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Where Does A Contract Begin And Where Does It End?

A comment by the chairman at an arbitration hearing I attended highlighted a typical difference between common law and civil law legal traditions. In response to an attorney's objection that the witness should not be required to respond to a contractual interpretation question, a presumably weary chairman replied that the tribunal was proceeding with the assumption that (under the law applicable to the proceedings) it was permissible to ask questions to the witnesses on the meaning of the contract and that had English law applied, they would have intervened days ago (to prevent this line of questioning).

He was referring to the parol evidence rule, a common law rule which provides that evidence outside the four corners of an agreement is generally inadmissible to vary the terms of that agreement.

I. The Parol Evidence Rule

Parol evidence rule states that evidence of what may have been agreed to between the parties prior to the execution of an integrated written instrument cannot vary the terms of the writing.[1] So the rule broadly means that an integrated written contract cannot be supplemented with evidence of parties' understandings prior to that contract. Parol evidence rule therefore "bars admission of prior or contemporary oral representations to add to the terms of a written

[1] *Braten v. Bankers Trust Co.*, 60 N.Y.2d 155, 161-162, 468 N.Y.S.2d 861, 864, 456 N.E.2d 801 (1983).

agreement"[2] and "extends to prior written agreements as well" (but not necessarily contemporaneous ones)[3].

The rule is deceptively simple and gives rise to questions such as "can extrinsic evidence be used to find out if the agreement is integrated?" and "can extrinsic evidence be used to find out the meaning of the existing agreement?" The answers to these questions depend on whether one takes a strict or liberal view of the rule or a mixed one. Broadly, the rule can mean that extrinsic evidence of a prior agreement between the parties on the same subject matter as their subsequent written contract is inadmissible or it may mean that and also that any extrinsic evidence on the meaning of the contract is inadmissible.

In the United States, there are two main approaches that may be summarized by Professors Corbin and Williston's[4] views on the rule.[5] New York, generally maintains a Willistonian approach[6], which I refer to as the strict interpretation of the parol evidence rule. For the purposes of this article, I have depended on New York case law, from which one can draw a sharper contrast to civil law jurisdictions. California, Washington, Alaska and Arizona for example are adherents of Corbin's view of the rule[7] and Restatement (Second) of Contracts[8] is even arguably more liberal.

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2 *Holland v. Ryan*, 307 A.D.2d 723, 762 NYS2d 740 (4th Dep't 2003); *SAA-A, INc. v. Morgan Stanley Dean Witter & Co.*, 281 A.D.2d 201, 721 N.Y.S.2d 640 (1st Dep't 2001).

3 *Cornhusker Farms, Inc. v. Hunts Point Co-op, Market, Inc.*, 2 A.D.3d 201, 769 N.Y.S.2d 228, 230 (1st Dep't 2003); *Doherty v. New York Telephone Co.*, 202 A.D.2d 627, 609 N.Y.S.2d 306 (2d Dep't 1994).

4 Whose "Corbin on Contacts" and "Williston on Contracts" are among the most cited and influential common law contract law treatises in print.

5 Eric A. Posner, *The Parol Evidence Rule, The Plain Meaning Rule, and the Principles of Contractual Interpretation*, 146 U. Pa. L. Rev. 533, 568-569 (1998).

6 John D. Calamari and Joseph M. Perillo, *A Plea for a Uniform Parole Evidence Rule and Principles of Contract Interpretation*, 42 Ind. L.J. 333, 343 (1967).

7 Peter Linzer, *The Comfort of Certainty: Plain Meaning and the Parole Evidence Rule*, 71 Fordham L. Rev. 799, 814 (2002).

8 *Restatement (Second) of Contracts* § 214 (1981)

One aspect to bear in mind in all this is that, despite references to witness testimony, evidence and inadmissibility, parol evidence rule is a rule of substantive law[9] and not of procedural law or evidence[10]. As a result, it is applicability is a matter of the contract's governing law and not the procedural law applicable to the proceedings.

A. Liberal Interpretation

With a more liberal approach towards the rule, Corbin's view of the parol evidence rule is that it does not relate to a contract's interpretation and only means that the parties' agreement that a written agreement will be the exclusive contract amongst them necessarily terminates and supersedes any earlier agreement, whether written or oral.

Accordingly, while evidence concerning prior agreements is barred, there is no bar to introducing extrinsic evidence on the contract's meaning.[11] However, there is a thin line between the two and this approach leads to the risk that words that would be an addition to the parties' agreement (and would thus be barred under Corbin's view of the parol evidence rule) could then be introduced as extrinsic evidence on the meaning of a contract.[12]

B. Strict Interpretation of the Parol Evidence Rule

A contract interpretation dispute is about the parties' attempts to ascribe different meanings to the contract's terms and each party will see the other's position as varying the terms of the contract. A consequence of parol evidence rule under its strict interpretation is that the meaning

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[9] *Fogelson v. Rackfay Const. Co.*, 2000 N.Y. 334, 338, 90 N.E.2d 881, 883 (1950).
[10] *Municipal Capital Appreciation Partners, I, L.P. v. Page*, 181 F. Supp. 2d 379, 391 (S.D.N.Y., 2002); *Wayland Inv. Fund, LLC v. Millenium Seacarriers, Inc.*, 111 F. Supp. 2d 450, 455 (S.D.N.Y. 2000); *Centronics Financial Corp. v. El Conquistador Hotel Corp.*, 573 F2d 779, 782 (2d Cir. 1978).
[11] Linzer, *supra* at 814-832.
[12] Linzer, *supra* at 800-801.

of the contract cannot be proven by extrinsic witness evidence; limiting the adjudicator to the four corners of the document, absent certain exceptions. Therefore, under the strict interpretation of the rule, evidence on what the parties thought the contract meant is irrelevant if the contract wording can be attributed a plain meaning. This is another deceptively simple proposition as plain meaning is a subjective concept that may vary with context.

The rationale of the strict interpretation of the rule is the recognition that the law should afford some presumption of validity and finality to a seemingly complete written agreement; interpreting it with minimal consideration of extrinsic evidence. In other words, the strict interpretation of the rule "precludes introduction of evidence to increase a party's obligations under an agreement where those obligations were explicitly outlined in the contract itself"[13] and "permits party to a written contract to protect himself against perjury, infirmity of memory or death of witnesses."[14]

C. Integration and Merger Clause

Parol evidence rule, by definition, applies to an integrated contract. Strict and liberal interpretations of the parol evidence rule differ on how the existence of an integrated contract should be ascertained.[15] The liberal interpretation of the rule suggests that parties' intent to have an integrated contract can be shown by extrinsic evidence.

From a strict interpretation perspective, a contract that appears to be complete and unambiguous is presumed to be an integrated writing. Written form coupled with an intention that the writing completely embody the contract between the parties determine whether the contract is integrated

[13] *Omni Quartz, Ltd. v. CVS Corp.*, 287 F.3d 61, 64 (2d Cir. 2002); *Gerard v. Almouli*, 746 F.2d 936, 939, 39 U.C.C. Rep. Serv. 1224 (2d Cir. 1984).
[14] *Fogelson v Rackfay Constr. Co.*, 300 N.Y. 334, 90 N.E.2d 881
[15] Calamari and Perillo, *supra* at 337-339.

and triggers the parol evidence rule.[16] Accordingly, whether a contract is an integrated written instrument does not need to be stated explicitly. There is usually an explicit term in the contract stating that the contract is integrated, called a merger (or entire agreement) clause. However, the existence of this clause is not conclusive proof that the contract is integrated and its absence does not show otherwise either[17].

That being said, merger clauses (or entire agreement) are very usual. A typical one provides:

> "This agreement contains the entire agreement of the parties and supersedes any prior written or oral agreements between them respecting the subject matter contained herein."

A merger clause strives to ensure full application of the parol evidence rule, barring the introduction of extrinsic evidence to change or contradict the written terms, by "evincing the parties' intent that the agreement is to be considered a completely integrated writing".[18]

There are limits to the application of parol evidence rule even where the contract includes a merger clause. For example, under New York law, the general language of a merger clause is "insufficient to establish any intent of the parties to revoke retroactively their contractual obligations to submit disputes arising' under an earlier agreement to arbitration."[19] Similarly a merger clause may not preclude claims for fraud.[20]

D. Ambiguity and Other Exceptions

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[16] 11 *Williston on Contracts* § 33:15 (4th ed.); *Restatement Second, Contracts* § 209(3); *U.S. v. Clementon Sewerage Authority*, 365 F.2d 609 (3d Cir. 1966)

[17] *Thomas v. Scutt*, 127 N/Y/ 133, 138, 27 N.E. 961, 963 (1891); *Shah v. Micro Connections, Inc.*, 286 A.D.2d 433, 729 N.Y.S.2d 740 (2nd Dep't 2001); *DaPuzzo v. Globalvest Management Co., L.P.*, 263 F Supp. 2d 714, 731 (S.D. N.Y. 2003).

[18] *Jarecki v Shung Moo Louie*, 95 N.Y.2d 665, 745 N.E.2d 1006, 722 N.Y.S.2d 784 (2001).

[19] *General Motors Corp. v. Fiat S.p.A*, 678 F.Supp.2d 141, 148 (S.D.N.Y.2009) (quoting *Primex Int'l Corp. v. Wal–Mart Stores, Inc.*, 89 N.Y.2d 594, 599, 657 N.Y.S.2d 385, 679 N.E.2d 624 (1997))

[20] (for example in Texas, unless it explicitly includes a disclaimer of reliance) *Cowboy Partners, Ltd. v. Prudential Ins. Co.*, WL 1445950 (Tex. April 15, 2011)

One main exception to even the strict interpretation of the parol evidence rule is the existence of ambiguity in the contract.[21] In that case, evidence extrinsic to the agreement's four corners may be considered to ascertain the parties' intent. There is no ambiguity if the intention of the parties can be discerned from the agreement. In this context, ambiguity should exist even on the plain meaning of the contract.

Extrinsic evidence on the commercial context is usually admitted to understand if the contract is ambiguous or not integrated where such commercial context is required to make the determination. [22] Other usual exceptions are correction of clerical error, defenses against formation and to supplement a "partially-integrated" writing.

II. Civil Law Perspective

A. The Rule Barring Introduction of Witness Evidence to Contradict a Written Instrument

There is no general rule equivalent to the parol evidence rule in the civil law legal tradition. Civil law jurisdictions frequently have rules providing that a contract above a certain amount can be proven in court if it is in writing only, thereby making oral testimony inadmissible to prove the existence or the terms of a contract between the parties or to refute them.[23]

[21] *South Road Associates, LLC. v. Intern. Business Machines Corp.*, 4 N.Y.3d 272, 278, 793 N.Y.S.2d 835, 838, 826 N.E.2d 806 (2005).
[22] Posner, *supra*, at 570.
[23] *CISG-AC Opinion no 3, Parol Evidence Rule, Plain Meaning Rule, Contractual Merger Clause and the CISG*, 23 October 2004. Rapporteur: Professor Richard Hyland, Rutgers Law School, Camden, NJ, USA.

Any alleged subsequent modification or supplementation of a contract should again be subject to this rule of evidence as a contract in itself. For example, a Turkish procedural law principle[24] states that contracts above a minimal value must be proved in writing. A related principle is that contracts so proven cannot be refuted by witness evidence.[25]

B. Culpa in Contrahendo

At the first glance, the rule barring introduction of witness evidence to contradict a written instrument seems to be an even stricter stance than the strict interpretation of parol evidence rule. However, another civil law concept, *culpa in contrahendo* fills in a void.

Culpa in contrahendo, stemming from the duty of good faith, means the duty to negotiate in good faith and may provide an avenue for recourse in civil law jurisdictions that is unavailable in common law. For example, under Turkish law, it imposes good faith obligations on the parties during the negotiations of a contract.[26]

Therefore, even without arguing that the contract should be supplemented or interpreted with evidence on prior agreements (which have necessarily later been breached giving rise to the party's need to have them enforced), a party may argue *culpa in contrahendo* obligations have been breached and seek damages arising therefrom . Whether such compensation would be

[24] Law on Civil Law Procedure (*Hukuk Muhakemeleri Kanunu*), article 200, providing that all legal transactions concenringthe creation, ending, assignment, modification, novation, delay, admission and performance of a right that exceed 2500 TL should be proven by writing.
[25] Law on Civil Law Procedure (*Hukuk Muhakemeleri Kanunu*), article 201, providing that if an argument is advanced against an argument backed by writing in order to diminish the applicability and force of such argument, it cannot be advanced on the basis of witness evidence.
[26] Prof. Dr. M. Kemal Oğuzman, Prof. Dr. M. Turgut Öz, *Borçlar Hukuku Genel Hükümler*, at 428.

deemed a tort claim, a contract or a quasi-contract claim is disputed under Turkish law[27] but Turkish Court of Appeals finds it to be a contractual claim[28].

III. Example

Assume a seller and a buyer entered into a seemingly integrated contract covering usual pertinent issues for the sale of a land. The seller has also told the buyer and other reputable witnesses prior to the execution of the contract that he would remove the encroachments on the land but never did.

In the United States, whether the promise to remove the encroachments should be added to the contract between the parties would be a parol evidence matter. Depending on the relevant jurisdiction's take on parol evidence, witness evidence may or may not be introduced.

In Turkey on the other hand, although the buyer cannot bring the witnesses' testimony to contradict the sales contract under the procedural rule barring introduction of witness evidence to refute a written instrument; the buyer can argue that in promising to remove the encroachments during the contract negotiations and subsequently failing to make good on his promise, the seller breached its *culpa in contrahendo* duties.

IV. Conclusion

On the one hand, while there is such a thing as a merger clause reflecting the parties' request to end their bargain with the written document, there is no such thing as an "anti-merger clause" reflecting the parties' intent to allow an adjudicator to interpret the contract in light of all their

[27] Sibel Adıgüzel, *Sözleşme Görüşmelerinde Kusurlu Davranıştan Doğan Sorumluluk*, TAAD Yıl: 3, Sayı: 9 (2012)
[28] Adıgüzel, *Sözleşme Görüşmelerinde Kusurlu Davranıştan Doğan Sorumluluk* at 294.

previous dealings.[29] Parties usually seek certainty in the written document and do not want prior negotiations to have a bearing on the ultimate agreement except to the extent they have been included therein. Parol evidence rule protects this legitimate expectation.

On the other hand, there is an equally legitimate expectation that each parties' intents in respect of the contract should be fully taken into account, as a contract is, after all, a manifestation of the parties' mutual intent. Intent can only be understood in context, which necessarily involves prior dealings and understandings.

Parol evidence rule indicates the concern over reliability of documents versus the quest for the truth. Honorable as that quest may be, it may not always be fruitful. On the whole, the rule and its counterparts, like the civil law rule against introduction of witness evidence coupled with the *culpa in contrahendo* doctrine, are an example of the many issues in which the law must strike a balance between individual fairness and public policy and does so with variances and with different legal instruments.

[29] Posner, *supra*, at 551.