Mitchill v. Lath* (the ice house case), the issue was plainly about using extrinsic evidence to prove an additional term. Conversely, in *Frigaliment* (the chicken case), the issue was just as plainly about using extrinsic evidence to explain a term. But in many cases, the difference between the two will blur. For example, when trying to prove that the buyer can request a smaller quantity than that defined in the minimum quantity provision of a writing, is the buyer trying to clarify what "minimum" means or adding a new term (minimum does not always apply)? In *Columbia Nitrogen Corp. v. Royster Co.*, the court adopted the former view while in *Southern Concrete Services v. Mableton Contractors, Inc*., the court adopted the latter view. Ir probably is fair to say (1) the outcomes are more dependent on the specific facts than the language of the opinions suggests and (2) courts often admit the extrinsic evidence when they believe it to be accurate and exclude it when they believe it to be inaccurate.