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Oral History

Admissibility of Parol Evidence Clarified

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Now retired California Court of Appeal Justice John Racanelli once complained that the parol evidence rule was in "a shambles in this state," and blamed the California Supreme Court's opinion in *Pacific Gas & Electric Co. v. G.W. Thomas Drayage & Rigging Co.*, 69 Cal.2d 33 (1968). So did 9th U.S. Circuit Court of Appeals Judge Alex Kozinski, who accused *PG&E* and its progeny of casting "a long shadow of uncertainty over all transactions negotiated and executed under the law" of California. *Trident Center v. Connecticut General Life Ins. Co.*, 847 F.2d 564, 569 (9th Cir. 1988).

In a series of more recent cases, however, several intermediate appellate courts have begun to clarify the rule. In the most recent, *Roddenberry v. Roddenberry*, 44 Cal.App.4th 634 (1996), the Court of Appeal reaffirmed a two-step analysis that actually makes the rule workable.

Before 1968, the parol evidence rule was easy to apply because California followed the traditional plain-meaning rule and held, if no ambiguity or uncertainty was asserted and a writing was clear on its face, parol evidence was inadmissible to interpret contract language. But courts later found a rote invocation of the plain-meaning rule would sometimes yield undesirable results, and that even the plainest language was not immutable. A series of exceptions to the plain-meaning rule thus developed, and it became more and more difficult to determine when the general rule barring the introduction of parol evidence might apply. See 2 Witkin, "California Evidence," Section 982-983.

The first significant inroad appeared in *Masterson v. Sine*, 68 Cal.2d 222 (1968), where the court observed that it is "impossible" for a writing to be "wholly and intrinsically self-determinative of the parties' intent." The court considered the policies underlying the parol evidence rule — that written evidence is more accurate than human memory, and the potential for fraud by interested witnesses — but found that "[e]vidence of oral collateral agreements should be excluded only when the fact finder is likely to be misled." Thus, the court held that an oral collateral agreement may be proven if the parties might naturally have made it as a separate agreement. This was an unequivocal repudiation of the plain-meaning approach that focused solely on contract language.

Later that same year, the bottom dropped out when the Supreme Court issued *PG&E*. Because contractual obligations flow not from words, but from intentions, courts must consider any extrinsic evidence that assists in determining the parties' intentions — as long as the language is "reasonably susceptible" to an interpretation other than its plain meaning.

PG&E was followed by *Delta Dynamics Inc. v. Arioto*, 69 Cal.2d 525 (1968), where the issue was whether the parties intended termination to be the only remedy for breach of contract. The contract provided: "Should Pixey fail to distribute ... the minimum number of devices ... [the] agreement shall be subject to termination... In the event of breach the party prevailing in any action for damages ... shall be entitled to reasonable attorney fees."

When Pixey failed to meet its minimum, the other party sued. Although the contract specifically mentioned an action for damages, Pixey offered extrinsic evidence that the exclusive remedy was termination. The trial court rejected the evidence. Citing *PG&E*, the Supreme Court reversed because the contract was "fairly susceptible" to Pixey's interpretation.

This ruling provoked a dissent from Justice Stanley Mosk warning that the "trend" started by *Masterson* and *PG&E* was "ominous" because "[g]iven two experienced

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businessmen dealing at arm's length, both represented by competent counsel, it has become virtually impossible ... to draft a written contract that will produce predictable results in court. The written word, heretofore deemed immutable, is now at all times subject to alteration by self-serving recitals based upon fading memories of antecedent events."

This warning has not been ignored, and cases from the past few years suggest that the more extreme consequences of *PG&E* may be a dead letter. One of the most significant is *Banco do Brasil S.A. v. Latian Inc.*, 234 Cal.App.3d 973 (1991), where borrowers argued that in addition to their written loan agreement, the bank had collaterally and orally promised to extend a credit line. Even though the agreement contained an express integration clause, the trial judge allowed parol evidence of this alleged oral agreement.

But the Court of Appeal reversed, holding that where the claimed oral agreement directly contradicts the written agreement, the parol evidence rule bars the proffered evidence. In reaching this result, the court listed four questions, all of which would have to be answered affirmatively before admitting parol evidence: Does the written agreement appear to be complete on its face, or is there an integration clause? Does the alleged oral agreement or proposed interpretation directly contradict the written instrument? Would the oral agreement naturally have been included in the written instrument? And would evidence of the oral agreement be likely to mislead the trier of fact?

In the year following *Banco do Brasil*, two other appellate decisions broke with *PG&E* by dividing the parol evidence question into two steps: First the extrinsic evidence is examined to determine whether the contract's language is reasonably susceptible to the interpretation a party urges. Then evidence is considered to determine what the parties intended.

The two courts had a slightly different view of the first step. The 4th District said that "the court provisionally receives" the extrinsic evidence, allowing it to be admitted in the second step only if the proposed interpretation is reasonable. *Winet v. Price*, 4 Cal.App.4th 1159 (1992). The 2nd District held that the "evidence can be admitted" in the first step, but only to show that the written language is reasonably susceptible of the proposed interpretation. *Consolidated World Investments Inc. v. Lido Preferred Ltd.*, 9 Cal.App.4th 373 (1992). Whether provisionally received or admitted for a limited purpose, however, the evidence could not be used to create an ambiguity.

This more restrained and deliberate approach influenced the *Roddenberry* court. The case involved a dispute between two former wives of the late Gene Roddenberry, creator of the science fiction show "Star Trek." As part of a 1969 divorce settlement agreement, Roddenberry's first wife was allocated a "one-half interest in all future profit participation income from 'Star Trek.'" The question was, what exactly is "Star Trek"?

When the profit-sharing provision was written, "Star Trek" was a television series that had aired from 1966 to 1969. Later, it became incredibly profitable, and the first Mrs. Roddenberry contended "Star Trek" in the agreement included six subsequent motion pictures, several subsequent television series and other merchandise.

Because the term "Star Trek" was undefined, the trial court allowed extrinsic evidence. But then the court entered what the Court of Appeal called a "a split and inconsistent decision" by finding on the one hand that there was no contractual intent that the first Mrs. Roddenberry receive any profit sharing in the "Star Trek" animations, movies or merchandise, and on the other that she was entitled to profit sharing from the "Star Trek" television spin-offs, since those were merely continuations of the original series.

The Court of Appeal followed the two-step parol evidence analysis. Finding the term "Star Trek" in the settlement agreement was reasonably susceptible to different meanings and therefore ambiguous, it held parol evidence was properly received. Then the court said determining contractual intent depends on "evidence bearing directly on what the parties actually intended," not merely theoretical linguistic possibilities.

When the 1969 contract terms were being negotiated, the only "Star Trek" property in existence was the recently canceled original series and a debt of $3 million. There was no evidence that the parties ever discussed any subsequent "Star Trek" projects, let alone profit sharing in such projects.

Roddenberry is thus an example of the middle ground between the stringency of the plain-meaning rule and PG&E's free-for-all. The *Roddenberry* court admitted extrinsic evidence only after recognizing that the contract language was ambiguous — not to create an alternative meaning or contradict the written word. But *Roddenberry* was not a complete return to the earlier, plain-meaning rule. Had it been so, the analysis would simply have been to note that when the contract term was drafted in 1969 "Star Trek" had only one plain meaning, which would have been controlling.

From *Roddenberry* and other recent cases comes a new, clear picture. Parol evidence issues generally arise in one of two slightly different situations. Where there allegedly is a need to interpret a word or term of a written instrument (e.g., what does "deliver" mean?), courts should follow the two-step approach and admit the evidence only if the terms are reasonably susceptible to the proposed meaning. Where there is a purported understanding about terms not embodied in the written contract itself (e.g., the parties orally agreed that performance could be delayed), the court should ask the four questions identified in *Banco do Brasil* and admit the evidence only if all four questions are answered in the negative.

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