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The Parol Evidence Rule: Don't Be Afraid of the Dark

Scott J. Burnham
Professor of Law, University of Montana

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THE PAROL EVIDENCE RULE: DON'T BE AFRAID OF THE DARK

Scott J. Burnham*

I. Introduction .................................. 93
II. The Parol Evidence Rule Stated .................. 96
III. In Search of the Agreement of the Parties .... 100
IV. Not the Parol Evidence Rule ...................... 109
   A. Collateral Agreement .......................... 111
   B. Interpretation ................................ 112
   C. Modification .................................. 114
   D. Lack of Assent ................................ 115
   E. Consumer Protection Act ...................... 117
   F. Bad Faith ..................................... 118
V. Application of the Parol Evidence Rule ......... 120
   A. Was the Oral Agreement Made? ................ 121
   B. Was the Oral Agreement Part of the Parties' Entire Agreement? 123
VI. The Fraud Exception ............................ 133
VII. Conclusion .................................... 141

I. INTRODUCTION

In discussions of parol evidence, Professor Thayer's century—old dictum is oft quoted: "Few things are darker than this, or fuller of subtle difficulties."¹ Those who read on in Thayer's book will find that his purpose was not to shed light on the rule or to elucidate its difficulties, but to demonstrate that it is not a rule of evidence.² By contrast, it is the author's hope that by the end of this Article, some light will be shed on the much-misunderstood rule.

A good starting point for an understanding of the parol evidence rule is the case of Sherrodd, Inc. v. Morrison-Knudsen Co.

* Professor of Law, University of Montana School of Law. B.A., Williams College, 1968; J.D., New York University, 1974; LL.M., New York University, 1981. I appreciate the research assistance of David Duke and Karl Rudbach, students at the University of Montana School of Law.
1. JAMES B. THAYER, A PRELIMINARY TREATISE ON EVIDENCE AT THE COMMON LAW 390 (Boston, Little, Brown & Co. 1898).
Schlekeway Construction Inc., COP Construction Inc., and Safeco Insurance Co., decided by the Montana Supreme Court (the court) in 1991. The case arose out of an Army construction project in which COP Construction Inc. (COP) was a subcontractor of the general contractors Morrison-Knudsen and Schlekeway. When COP discussed subcontracting earth-moving work with Sherrodd, a representative of Morrison-Knudsen told Sherrodd that there were about 25,000 cubic yards of earth to move. Using that estimate, Sherrodd computed his price for doing the job at $3.90 per cubic yard and bid a price of $97,500, which COP used in making its bid. When its bid was accepted, COP accepted Sherrodd's bid.

Beginning work without a written contract, Sherrodd discovered that there were actually closer to 50,000 cubic yards of earth to move. Sherrodd complained to COP, which told him that he would be paid for the additional work and that he must sign a written agreement to be paid for work performed. The executed written agreement stated that Sherrodd would move "LS" [lump sum] of earth and that COP would pay $97,500. When the job was done, COP paid Sherrodd according to the terms of the written agreement—$97,500 less a deduction for uncompleted work. Sherrodd sued for payment for the additional work as orally promised by COP. Defendants moved for summary judgment, claiming that under the parol evidence rule, Sherrodd's evidence of the transaction must be limited to the terms of the written agreement.

A majority of the court, in an opinion by Chief Justice Turnage, affirmed the decision of the trial court granting summary judgment to defendants. The opinion strongly endorsed the view that commercial stability requires strict adherence to the express terms of written agreements—a policy that the court found stated in the parol evidence rule:

The parol evidence rule is the public policy of Montana and it is clearly established by statute and the decisions of this Court. If this public policy and rule is not upheld, contracting parties that include lawful provisions in written contracts would be under a cloud of uncertainty as to whether or not their written contracts

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4. Sherrodd, Inc. is a family corporation. In this discussion, "Sherrodd" is used interchangeably to stand for the corporation and the individual, William Sherrodd.
5. Sherrodd, 249 Mont. at 283-84, 815 P.2d at 1135-36. Although disputed by defendants, these facts are stated as true, because in the procedural posture of summary judgment, the trial court decided the motion on the basis of the facts as alleged by the plaintiff. Id. at 285, 815 P.2d at 1136.
6. Id. at 284-85, 815 P.2d at 1136.
7. Id. at 286, 815 P.2d at 1137.
may be relied upon. The public policy and law does not permit such uncertainty to occur. 8

The opinion also addressed Sherrodd’s claim that defendants’ misrepresentation had fraudulently induced him to enter into the agreement. The court pointed out that the written agreement between COP and Sherrodd stated that “Sherrodd has, ‘by examination, satisfied himself as to the . . . character, quantity and kind of materials to be encountered.’” 9 Because that evidence directly contradicted this express term of the agreement, the court refused to allow Sherrodd’s evidence on the issue of fraud. 10

In a dissenting opinion, Justice Trieweiler argued for reversal and remand for a trial by jury. According to this opinion, the evidence should have been admitted under the fraud exception to the parol evidence rule. The fraud exception, Trieweiler argued, should not be so narrowly applied as to eliminate evidence merely because that evidence contradicted the terms of the agreement. The opinion also expressed the view that the majority’s limitation of the fraud exception allowed the defendants to perpetrate a fraud. In circumstances where a party has little choice but to sign the agreement, that party should be protected from overreaching by the other party. 11

This Article explores the parol evidence rule and the fraud exception, using Sherrodd as a paradigm. Examination of Montana case law reveals a great deal of misunderstanding of the rule with resultant misapplication of it. 12 Part II examines the rule in the context of its historical background. Part III examines the problem the rule is designed to solve—finding the agreement of the parties. Part IV is a necessary diversion into areas where the parol evidence rule does not apply. Under the suggested approach to recognizing and resolving parol evidence questions, an attorney or court would first ask:

- What evidence are you offering?
- For what purpose are you offering it?

The answers to these questions will narrow the inquiry by eliminating many situations in which the rule does not apply.

Part V examines the proper application of the rule. After an

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8. Id.
9. Id. at 285, 815 P.2d at 1137.
10. Id. at 285-86, 815 P.2d at 1136-37.
11. Id. at 286-89, 815 P.2d at 1138-39.
12. The fact that Montana statutes and cases provide a focus for this Article should not suggest that the analysis and conclusions are confined to the borders of Montana. The inquiry into parol evidence and the attempt to find a rubric for its application are universal.
attorney or court has determined that the rule does apply, the following questions should be asked:

- Was the oral agreement made?
- Was the oral agreement part of the parties' entire agreement?

Part VI examines the fraud exception, suggesting an approach courts should take when a party alleges fraud. Under this approach, more agreements that were actually made would be honored, and more fraud would be prevented. The price courts would be asked to pay for preventing fraud is less efficient decision-making, for evidence would have to be heard rather than summarily excluded.

Let us begin with an examination of the rule itself.

II. THE PAROL EVIDENCE RULE STATED

A statement of the rule is found in section 28-2-905 of the Montana Code:

When extrinsic evidence concerning a written agreement may be considered. (1) Whenever the terms of an agreement have been reduced to writing by the parties, it is to be considered as containing all those terms. 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:

(a) when a mistake or imperfection of the writing is put in issue by the pleadings;
(b) when the validity of the agreement is the fact in dispute.

(2) This section does not exclude other evidence of the circumstances under which the agreement was made or to which it relates, as described in 1-4-102, or other evidence to explain an extrinsic ambiguity or to establish illegality or fraud.

(3) The term "agreement", for the purposes of this section, includes deeds and wills as well as contracts between parties. ¹³

To call the substance of this statute the "parol evidence rule" inappropriately describes its contents: The rule does not concern only evidence that is parol, it is not a rule of evidence, and it is not even a rule. Let us explore these propositions.

First, the rule does not concern only evidence that is parol.

The word *parol*, from the French for *oral*, refers specifically to that which is spoken.\(^{14}\) In an early usage, Blackstone stated:

> AGAIN; evidence in the trial by jury is of two kinds, either that which is given in proof, or that which the jury may receive by their own private knowledge. The former, or *proofs*, (to which in common speech the name of evidence is usually confined) are either written, or *parol*, that is, by word of mouth.\(^{15}\)

The rule bars not only spoken evidence, but other evidence as well. The Montana Code statement of the rule does not narrowly refer to "parol" evidence but broadly states that there can be "no evidence" of the terms. Because it bars all evidence, oral as well as written, the rule might better be described, as suggested by the catchline of section 28-2-905,\(^{16}\) as the "extrinsic evidence rule," barring evidence extrinsic to the written agreement.\(^{17}\) Although extrinsic evidence usually consists of spoken statements or agreements, it can also take other forms, such as additional documents or trade usage.

Second, the parol evidence rule is not a rule of evidence but a rule of substantive contract law. Once they reach a final agreement, the contracting parties may be understood as saying: "Everything that preceded was just talk. This is for real." That final agreement is often a writing. The parol evidence rule states as a rule of contract law that once the parties have reached a final written agreement, their prior oral discussions are displaced. If the substantive purpose of the rule is to distinguish between yesterday's talk and today's agreement, then the rule was named, in Corbin's term, "unfortunately."\(^{18}\) Perhaps it should be called the "Prior Negotiation Rule." The statement of the rule for this purpose is codified in section 28-2-904 of the Montana Code:

**Effect of written contract on oral agreements.** The execution of a contract in writing, whether the law requires it to be

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14. See infra note 17.
15. 3 WILLIAM BLACKSTONE, COMMENTARIES 368 (Philadelphia, Robert Bell 1772).
17. In keeping with tradition, I have no objection to calling it the parol evidence rule, but please, never the parole evidence rule. The words *parol* and parole have a common origin in the old French and Anglo-French *parol*. Prisoners on parole have "given their word" that they will not again transgress. As is often the case, the law stuck with the traditional spelling while modern French and English moved on. 2 OXFORD ENGLISH DICTIONARY 489-90 (compact ed. 1971). Lapses into the erroneous spelling are not uncommon. A Westlaw search employing the query "'parol evidence' and fraud" turned up 416 Montana state and federal cases; the query "'parole evidence' and fraud" revealed 21 more.
written or not, supersedes all the oral negotiations or stipulations concerning its matter which preceded or accompanied the execution of the instrument.19

One can now see how sections 28-2-904 and -905 of the Montana Code work together. When statutes were first enacted in Montana, the section that is now 28-2-904 was taken from the California Civil Code section that had its origin in the Field Code.20 Placed with the substance of contracts, the provision states the effect a writing has on prior negotiations. In the 1895 Codes and Statutes of Montana, the provision that is now section 28-2-905 was part of the Code of Civil Procedure, where it was placed with the rules of evidence.21 That section provides the mechanism to enforce the exalted status of the writing—by excluding evidence of the negotiations. The evidence is excluded not because the rules of evidence say that it is not trustworthy, but because the rules of contract law say that it is not part of the agreement. When the Montana Code was adopted in 1978, the provision was moved to its rightful place in Title 28 with the rules of contract law.

The Montana Supreme Court has been notoriously inconsistent in distinguishing between the parol evidence rule as a rule of evidence and as a rule of contract law. On the one hand, the court has applied the rule at the pleading stage, which it would not do with a rule of evidence.22 On the other hand, when an appellant claims that the trial court’s admission of testimony violated the parol evidence rule, the court has frequently held that an appellant who failed to object to the testimony at trial is barred from raising the issue on appeal.23 The court would be correct if it were dealing with a party’s failure to make an evidentiary objection. However, the court is wrong when it fails to apply the substantive law of contracts to the facts before it. Farnsworth concludes from the substantive nature of the rule:

19. MONT. CODE ANN. § 28-2-904 (1993). In Norwest Bank Billings v. Murnion, 210 Mont. 417, 422-25, 684 P.2d 1067, 1070-71 (1984), the court pointed out that the trial court had incorrectly applied § 28-2-904 rather than § 30-2-202 to a transaction involving the sale of goods. After comparing the two statutes, the court correctly concluded that the result would be the same under both statutes.


22. See, e.g., Sherrodd, 249 Mont. at 284-86, 815 P.2d at 1136-37.

Therefore, under an exclusionary rule of evidence, failure to object at trial ordinarily waives any ground of complaint against admission and the evidence becomes part of the proof in the case. There is, however, sound authority that an objection based on the parol evidence rule is not lost by failure to raise it at trial, so that in this context the parol evidence rule is treated as "substantive" rather than as "evidentiary."

Finally, the rule can be said not to be a rule at all. It is a cluster of concepts, used for a variety of purposes. It also looks unlike a rule because it is so riddled with exceptions, some of which are expressed in the statement of the rule itself. Because of the many exceptions, it is rarely possible to predict whether a court will enforce an oral promise alleged to be part of an agreement otherwise in writing. Some commentators, frustrated by the lack of legal certainty, advocate abandoning the rule. This proposal calls to mind the baseball fans' suggestion that close calls at first base could be eliminated by moving the bag another foot from home plate. Instead of focusing on the rule, critics should start by identifying the problem. With parol evidence, the problem is finding the agreement that governs the parties at a particular point in time. Solving that problem is often difficult. Therefore, the close calls arising from the application of the rule in practice will not be

24. E. Allan Farnsworth, Contracts § 7.2, at 468 (2d ed. 1990). However, authority exists in support of the court's position. McCormick states:

The principal practical consequence of the now accepted theory that the parol evidence rule is a rule of substantive law, rather than a rule of evidence, is that a failure to object to evidence of an oral agreement is not a waiver, as a failure to assert an objection upon mere exclusionary rule of evidence would be. A few courts seem to permit the parol evidence rule to be invoked for the first time on appeal. But the preponderant, and it is believed the fairer, view is that the party must have raised the question in some fashion at the trial, as by motion for judgment on this ground or by request for instructions, as a condition to his raising it on appeal.

McCormick, supra note 2, at 433 n.2 (citations omitted). See also Gary D. Spivey, Annotation, Modern Status of Rules Governing Legal Effect of Failure to Object to Admission of Extrinsic Evidence Violative of Parol Evidence Rule, 81 A.L.R.3d 249 (1977).


Official Baseball Rule § 1.04 provides in part, "The infield shall be a 90-foot square."

29. Official Baseball Rule § 6.05(j) provides in part: "A batter is out when . . . after [the batter] hits a fair ball, [either the batter] or first base is tagged before [the batter] touches first base." The rule is often formulated as "a tie goes to the runner."
resolved by changing its theoretical expression. An early Pennsylvania case put it perfectly:

There is scarcely any subject more perplexed, than in what cases, and to what extent, parol evidence shall be admitted. Not only have different men viewed the subject differently, but the same man, at different times, has held opinions not easily reconciled, and I doubt whether any lawyer of many years’ standing, and much reflection, can say his mind has never wavered on this subject. In theory, adhere to the writing—neither see nor hear anything out of the deed, seems to sound well; and it would work well in practice, if all who gave instructions to scriveners were perfect; if all scriveners perfectly understood their instructions, and put them on paper perfectly according to law, and the whole was completed, by executing them at the time and in the order and manner which their nature and the law requires; but when this perfection cannot be even imagined to exist in this world, and the want of it is as apparent in deeds and other writings, as anywhere else, the beautiful theory must yield to substantial justice. 30

To balance theory and substantial justice in the application of the rule, let us first examine the problem the rule was designed to solve—finding the agreement of the parties.

III. IN SEARCH OF THE AGREEMENT OF THE PARTIES

Is it that hard to find the parties’ agreement? Yes! At one time the only enforceable agreement was the one made under seal. 31 The idea that a contract is a fixed and immutable document has been displaced by the view of the contract as a process that proceeds from negotiation, through execution, through performance and modification, and continues in the parties’ relationship. 32 The Uniform Commercial Code (U.C.C.) definitions of agreement and contract reflect this expansive view of contract. According to the U.C.C., “‘contract’ means the total legal obligation which results from the parties’ agreement” 33 and “‘agreement’ means the bargain of the parties in fact as found in their language or by implication from other circumstances, including course of dealing or usage of trade or course of performance as provided in this Code.” 34

31. For better or worse, the distinction between sealed and unsealed instruments has been abolished. Mont. Code Ann. §§ 1-4-204, 30-2-203 (1993).
contract, then, is more than the agreement, and the agreement is found in a number of sources, not in a single written document.

No writing can contain all understandings or provide for all contingencies. Contract law looks outside the writing on numerous occasions: to fill gaps where the parties omitted a term; to read in a default provision where the parties did not create their own rule; to interpret the meaning of terms; and to supplement terms with custom and usage, course of performance, and course of dealing. For example, in a recent case upholding oral modifications of a written agreement, the court reported approvingly the parties' testimony about the role of the written agreement:

When asked what role the written contract played in the administration of the contract and the construction project, Kelley [MPC's chief operating officer responsible for administration of the contract] testified:

"Well, the contract is a point of beginning. You've got to start someplace, as we do on any job. And then you negotiate on a daily basis and do the job."

In addition, Brad Haines, president of Haines Pipeline, testified to instances when changes in the contract were made that were not committed to writing.36

At the same time, contract law must have a way of distinguishing obligations from "just talk."36 In spite of the popular expression disparaging oral contracts, "It was only a verbal agreement," the fact that an agreement is written rather than oral does not create this distinction.37 The "Prior Negotiation Rule," section 28-2-904 of the Montana Code, got it wrong.38 A written agreement that follows oral understandings has no greater legal significance than an oral agreement that follows written understandings—both equally displace the prior discussions.39 Nevertheless, the former is more customary. Although there is no obligation to commit agreements to writing, the parties' intention to have a legally operative


36. The concept of consideration is helpful when there is an absence of consideration, but because a single consideration can support multiple obligations, its presence does not help identify the "real" obligations. For example, if A promises B a car, the fact that B did not offer any consideration makes A's promise unenforceable. If B offered consideration, that fact does not help determine whether A's obligation involves only the car or also an alleged oral warranty.

37. Lawyers as well as the lay public often fail to make the distinction between oral, meaning using the mouth, and verbal, meaning using words. Verbal agreements may be either written or oral.

38. See supra text accompanying notes 18-24.

39. CORBIN, supra note 18, § 573.
agreement may be clearer when they use a writing. Therefore, once a signed writing exists, it seems fair to use that writing as a starting point for the parties’ intended agreement. In this context, the parol evidence rule makes sense in placing a burden on the proponent of the oral evidence. A party who alleges oral terms in the face of a writing should have the burden of explaining why all the terms were not included in the writing. Similarly, the context explains why courts are more hostile to evidence that contradicts the writing. A party who did not intend the provision as drafted to govern has a difficult burden in explaining why he or she nevertheless signed the writing.

While it is no doubt significant that at some point the parties reduced their agreement to writing and signed the writing, that moment is not of such overwhelming significance that we must ignore the rest of the story. Consider, for example, the function of the writing in the context of Sherrodd. Initially, Sherrodd orally agreed to do the job for $97,500, but what did this agreement mean? Was he saying, “I will move all the earth there is for $97,500”? He had an absolute right to make such a promise, but he would have been foolish to do so, since he relied solely on COP’s estimate of the quantity of earth. More likely he was saying something like, “On the basis of your representation that there are 25,000 cubic yards, I will do the job for $97,500” or “I move earth for $3.90 a cubic yard, so if there are 25,000 cubic yards, then I will do it for $97,500” or “Based on our mutual assumption that there are 25,000 cubic yards, I will do the job for $97,500.” Note that each of these agreements is perfectly enforceable under the statute of frauds. If the only agreement between the parties was oral, then Sherrodd would have recovered for the additional work done under any of these interpretations.

Yet there was more to it—the parties committed their agreement to writing. The writing stated that Sherrodd would move “LS” [lump sum] of earth for $97,500. Now he really seems to have said, “I will move all the earth there is for $97,500.” But he alleged a side, oral agreement, under which he would be paid for moving the additional earth that both parties knew about. These facts and circumstances showing how an agreement came to be made set the stage for a classic parol evidence problem. The writing stated that Sherrodd would receive only $97,500 for the job, and the alleged oral agreement stated that he would receive more. Where is the

40. Sherrodd, 249 Mont. at 283-84, 815 P.2d at 1136.
41. Id. at 284, 815 P.2d at 1136.
agreement found?

COP denied making the oral agreement. But the inquiry does not differ if COP admitted the side agreement. The issue is not whether it was said, but whether it was part of the agreement. COP was perfectly free to say, "Sure we said it, but we said lots of other things too. And we agreed that the only things we said that would count are the ones found in the writing." Thus the parol evidence rule transforms a question of fact into a question of law. The inquiry is not whether the oral agreement was made but whether the oral agreement is legally enforceable.

In deciding whether the oral agreement is legally enforceable, it is important to begin with the proposition that in general, there is nothing wrong with oral promises. The Montana Code provides that "[a]ll contracts may be oral except such as are specially required by statute to be in writing." Oral contracts may present problems of proof, so the law may want to discourage their making, but it does not deny them enforcement, with the few exceptions collectively known as the statute of frauds. There is also, of course, nothing wrong with contracts being written. It follows, then, that there is nothing wrong with a contract being partly written and partly oral. The evidence of the contract may be found equally in the writing and in other evidence, including oral evidence.

Does the parol evidence rule affect this conclusion? Let us look at the statute more closely. It begins: "Whenever the terms of an agreement have been reduced to writing by the parties, [the agreement] is to be considered as containing all those terms." This sentence says nothing more than that the written terms of the agreement are part of the agreement. So far, the rule does not express a bias in favor of the written terms, for the agreement could contain oral terms as well. But it goes on to state: "Therefore,
there can be between the parties... no evidence of the terms of the agreement other than the contents of the writing..." The word *therefore* suggests a logical conclusion. And what is that conclusion? That there can be no evidence of the terms of the agreement other than what is in the writing. This sentence could be saying one of two things. First, that the writing is the only part of the agreement. Both logic and experience tell us that this is not so. This conclusion certainly does not follow from the statement that the written terms are part of the agreement. We also know that an agreement can be partly written and partly oral, can have blanks in it, can require gap fillers, and so forth. Therefore, this meaning is preposterous. Second, the sentence could be saying that there can be no evidence of those terms that are in writing other than the contents of the writing. This interpretation makes more sense. In drafting, the same language should always mean the same thing. If the phrase "the terms of the agreement" in the second sentence is understood consistently with the phrase "the terms of an agreement" in the first sentence, it refers to those terms that are reduced to writing. This interpretation is also consistent with the parol evidence rule as a "Prior Negotiation Rule": the written terms were intended to replace earlier negotiations. Therefore, the rule does not exclude evidence of all oral terms, but only of those that contradict the written terms. The rule leaves open the possibility of additional oral terms that are equally part of the agreement.

This second interpretation finds expression in the more modern statement of the parol evidence rule found in the U.C.C.:

**Final written expression—parol or extrinsic evidence.**

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 (30-1-205) or by course of performance (30-2-208); and

(b) by evidence of consistent additional terms unless the court finds the writing to have been intended also as a complete

49. See supra text accompanying notes 18-24.
and exclusive statement of the terms of the agreement.\textsuperscript{50}

In this statement of the rule, evidence is inadmissible when the writing is "intended by the parties as a final expression of their agreement with respect to such terms as are included therein."\textsuperscript{51} That is, the evidence is excluded not merely because the terms are reduced to writing but only after it is determined that the parties intended that writing to represent the final expression of those terms. Furthermore, the evidence that is excluded is only that which contradicts the writing, leaving open the possibility of additional oral terms to supplement the writing. According to subsection (b), however, the supplementary terms may also be excluded if the writing was "intended also as a complete and exclusive statement of the terms of the agreement."\textsuperscript{52} The inquiry therefore shifts from the fact of the writing to what the parties intended by the fact of a writing.

It is now clear that there is an exception to the general rule that there is nothing wrong with a contract being partly written and partly oral. There is something wrong with a contract that is partly written and partly oral if the parties intended the contract to be entirely written. This concept is called integration or merger, for the entire agreement can be viewed as integrated or merged in the writing.

The concept of integration lies at the heart of parol evidence analysis. A court must first determine whether the parties intended the writing to be the final and complete expression of their agreement. If the answer is yes, then the oral understandings may be excluded. If the answer is no, then the oral understandings have equal weight with the writing. All too often a court concludes, without analysis of the integration issue, that a writing represents the entire agreement of the parties. For example, in Sherrodd, the majority stated:

Section 28-2-905, [of the Montana Code], provides that when an agreement has been reduced to writing by the parties, there can be no evidence of the terms of the agreement other than the contents of the writing except when a mistake or imperfection of the writing is claimed or when the validity of the agreement is the fact in dispute.\textsuperscript{53}

This statement in Sherrodd, followed by the application of the

\textsuperscript{50} MONT. CODE ANN. § 30-2-202 (1993).
\textsuperscript{51} MONT. CODE ANN. § 30-2-202.
\textsuperscript{52} MONT. CODE ANN. § 30-2-202(b) (1993).
\textsuperscript{53} Sherrodd, 249 Mont. at 285, 815 P.2d at 1136-37.
parol evidence rule at the pleading stage to exclude evidence of the oral understanding, demonstrates one of the most important aspects of parol evidence analysis: The rule transforms what would otherwise be a question of fact to be decided by a jury into a question of law to be decided by a court. The function of a court in administering the parol evidence rule gives preference to the written evidence. Therefore, as McCormick observed, the rule indirectly favors the party with stronger bargaining power who drafted the writing:

The types of transaction wherein is involved this kind of competition between claims based upon writings and those based upon alleged oral agreements dealing with the same affair, are infinitely various, but usually if there is a difference between the two parties in economic status, the one who relies upon the writing is likely to be among the "haves," and the one who seeks escape through the oral word will probably be ranged among the "have nots," in Sancho Panza's classification. The average jury will, other things being equal, lean strongly in favor of the side which is threatened with possible injustice and certain hardship by the enforcement of the writing.

This pattern is, of course, represented by the parties in Sherrodd. Acknowledging the majority's view that written agreements should be reliable on their face, Justice Trieweiler in dissent stated that "a justice system worth its salt should have equal compassion for Montana's many subcontractors who, while operating without the benefit of legal advice, sign whatever is necessary in order to keep their operations afloat and their crews at work."

Trieweiler was fully aware that his position would take the question out of the hands of a court: "I would reverse the judgment of the District Court and remand for a jury trial to determine the merits of the plaintiff's claim. That is really all the protection that Montana's general contractors need."

In Sherrodd, the Montana Supreme Court used the parol evidence rule to serve a number of functions:

- **Prevention of Perjury.** Oral expressions are not as reliable as written expressions. A party might inexactely recall what was said or make it up entirely. If the court excludes evidence of the oral expressions and limits itself to the fixed expressions of the writ-

55. McCormick, supra note 2, at 428.
56. Sherrodd, 249 Mont. at 289, 815 P.2d at 1139.
57. Id.
ing, then there is little dispute about what was said and less pos-
sibility of error.

- **Judicial Efficiency.** If a court does not have to listen to the tes-
timony but can make determinations on the basis of the writing, then it can decide issues much more quickly. In fact, many cases can be disposed of in the motion stage. In addition, because the parol evidence rule is a matter of substantive law, the issue can be decided by the judge without consulting the jury.

- **Channeling Behavior.** If contracting parties know that there is a parol evidence rule that will be strictly enforced, then they have an incentive to put all their understandings in writing. Good business practices would thereby be promoted.

A problem with all of these functions is that they conflict with the primary function of contract law—to carry out the agreement of the parties. As previously discussed, the parol evidence rule can and should serve that function. At best, courts use the parol evidence rule as a tool in the process of finding the agreement of the parties. At worst, courts use the rule to tell the parties how to make their agreements, punishing them for failing to reduce their agreements to writing.

Neither statutes nor common law requires that contracts be reduced to writing. Yet the court finds it to be the "public policy" of the state to encourage writings in order to discourage uncertainty. Where does this bias against oral agreements come from? The bias seems particularly alien in a society that values informal commitments, speaking respectfully of "a handshake deal" or one whose "word is his bond."

Perhaps its origin lies in the Field Code, the source of the Montana contract statutes. The Field Code was the American culmination of the nineteenth—century codification movement. Distressed that the common law was so indeterminate as to appear arbitrary, the codifiers wished to make the law explicit and accessible, not synthesized from cases and principles, but found in black letters in bound volumes. The Field Code Commissioners stated:

The question whether a Code is desirable is simply a ques-

58. See supra text accompanying notes 31-34.
60. "An honest man's word is as good as his bond." Miguel de Cervantes, Don Quix-
61. See supra text accompanying notes 20-21.
tion between written and unwritten law.

That this was ever debatable is one of the most remarkable facts in the history of jurisprudence. If the law is a thing to be obeyed, it is a thing to be known, and if it is to be known, there can be no better, not to say no other, method of making it known than of writing and publishing it.\(^\text{62}\)

In other words, the codification movement was itself a rebellion against the perceived arbitrariness of the oral word and a celebration of the sanctity of the written word in legislation. The same rationale applies to contracts, which can be described as private law-making. It is probably no coincidence that the drafters of the Field Code included a number of provisions in the contracts section that discourage oral contracts.\(^\text{63}\)

Of course, the parol evidence rule survives in jurisdictions that have not codified contract law. Even in those jurisdictions, the rule represents a longing for the formalism and certainty of writings.\(^\text{64}\) Nevertheless, Montana seems to be more strict in its application of the rule than other jurisdictions. This strictness may be seen by contrasting the Field Code provision with the more modern provision of Article 2 of the U.C.C., which was enacted in Montana in 1963 and overrides the Field Code provision with respect to transactions in goods.\(^\text{65}\)

California, which also enacted the Field Code version of the parol evidence rule, has not moved it from the Code of Civil Procedure, but amended it in 1978 to reflect the understanding of the integration concept:

Terms 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.\(^\text{66}\)


\(^{63}\) See, e.g., Mont. Code Ann. §§ 28-2-804 (written instrument presumptive evidence of consideration), 28-2-1602 (modification of written contract) (1993), and the many statutes accepting a writing in lieu of consideration.

\(^{64}\) See McCormick, supra note 2, at 430 n.4.


\(^{66}\) Cal. Civ. Proc. Code § 1856(a) (West 1983) (emphasis added). The California Code also makes explicit the function of the judge. Section 1856(d) provides:

The court shall determine whether the writing is intended by the parties as a final expression of their agreement with respect to such terms as are included therein and whether the writing is intended also as a complete and exclusive statement of the terms of the agreement.

As seen in the California and U.C.C. pronouncements of the rule, a more exact statement of the rule would provide that "when an agreement has been reduced to writing by the parties, and the parties intend the writing to contain their entire agreement, then there can be no evidence of the terms of the agreement other than the contents of the writing." This statement indicates the most difficult step in the application of the parol evidence rule—how to determine whether the parties intended the writing to contain their entire agreement.

Only when the parties intend the writing to contain their entire agreement does the parol evidence rule exclude other evidence. Conversely, the parol evidence rule applies only when the extrinsic evidence is offered as part of the agreement. Very often, the evidence is offered for other purposes. Before addressing the application of the rule, it may be helpful to examine situations in which the evidence is offered for other purposes. Distinguishing between situations in which the parol evidence rule does and does not apply will help narrow the inquiry.

IV. NOT THE PAROL EVIDENCE RULE

In the classic case, Party P alleges that Party D said X. P may offer evidence of X either in pleading or at trial. At the pleading stage, D moves for dismissal or for summary judgment on the grounds that if the pleaded material is excluded under the parol evidence rule, then P fails to state a claim. At trial, when P offers the evidence, D's attorney interjects, "Objection! Parol Evidence Rule." Similarly, D's expectation is that if the evidence is excluded, P will not be able to prove an element of the claim. At either of these stages, the appropriate procedure for the judge is to ask P's attorney two questions. First, "What evidence are you offering?" Second, "For what purpose are you offering it?"

This functional analysis will bring greater clarity to the analysis of parol evidence issues. In briefing a pretrial motion, the attorney for the party offering the evidence should address these questions. Whether addressed by the brief or not, judges should begin their analysis with them. During a trial, the judge should expressly ask these questions. The first question focuses on exactly what extrinsic evidence is being offered. Obviously a court must first hear the evidence before determining whether to exclude it under the rule. Because application of the rule is a question of law, a court should hear the evidence outside the presence of the jury for purposes of this determination.

The second question focuses on why the evidence is being of-
In a true parol evidence issue, P offers X to show that X is part of the original contract between the parties, usually for the purpose of proving that D did not perform according to X and is therefore in breach. If a court decides to exclude the evidence, at the pretrial stage it will decide whether P has a claim without that element. At trial, a court will instruct the witness not to testify to X and will bring back the jury. If a court decides to admit the evidence, at the pretrial stage it will assume that the facts as alleged are true for purposes of the motion and make a determination on that basis. At trial, a court will allow the jury to hear the evidence and determine as a matter of fact whether X actually occurred. Because the rule is a rule of substantive law, the judge can exclude the evidence as a matter of law even if D has not objected to it. Further, the judge can instruct the jury not to consider the excluded evidence even if the jury has heard it.

In most cases, P does not offer X to show that X is part of the original contract between the parties, but offers X for some other purpose. These cases do not involve the parol evidence rule. It is, therefore, extremely important that lawyers and judges ask the second question: For what purpose is the evidence offered? Among the many possible responses to this question are the following:

A. **Collateral Agreement.** X is part of a second contract between the parties (and because D did not perform according to X, breach occurs).

B. **Interpretation.** X explains the meaning of a term of the contract (and if the term is interpreted according to X, then breach occurs).

C. **Modification.** Although X was not originally part of the contract, we modified the contract to include X (and because D did not perform according to X, breach occurs).

D. **Lack of Assent.** Because of X, P did not freely assent to the contract (and therefore either no contract exists or the contract should be reformed to include X).

E. **Consumer Protection Act.** D’s expression of X constitutes a violation of the Consumer Protection Act (entitling P to damages under the Act).

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68. See supra text accompanying notes 18-24.
F. Bad Faith. D's expression of X violates the covenant of good faith and fair dealing (entitling P to damages for breach of contract, unless P and D are in a special relationship, in which case P is entitled to tort damages).

Each of these cases involves parol evidence in the general sense: P's testimony is an offer of proof of extrinsic evidence, usually an oral statement. Parol evidence, however, has a narrower meaning in the context of the parol evidence rule. Recall that the purpose of the rule is to determine whether the agreement consists of the writing alone, or the writing as supplemented by oral understandings. Because the evidence is not offered for that purpose in these examples, the examples do not involve the parol evidence rule. Let us examine them in greater detail.

A. Collateral Agreement

If nothing is wrong with oral contracts, then nothing is wrong with parties having two contracts, one written and one oral. For example, D contracts to sell her house to P. The written agreement between them states that D is selling P no personal property. P then alleges, "Just before we signed the contract, D said, 'I'll include the refrigerator for $100,' and I said, 'It's a deal.'" D invokes the parol evidence rule to bar P's testimony. The rule is not applicable, for there is no problem with the parties having two agreements, one written and one oral.

In this situation, the oral agreement is called a collateral agreement. The court failed to recognize the possibility of a collateral agreement in Eiselein v. Montana Bank.\(^6\)\(^9\) Plaintiff ranchers alleged that defendant bank orally promised them a $150,000 loan commitment and also entered into a written agreement to loan them $35,000.\(^7\)\(^0\) Holding that evidence of the oral agreement was inadmissible under the parol evidence rule because the entire agreement was merged in the writing, the court refused to enforce the oral promise.\(^7\)\(^1\) This analysis overlooked the likelihood of a collateral agreement, as Justice Trieweiler pointed out in a concurring opinion.\(^7\)\(^2\) Trieweiler correctly observed that the parties could have made two separate agreements, one oral and one written. He agreed with the result, however, because even if admissible, the defendant's alleged promise was not enforceable as a matter of law.\(^7\)\(^3\)

\(^7\)\(^0\) Eiselein, 250 Mont. at 72-73, 818 P.2d at 366.
\(^7\)\(^1\) Id. at 75, 818 P.2d at 367-68.
\(^7\)\(^2\) Id. at 75-80, 818 P.2d at 368-71.
\(^7\)\(^3\) Id. at 79-80, 818 P.2d at 370-71.
The situation Trieweiler discussed in *Eiselein* arises frequently. A party's alleged collateral agreement often fails because the promise is not legally enforceable, usually because of lack of consideration. For example, if P alleges, "Just before we signed the contract, D said, 'I'll include the refrigerator,' and I said, 'It's a deal,'" then the alleged collateral agreement would fail for lack of consideration—P is exchanging nothing for D's promise of the refrigerator. There would be consideration if the refrigerator was included in the price P agreed to pay for the house. Therefore, P must prove that the written agreement does not represent the entire agreement of the parties, but was supplemented with an oral promise. If offered for this purpose, the evidence would invoke parol evidence rule analysis.

**B. Interpretation**

If the purpose of the parol evidence rule is to find the agreement, then logically a court must first find the terms of the agreement before it can determine what they mean. Therefore determining what the terms mean is not a question involving the parol evidence rule, as recognized in the statutes. On a question of interpretation, however, most courts follow an analysis analogous to the parol evidence rule analysis. The first step is to determine what evidence a party wishes to offer to show the meaning of a term. A court will generally allow evidence as to what a term means only after determining that the term is ambiguous. But should a court allow extrinsic evidence to prove that the term is ambiguous? Just as it allows extrinsic evidence to determine whether an agreement is integrated in parol evidence rule analysis, a court will generally hear the evidence to prove that a term is

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74. Section 28-2-905(2) of the Montana Code provides: "This section does not exclude other evidence of the circumstances under which the agreement was made or to which it relates, as described in 1-4-102, or other evidence to explain an extrinsic ambiguity or to establish illegality or fraud." *Mont. Code Ann.* § 28-2-905(2) (1993)

An example of an extrinsic ambiguity is the issue of whether a document that purports to be a deed is in reality a mortgage. *See, e.g.,* Boysun v. Boysun, 140 Mont. 85, 368 P.2d 439 (1962).

Section 1-4-102 of the Montana Code provides:

*Consideration of circumstances surrounding execution.* For the proper construction of an instrument, the circumstances under which it was made, including the situation of the subject of the instrument and of the parties to it, may also be shown so that the judge be placed in the position of those whose language he is to interpret. *Mont. Code Ann.* § 1-4-102 (1993).

ambiguous after excusing the jury. 76 A court will then determine as a matter of law whether the term is ambiguous. If it determines that the term is not ambiguous, then a court does not admit the evidence. If it determines that the term is ambiguous, then because determination of what the term means is a question of fact, a court permits the jury to hear the evidence and determine the meaning of the term.

The Montana courts have fairly consistently recognized this exception to the parol evidence rule. 76 In Weinberg v. Farmers State Bank, the court correctly distinguished between parol evidence used to explain and to modify an agreement, allowing evidence on the meaning of a promissory note. 77 In Weston v. Montana State Highway Commission, the plaintiff claimed that the word “supervisor” in a written agreement meant “non-supervisor.” 78 After reviewing the evidence on the issue of ambiguity, the court stated that “[t]he language in the contract is clear and unambiguous. We find no need for further interpretation and/or parole [sic] evidence.” 79

In Payne v. Buechler, 80 however, the court got off the track by addressing the interpretation issue before it first found the agreement. Plaintiff broker sued for a commission because even though he did not sell the house, the written contract he produced stated that his right to sell was exclusive. Defendant offered to prove that the right to sell was in fact non-exclusive, but, invoking the parol evidence rule, the court refused to admit that evidence. 81 That reasoning might have been correct if defendant had alleged either an oral agreement that contradicted the written agreement or that “exclusive” meant “non-exclusive.” But that was not the nature of her proof. Defendant wished to testify that on her copy of the agreement, the parties had stricken the word “exclusive” and written in “non-exclusive.” Because her copy had been destroyed, she attempted to testify to its contents but was barred from doing so. 82 Justice Shea’s dissent correctly stated that the parol evidence rule

75. By determining that a term is not ambiguous and then declaring its meaning, a court reserves for itself what would otherwise be a jury question. As with parol evidence, this approach may reflect a distrust of juries. See Farnsworth, supra note 24, § 7.14.
78. 186 Mont. 46, 48, 606 P.2d 150, 151 (1980).
79. Weston, 186 Mont. at 49, 606 P.2d at 152.
82. Id.
would not exclude this testimony. It was a question of fact whether the agreement was found in plaintiff's or defendant's version. The finder of fact first had to determine that the agreement was found in the broker's copy of the agreement before the court as a matter of law could bar extrinsic evidence of understandings not contained in that writing.

C. Modification

Once the parties have made the agreement for today, they are free to modify it tomorrow. The parol evidence rule, which bars evidence only of understandings made before the parties reduced the agreement to writing, does not apply to understandings made after that time. Although determining whether a modification is effective does not represent an application of the parol evidence rule, as with interpretation, the analysis is analogous. The first step is to find the original agreement. Next, the evidence establishing the alleged modification may be heard. Finally, it can be determined whether the modification in fact occurred and whether it is permitted as a matter of substantive contract law.

The policies behind the parol evidence rule also are evident in the rules on modification. The distrust of oral agreements is reflected in section 28-2-1602 of the Montana Code, which provides:

How written contract may be altered by parties. A contract in writing may be altered by a contract in writing or by an

83. Id. at 328, 628 P.2d at 655. Justice Shea reasoned, citing the language of § 28-2-905(1)(b):

The validity of the agreement is “the fact in dispute” and therefore falls within the exception listed in section 28-2-905(1)(b) [of the Montana Code]. That is, the plaintiff broker contends he had an exclusive listing and was therefore entitled to a commission. But the defendant owner contends the broker had only a “nonexclusive” listing, and that he wrote “nonexclusive” on her copy of the listing agreement. Assuming the defendant to be correct, the listing agreement being held by the plaintiff broker would be invalid as an “exclusive” listing. Applied here, it would mean that under the facts here, the plaintiff could not collect a commission. Id.

84. The arguments about allowing extrinsic evidence on interpretation issues are well developed in California. Compare Pacific Gas & Elec. Co. v. G.W. Thomas Drayage & Rigging Co., 442 P.2d 641, 644 (Cal. 1968) (in which Justice Traynor states that the issue is “whether the offered evidence is relevant to prove a meaning to which the language of the instrument is reasonably susceptible”) with Trident Center v. Connecticut Gen. Life Ins. Co., 847 F.2d 564, 569 (9th Cir. 1988) (in which Judge Kozinski states, “While this rule creates much business for lawyers and an occasional windfall to some clients, it leads only to frustration and delay for most litigants and clogs already overburdened courts.”). See also Olivia W. Karlin & Louis W. Karlin, The California Parol Evidence Rule, 21 Sw. U. L. Rev. 1361 (1992).

The court has determined that in this statute, the word "executed" means performed by both parties. Many parties in Montana have performed their part of an oral modification of a written agreement only to find that the modification is not enforceable because the other party has not performed—usually by not paying them for their performance! The hardship of these results might be mitigated by application of the doctrine of waiver.

The majority in Sherrodd wrongly addressed modification when it stated:

Next we consider Sherrodd's claim that COP officers induced Sherrodd officers to sign the contract with the promise that more money would be paid than the contract provided. Section 28-2-1602 [of the Montana Code] provides that a written contract may be altered only by a subsequent contract in writing or by an executed oral agreement.

If the representation was made before the written contract was signed, then clearly it could not have been a modification of that written contract. Instead of a modification issue, the facts present a true parol evidence issue—whether the agreement consisted solely of the written contract or the written contract as supplemented by the oral understanding.

D. Lack of Assent

Lack of assent represents an exception to the parol evidence rule because the basis for the rule is the agreement of the parties: once the parties have agreed that the writing represents the entire agreement, then extrinsic evidence may not be admitted. Because contracts are voluntary acts, a party who does not freely assent cannot create an agreement. Therefore, parties are free to introduce evidence showing that no contract was formed because they lacked assent. This exception is also provided for in the statute.

Extrinsic evidence is generally permitted to prove all the traditional defenses that show lack of formation of a contract: of-
fer, acceptance, consideration, capacity, illegality, duress, fraud, mistake, and the like. Evidence of a condition precedent is also permitted to prove an understanding that some event must occur before the obligations in the writing become performable. The particular issues that arise under the fraud exception, which were raised in Sherrodd, are discussed in a later part of this Article.  

If the parties omit an understanding by mistake, the writing should be revised to include the omitted provision under the equitable doctrine of reformation. A writing is clearly not integrated when the parties have failed to include one of their understandings in it. As Calamari and Perillo concisely put it, "Contracts are not reformed for mistake; writings are." This conception of mistake makes clear the ethical obligation of an attorney in this situation. An attorney cannot use the parol evidence rule as a shield, saying, "Ha ha! I admit we agreed to that, but we also agreed that the writing would represent our entire agreement, so you can't have that included." The attorney must agree to reform the writing that excluded the agreed-upon provision. Nor can an attorney allow the client to make the decision as to whether to inform the other side of the mistake. The document simply does not represent the parties' agreement. According to this reasoning, the result should be no different if a provision is omitted intentionally rather than mistakenly. That is, the parties come to an understanding and agree that the writing will not include a particular understanding they have. A classic example is the commissioned salesman who is told by the boss that he will be paid a higher commission than that stated in the contract in order to conceal the higher payment from other salespersons. In this situation, a party cannot claim mistake, but because the writing does not represent the agreement, it should be reformed.  

92. See infra text accompanying notes 156-92.  
94. Section 28-2-1611 of the Montana Code provides: When written contract may be revised by court. When, through fraud or a mutual mistake of the parties or a mistake of one party while the other at the time knew or suspected, a written contract does not truly express the intention of the parties, it may be revised on the application of a party aggrieved so as to express that intention, so far as it can be done without prejudice to rights acquired by third persons in good faith and for value.  
96. 3 George E. Palmer, Law of Restitution § 13.10, at 68 (1978). Palmer states: If the agreement for commissions had been omitted from the writing by mistake, it would be given effect in equity through a decree for reformation. There are no sufficiently persuasive reasons for a different result because the incorrect expression was intentional. In each case the trier of the facts must be satisfied that there
E. Consumer Protection Act

In this example, P offers the evidence not to prove that X is part of the contract but to prove that D’s statement of X violated the Consumer Protection Act (CPA). Claims brought under the CPA have many advantages over claims at common law, not the least of which is that the parol evidence rule does not apply to a claim arising under the CPA. As stated by the Texas Court of Appeals, “To apply the parol evidence rule in [Deceptive Trade Practices Act] cases would frustrate the legislature’s purpose in passing the statute without furthering the objectives of the parol evidence rule.”

The CPA does not require plaintiffs to prove that there was a contract or that there was fraud, but simply that they suffered a loss because the other party employed an unfair or deceptive act or practice. In other words, the making of the statement constitutes the claim; whether the statement is part of a contract is irrelevant. For example, a used car dealer states during negotiation that if anything goes wrong with the car during the first thirty days, the dealer will fix it. The writing states that the car is sold “as is” without any warranty. When the car breaks down in the first thirty days, the seller refuses to fix it, claiming that the writing represents the entire agreement.

If the buyer claims common law breach of contract, the buyer will probably lose because under parol evidence rule analysis, the oral statement is not part of the contract. If the buyer claims fraud, the buyer will probably lose because the subject of the fraud is directly addressed in the contract. However, the buyer should be successful under the CPA. Under the administrative regulations adopted in Montana, it is an unfair or deceptive act or practice for a seller “to state that a transaction involves rights, remedies or obligations that it does not involve” or for a motor vehicle dealer to “misrepresent warranty coverage.” The court has recently rec-

was such an oral agreement, and that this was the agreement the parties meant to put into effect.

Id.

98. Honeywell v. Imperial Condominium Ass’n, 716 S.W.2d 75, 78 (Tex. Ct. App. 1986); see also Love v. Keith, 383 S.E.2d 674, 677 (N.C. Ct. App. 1989) (“Where, as here, the evidence was submitted not to vary, add to, or contradict the contract, but rather to prove an unfair or deceptive practice, the parol evidence rule will not bar its admission.”).
99. See infra text accompanying notes 166-69.
ognized the breadth of the CPA. The successful plaintiff under the Act may recover minimum damages, treble damages, and attorneys’ fees, provisions clearly intended to have a deterrent effect on those who engage in deceptive practices.

F. Bad Faith

The court has clearly established that in Montana the implied covenant of good faith and fair dealing is found in every contract. The conduct required by the covenant is statutorily defined in Montana as “honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade.” The duty is probably breached when a promisor makes a false promise, for to promise something without any intention of performing it is not honest. As discussed above, a consumer could bring a claim under the Consumer Protection Act. A party who is not a consumer might make an analogous bad faith claim, raising the fact that D said X, not for the purpose of showing that X is part of the agreement, but for the purpose of showing that D’s statement of X was a breach of the implied covenant of good faith and fair dealing.

This claim was made unsuccessfully in Farris v. Hutchinson. Plaintiff alleged that defendant, her employer, told her that her position was permanent, even though a written contract stated that it was for one year. She did not allege breach of a term of the contract, for under Story breach of the contract is not necessary for a claim of bad faith. The majority nevertheless held that “the consideration of oral negotiations between the [defendant] and [plaintiff] prior to the signing of the contracts is barred by the Parol Evidence Rule.” The court apparently found that because plaintiff did not allege that the conduct prior to the signing constituted fraud, the conduct was not admissible to prove bad faith.

The majority was particularly persuaded by the fact that the alleged oral representation contradicted the express term of the agreement: “[I]n suits of good faith and fair dealing relative to termination at the expiration of the term, the alleged implied cove-

nant cannot be in direct contradiction of the written term contract.” 108 In this reasoning, the majority confused the parol evidence rule with the exception that allows evidence showing lack of assent, in this instance because of fraud. 109 The written contract specified a term of one year. 110 The parol evidence offered was a promise of employment for a longer term. 111 When the court stated that “the implied covenant cannot be in direct contradiction of the written term contract,” 112 by implied covenant it meant the oral promise that plaintiff sought to enforce. In traditional parol evidence analysis, the court would be correct. But here the implied covenant meant the implied covenant of good faith and fair dealing. That is, plaintiff offered the evidence not for the purpose of proving that the oral representation was part of the substance of the contract but for the purpose of showing that the behavior of defendant constituted bad faith. To suggest that behavior contradicts a term is illogical. The court used the fraud analogy, finding that there cannot be bad faith, just as there cannot be fraud, when the alleged false representation directly contradicts the contract term. The court might better have used the Consumer Protection Act analogy: defendant engaged in bad behavior—actionable behavior—individually of what the contract said.

Justice Hunt’s dissent in Farris clearly identified the weakness in the majority opinion:

Under the holding of this case, an employer may make significant oral representations to an employee concerning the terms of the employment, induce the employee to sign a written contract with provisions contrary to the oral representations on the basis that the written contract is only a formality, and then completely avoid all liability for the oral misrepresentations which induced the employee to sign the written contract in the first place. The majority opinion prohibits an employee from even presenting evidence of the wrongdoing, encourages employers to deal dishonestly with employees, and leaves a large segment of the working population (destined to grow larger as employers familiarize themselves with the majority opinion) without any legal recourse. 113

The dissent argued that the facts of the case fell under the fraud

108. Id. (citations omitted).
109. The majority also confused the parol evidence rule with modification, for the quoted passage was followed by a citation to § 28-2-1602 of the Montana Code. Id.
110. Id. at 336, 838 P.2d at 375.
111. Id. at 337, 838 P.2d at 376.
112. Id. at 338, 838 P.2d at 376.
113. Id. at 342, 838 P.2d at 378-79.
exception to the parol evidence rule, reasoning that even though plaintiff did not allege fraud, "the rationale for the exception to the parol evidence rule applies equally to both situations." The dissent expressed a fear that a rule that was designed to prevent fraud would in fact encourage fraud. The court in Farris used the parol evidence rule to channel behavior. But which direction should channeling take, telling parties not to make false representations or telling parties not to pay any attention to them? The majority took the latter course, putting the burden on the victim, while the dissent took the former course, putting the burden on the perpetrator.

The point that behavior can violate the implied covenant of good faith and fair dealing was also missed by the court in Sherrodd:

Because of the inadmissibility of Sherrodd's evidence as to alleged misrepresentations, the claim of breach of the covenant of good faith and fair dealing also fails. There is no allegation of any violation of the express terms of the written contract, as would be required in this arms-length contract under our opinion in Story v. City of Bozeman (1990), 242 Mont. 436, 791 P.2d 767. Bad faith is not limited to a party's violation of express terms. Bad faith is lack of "honesty in fact," and a party can act dishonestly during many parts of the contractual relationship. For example, a party who makes an intentional material misrepresentation during negotiations probably exhibits bad faith. Therefore, applying the reasoning of the dissent in Farris, the court in Sherrodd could have found that when defendant made an oral promise that it did not intend to keep, there was a breach of the implied covenant of good faith and fair dealing even if the promise was not part of the agreement.

V. APPLICATION OF THE PAROL EVIDENCE RULE

We have now completed the first two parts of the analysis. We have asked:

- What evidence are you offering?
- For what purpose are you offering it?

114. Id. at 343-44, 838 P.2d at 380.
115. Sherrodd, 249 Mont. at 286, 815 P.2d at 1137.
116. See McGregor v. Mommer, 220 Mont. 98, 714 P.2d 536 (1986) (finding fraud in negotiation). Although the court did not find the fraud to constitute bad faith, the issue was the tort of bad faith and the standard was the now discarded Nicholson test. Id. at 108-09, 714 P.2d at 542-43 (citing Nicholson v. United Pac. Ins. Co., 219 Mont. 32, 710 P.2d 1342 (1985)).
Having eliminated instances where the introduction of extrinsic evidence does not invoke the parol evidence rule, let us now examine instances that do. The parol evidence rule applies when evidence is offered for the purpose of showing that an extrinsic agreement, usually oral, is part of the parties' agreement. When analyzing a parol evidence question, it will be helpful to ask these two questions:

- Was the oral agreement made?
- Was the oral agreement part of the parties' entire agreement?

Because a party who fails to prove that the oral agreement is part of the parties' agreement often attempts to show that the oral promise induced the agreement, it will also be helpful to ask whether a party was defrauded.

A. Was the Oral Agreement Made?

When Party P alleges that an extrinsic agreement should be admitted and enforced, P must prove that the answer to both questions is YES: D made the agreement, and it was part of the entire agreement. D will usually answer both questions NO: We didn't make the oral agreement, and the writing represents the entire agreement. In Sherrodd, for example, COP disputed Sherrodd's version of the facts, claiming that COP agreed to assist Sherrodd in seeking additional compensation from the owner because of changed circumstances but that COP did not agree to pay Sherrodd itself. COP also claimed that the writing represented the entire agreement. However, in the procedural posture of a motion for summary judgment or an appeal where the trial court has made a finding of fact, a court must usually assume that the answer to the first question is YES: The parties made the oral agreement. This approach gives tremendous weight to the second question, for if the answer to the second question is NO, then the answer to the first question is moot: even if the oral agreement was actually made, the parties did not intend it to be part of their agreement. Therefore, the first question is frequently disregarded.

The first question is a classic fact question—your word against mine. Law students always focus initially on this question, believing that parol evidence is a fact question rather than a law question and that the most important issue is whether the agreement was made. Like many intuitive responses, the mistaken notion of the students reflects a great deal of common sense—if a party

117. Sherrodd, 249 Mont. at 284, 815 P.2d at 1136.
made the promise, that fact ought to be given a lot of weight. For
if the parties made the oral agreement, then that fact suggests that
the writing does not contain their entire agreement and helps in
the process of finding their true agreement.

Consider an analogy to the statute of frauds, the statutes re-
quiring that certain agreements be evidenced by a writing. Courts
have generally construed these statutes narrowly in order to en-
force agreements parties clearly made but neglected to reduce to
writing. Consider two situations. In the first, P says to D, “Thanks
for agreeing to sell me your car for $5,000. I’m here to pick it up.”
D expresses astonishment and denies any such agreement. If this
were merely a fact question, the chance of legal error might be
quite high, for if the trier of fact were to believe P and not D, then
D would be forced into a transaction D never in fact made. The
statute of frauds would come to D’s aid, in effect requiring a higher
showing of proof by P, i.e., some memorialization of the
transaction.118

In the second hypothetical, assume that when P comes to pick
up the car, D says, “Yes, I did make that agreement with you. But
ha ha, it is not enforceable because of the statute of frauds!” Is
there any reason D should be able to use this “technicality” to es-
cape a deal D in fact made? No, according to the U.C.C., which
enforces, as an exception to the statute of frauds, an oral agree-
ment that a party admits making.119 Under the U.C.C. statute of
frauds, then, the rule is not used formalistically to deny enforce-
ability to agreements. Rather, the rule has no application when the
agreement was actually made.

The analogy to the parol evidence rule breaks down at the
next step, for P must show not only that the agreement was made
but that it was intended to be part of the agreement. Nevertheless,
if a court finds that the oral agreement was in fact made, the focus
should reasonably shift to P’s explanation for why the writing did
not include that agreement. This approach would have some im-
 pact on the functions of the parol evidence rule. The perjury func-
tion is affected because more allegations would survive the motion
stage and juries would get to decide the question of fact of whether
the agreement was made. The efficiency function is compromised

119. Section 30-2-201(3)(b) of the Montana Code provides that “[a] contract which
does not satisfy the requirements of subsection (1) but which is valid in other respects is
enforceable . . . if the party against whom enforcement is sought admits in his pleading,
testimony or otherwise in court that a contract for sale was made.” Mont. Code Ann. § 30-
2-201(3)(b) (1993).
because fewer cases could be dismissed on motion, since for purposes of the motion a court assumes that the agreement was made. The channeling function is the most seriously compromised, because parties would be less frequently penalized for failing to put their agreements in writing. But these are not the proper functions of the rule. By focusing on whether the agreement was actually made, more agreements that were actually made would probably be enforced. The proponent of the oral evidence, however, would still have to answer the second question.

B. Was the Oral Agreement Part of the Parties’ Entire Agreement?

Assuming then, that the oral statement was made, the law must now distinguish between those statements that the parties regarded as “just talk” and those that they intended to be legally operative as part of the contract. This is the key issue in parol evidence—how to determine what the parties intended.

Samuel Williston made the answer to this question easy. The last of the great formalists, Williston’s views reflected the idea of a contract as an airtight document, an idea that still lingers in Montana. He suggested that examination of the contract would determine whether the parties intended that the writing contain their entire agreement. Parties often express that intention in a merger clause, a boilerplate provision that states that the entire agreement is found in the writing. According to Williston’s first test, if the writing contains a merger clause, that is the end of the story.120 But what limited storytelling that is! The mere fact that the writing says that is all there is does not mean it is true, any more than the statement in a will that a person is of sound mind proves that the person is not loony.121 The rest of the story may show any number of reasons why terms were omitted. The parties may have omitted a term intentionally or inadvertently. In a contract of adhesion, a party may not have known of the presence of the merger clause. One party may have prevailed upon the other to omit a term rather than mess up the neatly printed fabric of the agreement. Because Williston’s reliance on merger clauses proves too much, a modern trend gives them less weight.122

To determine how much weight to give a merger clause, a court must examine the clause itself and the circumstances of its

120. 4 SAMUEL WILLISTON, CONTRACTS § 633 (3d ed. 1961).
121. I recall a cartoon in which the lawyer reading the will intones, “I, Emperor Duane IV of Nebraska, being of sound mind . . . .”
inclusion in the contract. The inquiry should take two steps. First, did the circumstances, including the writing itself, give clear notice to the party alleging extrinsic evidence that oral representations did not count and that the writing was the entire agreement? For example, was the merger clause buried in boilerplate, was it comprehensive, and was the party’s attention called to it? Second, how sophisticated was the party in comprehending and processing the notice? For example, if the party is a sophisticated business person negotiating a complex transaction, then a boilerplate merger clause should suffice. In fact, a merger clause may not be necessary to show finality and completeness when sophisticated corporate parties have hammered out a comprehensive agreement. On the other hand, if the party is an unsophisticated individual signing a contract of adhesion, then the strongest merger clause may not prove that the agreement was merged in the writing.

Under this approach to integration, a merger clause will have weight, but a court will have to listen to a party’s explanation of why the agreement is not found entirely in the writing even though the writing purports to be complete. As an example, consider a personal guaranty given by an officer of a corporation to a lender, a transaction that frequently raises parol evidence issues. When the lender seeks to enforce the contract, the guarantor may allege that the lender made an oral representation; for example, that the lender would look first to the principal debtor or would seek an amount less than that stated in the guaranty. Examining this phenomenon, one expert observed:

No one seems to know why guarantors, many of whom are sophisticated business people, rely on representations at odds with the terms of the written instrument. Nor does anyone seem to know why lending officers make these representations, if in fact they do. One explanation is that because guarantors are understandably reluctant to become liable for someone else’s debt, lending officers try to persuade them by making promises they later regret. The guarantors, for their part sign the document containing language contrary to the agreement because they fail to read it carefully, fail to understand it, or rely on the assurances of the lend-

123. In ARB, Inc. v. E-Systems, Inc., 663 F.2d 189, 199-200 (D.C. Cir. 1980), the circuit court considered the agreement integrated because an additional term “would disrupt the delicate balance, the harmony, that the written contract establishes among the respective obligations of the parties.”


Courts frequently invoke the parol evidence rule to exclude testimony of the lender's statements because the guaranty document contains a merger clause. The reasoning behind exclusion appears to emphasize the channeling function: With a strong parol evidence rule, guarantors will know they must rely on the writing and not on the oral representations. They will therefore tune out what they hear and pay more attention to what they can read.\textsuperscript{127}

Consider on the other hand the functions that might be served by a rule that would not honor the merger clause on its face but would allow a guarantor to offer evidence of the facts and circumstances of the making of the agreement. If, after hearing this evidence, a court determines that the agreement is not integrated and admits the extrinsic evidence, presumably it may be believed by a jury. In that event, lenders will learn that they had better keep quiet, encourage the guarantors to read the document, and advise the guarantors to consult with their attorneys if they have any questions. This result seems more desirable. In balancing two public policy interests—promoting the certainty of written agreements and enforcing agreements that are actually made—the latter should be given greater weight. One way to serve this policy is through training of bank personnel. It could be said that this policy is already served by merger clauses, which in effect tell parties exactly what bank personnel would tell them. But the fact is that a merger clause is just one more item of boilerplate that parties do not read, particularly when they are persuaded that it is not meaningful. If the concept is important enough to communicate clearly to the guarantor, the bank should put language in a conspicuous place in the guaranty.\textsuperscript{128} Rare will be the judge who will admit the

\textsuperscript{126} Id. at 549.
\textsuperscript{128} For example, one author has this suggestion for the contract of adhesion: Ideally, for an integration clause to have any significant reliability in a purely adhesion situation, the form would be more like “Write anything anyone said about this sale which was important to you in the space that follows. Understand this: If you haven't got it in writing, you haven't got it.” And if the seller then instructed the customer to write “nobody said anything” if nobody did, or “it's all here” if it was, then that statement in that blank would be very persuasive on the point that the contract was integrated.

\textbf{Corbin, supra note 18, § 578, at 530.}
evidence in the face of that warning.

A good example of conspicuous communication of the importance of the writing is the Federal Trade Commission Used Motor Vehicle Trade Regulation Rule.129 Testimony before the Federal Trade Commission (FTC) indicated that used car dealers notoriously made false representations to buyers, particularly about the extent of the seller’s liability for post-sale problems. When the customer complained about a problem after the sale, the seller would point to language in the agreement, which first stated that there are no warranties (often the words “AS IS” were used, which is usually sufficient under the statute to disclaim all implied warranties) and second stated a strong merger clause, indicating that the writing represented the entire understanding of the parties. Armed with this language, the seller would stand behind the parol evidence rule.130

The FTC rule requires the seller to post a sticker on the car that clearly indicates the warranty terms of the sale and that warns the customer: “IMPORTANT: Spoken promises are difficult to enforce. Ask the dealer to put all promises in writing.”131 This regulation represents the formalist paradigm for solving integration problems. The customer is clearly informed of the terms of the deal, is warned in advance of the possible pitfalls, and is told what he or she can do about it. Theoretically, customers should not fall into any traps, and if they do, their story will not be compelling.132

Let us examine the merger clause in Sherrodd in its full context. The court assumed for purposes of the pretrial motion that the oral promise was made, but found that it was not part of the contract because of the merger clause. The court neglected to point out, however, that the subcontract between Sherrodd and COP did not contain a merger clause. It contained an “Additional Provision” stating that “[t]he attached provisions of the agreement be-

132. But see Curtis v. Bill Byrd Automotive, Inc., 579 So. 2d 590 (Ala. 1990). In Curtis, plaintiff claimed that he had been defrauded when he purchased a used car both by affirmative statements and by silence when disclosure was required. Id. at 592. Defendant raised compliance with the FTC Used Car Regulation in its defense. Id. at 593. The majority admitted the parol evidence in spite of the disclosures. Id. at 592-94. The dissent found that there could be no fraud when the customer had been clearly told that the writing represented the entire agreement and had been warned not to rely on the representations of the seller and in fact had not relied on them but had conducted an independent investigation. Id. at 594-95 (Maddox, J., dissenting).
between Cop Construction Co. and Schlekeway & Associates are hereby made a part of this agreement between Cop Construction Co. and Sherrodd, Inc.” Buried in the “Standard Subcontract Provisions” of the agreement between COP Construction Co. and Schlekeway & Associates was the merger clause:

It is distinctly understood and agreed by Subcontractor that this Subcontract is made for the consideration herein named, and that the Subcontractor has, by examination, satisfied himself as to the nature and location of the work, the character, quantity, and kind of materials to be encountered, the character, kind and quantity of equipment needed during the prosecution of the work, the location, conditions and other matters which can in any manner affect the work under this Subcontract. No verbal agreement with any agent either before or after the execution of this Subcontract shall affect or modify any of the terms or obligations herein contained and this contract shall be conclusively considered as containing and expressing all of the terms and conditions agreed upon by the parties hereto.\textsuperscript{133}

Incorporation by reference is a well-accepted practice that saves considerable time in drafting. A document or provision that is incorporated by reference is as much a part of the original document as if it had been expressly set forth in that document. The technique is often used in the construction industry, where specifications in the contract between the owner and the general contractor may be incorporated by reference in contracts between the general contractor and subcontractors. An issue that often arises, however, is the scope of the incorporated document. In a leading case, the United States Supreme Court stated that “in the case of sub-contracts, as in other cases of express agreements in writing, a reference by the contracting parties to an extraneous writing for a particular purpose makes it a part of their agreement only for the purpose specified.”\textsuperscript{134}

Did Sherrodd and COP intend to incorporate all the provisions or only those relevant to their agreement? A number of cases have held that only provisions concerning technical aspects of the work are incorporated and not administrative clauses.\textsuperscript{135} As between COP and Schlekeway, the merger clause clearly states that the writing is final and complete. But did the incorporated merger clause serve the same function between Sherrodd and COP? Sher-

\textsuperscript{133} Appellant’s Brief app., Sherrodd (No. 90-347).
rodd thought an enforceable promise was made to him. Did the writing alert him to the fact that this promise did not count? Note that in the merger clause, "this Subcontract" refers to the agreement between COP and Schlekeeway and "the Subcontractor" refers to COP. It seems reasonable for the contract between Sherrodd and COP to incorporate by reference technical aspects of the job, but not a merger clause that was personal to the original parties. 136

Furthermore, courts are often sympathetic to consumers who have good explanations for why they signed a writing that excluded an oral representation. 137 Although Sherrodd was technically not a consumer, his economic circumstances placed him, like a consumer, in a very weak bargaining position. He had no opportunity to negotiate the agreement but had to sign what was offered him. In fact, unlike most consumers, he could not simply walk away from the deal. Considering all of these circumstances, the merger clause should have been given little weight.

This is not to say that every time a court finds that there was an oral agreement, it must find that that agreement is part of the contract. There may be circumstances when, because of the nature of the agreement or the effect on third parties, a writing should be regarded as complete despite evidence of actual side agreements. Williston's first test—whether there is a merger clause—may be overly formalistic, but his second test is more functional. He asks if the additional terms were such as might naturally be made and not included in the writing by parties situated as were the parties to the written contract. 138 The written agreement is more likely regarded as complete if it is the function of the agreement to be complete. A will is a clear example of an agreement intended to be complete on its face. Estates law generally provides that terms

136. It seems especially unreasonable that the court excluded the extrinsic evidence of fraud because that evidence directly contradicted the written terms when those terms were so tenuously connected to the written contract. Sherrodd, 249 Mont. at 285, 815 P.2d at 1137. See infra text accompanying notes 151-66.


138. Williston, supra note 120, § 638, at 1040-41. Williston states:
[The test of admissibility is much affected by the inherent probability of parties who contract under the circumstances in question, simultaneously making both the agreement in writing which is before the court, and also the alleged parol agreement. The point is not merely whether the court is convinced that the parties before it did in fact do this, but whether parties so situated generally would or might do so.

Id.
outside the writing are not admissible unless executed with the proper formalities.\textsuperscript{139} Other agreements may not be executed with the same formalities, but may by their nature be intended as final and complete. Examples include a recorded deed, a separation agreement between husband and wife that concludes all aspects of their relationship, and a carefully negotiated agreement between two sophisticated businesses. In these circumstances, even if the oral agreement was in fact made, the agreement might nevertheless be regarded as complete without it.

The problem with Williston's tests is that they bear no relationship with reality. They are objective tests, looking at what reasonable parties do or what probability shows most parties do.\textsuperscript{140} The tests do not look to the actual circumstances of the parties. Hearing evidence of the actual circumstances would invite perjury and would require juries to sort out the facts, all of which would require court time, thus reducing judicial efficiency. For example, courts frequently find the existence of an oral agreement but determine that it is not part of the contract when the oral agreement contradicts the written agreement. In that case, a court generally assumes that the writing reflects the parties' final and complete agreement as to the terms contained in the writing. Before summarily determining that no oral agreement may be allowed to contradict a writing, however, a court should look at the circumstances of the parties and determine whether in fact the parties intended the oral agreement to have greater weight than the writing. For example, the company and the sales person may have intentionally misstated the commission term in the writing.\textsuperscript{141}

If a court gives too much weight to the writing, it ignores the fact that the writing never reflects the parties' final and complete agreement.\textsuperscript{142} The agreement is supplemented by so many things—gap fillers, default rules, course of performance, course of dealing, usage of trade, interpretation—that we must ask, why not supplement it with oral understandings as well? For example, a buyer contracts to buy goods for a price of $100,000. The seller delivers and demands $120,000. The buyer insists on adherence to the written agreement. The seller offers evidence of custom and

\textsuperscript{139} MONT. CODE ANN. § 72-2-522 (1993). This rule has been considerably relaxed, reflecting the reality that people often make less formal agreements. See MONT. CODE ANN. § 72-2-523 (1993).

\textsuperscript{140} Similarly, default rules applied in areas of the parties' non-agreement are criticized for failing to carry out the parties' actual intentions. See Lawrence Kalevitch, Gaps in Contracts: A Critique of Consent Theory, 54 MONT. L. REV. 169 (1993).

\textsuperscript{141} See supra text accompanying note 85.

\textsuperscript{142} See supra text accompanying notes 32-61.
usage in the trade under which increases in the seller's cost of doing business can be passed on to the buyer. This evidence is, by statute, allowed to supplement even the terms of the parties' integrated written agreement. Because parties in the trade are presumed to bargain in the context of that trade, trade practices are assumed incorporated unless specifically excluded. Should the result be any different if the seller alleged not a trade custom, but an oral understanding between the parties that increases in cost could be passed on to the buyer?

One circumstance that must be considered is the effect of the oral understanding on third parties. It is sometimes asked whether the parol evidence rule "applies" to third parties. As framed, the question is absurd. Because the purpose of the rule is to help find the contract, it can also be used to find the obligations of the third party. For example, assume the third party is Surety S who executes a performance bond with Contractor C for the benefit of Owner O. The written contract between C and O states that C will do job X, but the parties entered into a side agreement stating that C will also do Y for the same consideration. C defaults and O seeks performance from S. Is S's obligation to perform X only or X plus Y?

The first step is to find the contract between C and O by asking the two questions:

- Was the oral agreement made?
- Was the oral agreement part of the parties' entire agreement?

If the answer is that the writing represents an integration of the agreement, that is the end of the inquiry, for then the contract is for X only. If the answer is that the agreement is not integrated, then the contract between C and O is for X plus Y. Is term Y binding on S? For that purpose, it is necessary to find the contract between C and S (or at least the promise of which O claims to be the beneficiary). Again, start with the two questions. If the agreement between C and S is found only in a writing that binds S to perform C's obligations in the written agreement between C and O, then S is bound only by X. But if the agreement between C and S discloses the oral agreement and the scope of S's performance included Y, then S is bound to perform both X and Y.

144. See, e.g., Nanakuli Paving & Rock Co. v. Shell Oil Co., 664 F.2d 772 (9th Cir. 1981).
Application of the rule to a third party might also arise in the event of assignment and delegation. For example, in the above hypothetical involving the purchase of goods for $100,000, assume that the first buyer assigned its right to receive the goods and delegated its duty to pay for them to a second buyer. If the seller demanded an additional $20,000 from the second buyer, the second buyer would be bound if the obligation arose by custom and usage in the trade, but would not be bound by an oral understanding between the original parties of which it had no notice.

In *Baker v. Bailey*, the court refused to enforce an oral agreement that was actually made because of the nature of the agreement and its effect on third parties. Mr. and Mrs. Bailey lived in a mobile home on land owned by their daughter and son-in-law, who also had a home on the property that obtained water from a well. The daughter and son-in-law installed a pipeline from their water line to the mobile home. Six years later, the daughter and son-in-law conveyed one acre on which the mobile home was located to the Baileys and the remaining forty-five acres to the Bakers. At this time, the Baileys and the Bakers entered into a written Water Well Use Agreement to assure the Baileys access to the water now located on the Bakers' land.

The agreement provided that the right to use the water extended only to the Baileys. If the Baileys sold their property, the Bakers had no obligation to provide the new owners with water. The Bakers also received a right of first refusal in the event of a sale by the Baileys. Two years after execution of the agreement, the Baileys decided to sell the land at an asking price of $47,500. The Bakers then informed the Baileys that they would not make water available to any purchasers. When the Baileys received an offer of $8,000 for the land without water, the Bakers exercised the right of first refusal, purchasing the land for $8000.

When the Bakers sued to recover unpaid expenses, the Baileys counterclaimed, alleging breach of the agreement. At trial, the Baileys offered evidence of oral understandings between the parties. They testified that because the Bakers were concerned that the future owners of the Bailey property might be undesirable, the parties orally agreed that the Bakers would transfer the water rights to a reasonable purchaser of the property. The writing,

146. 240 Mont. 139, 782 P.2d 1286 (1989).
147. *Baker*, 240 Mont. at 141, 782 P.2d at 1287.
148. *Id.* at 141-42, 782 P.2d at 1287.
149. *Id.* at 142, 782 P.2d at 1288.
150. *Id.* at 143, 782 P.2d at 1288.
however, stated that the right was personal to the Baileys. 151

If the oral agreement in *Baker* were enforceable, there would be increasingly complex questions about what it meant. Was the agreement personal to the Bakers or did it run with the land? That is, if the Baileys sold to a purchaser approved by the Bakers, would those purchasers have to obtain approval from the Bakers—or from their successors—when *they* sold? If so, where would a seller or purchaser find notice of this restriction? The parties could testify to these intentions, but ultimately many points were not decided. An advantage of writing things down is that parties not only memorialize their understandings, they work out details. In *Baker*, the problem was not just that the agreement was oral, but that it was indefinite. 152 Because of these factors—the conveyance-like nature of this agreement, the effect on third parties, and the need for details—the court properly determined that the parties should have reduced their understanding to writing.

The *Sherrodd* court may have been persuaded to invoke the parol evidence rule by the commercial nature of the agreement and the need for third parties to rely on the writing, for the majority noted that COP's bid included Sherrodd's bid. 153 The court, however, may have overlooked the sequence of events. Because COP's bid was submitted before the agreement was written down, COP could not have been relying on the written agreement but must have relied on the oral understandings. Safeco, the surety which provided COP's payment bond, represents the kind of third party against whom the parol evidence should not be admitted. Because it lacked knowledge of the oral agreement, Safeco's liability should be limited to the $97,500 expressed in the written agreement. If Sherrodd expected Safeco's obligation to be enlarged, then it was Sherrodd's responsibility to get that obligation in writing; Sherrodd had no such obligation to COP, which knew about the oral understanding.

The modern view of the integration doctrine, as advocated by

151. *Id.*

152. The role of negotiations in the application of the rule indicates why careful lawyers always save prior drafts of documents. The extrinsic evidence (in the case of prior drafts not oral evidence) may serve a function analogous to "legislative history," proving how a particular term came to be included in the private agreement. In *Baker*, the Bakers pointed out in their reply brief that in an initial draft, the Well Use Agreement ran with the land but that in the executed draft the benefit was personal to the Baileys. Appellant's Reply Brief at 5-6, *Baker* (No. 89-260). This change indicates that the earlier understanding was supplanted. *Id.* (appending the unexecuted draft as Exhibit 1); see also Depositors Trust Co. v. Hudson Gen. Corp., 485 F. Supp. 1355 (E.D.N.Y. 1980) (reviewing prior documents to ascertain the parties' intentions).

Corbin and reflected in the Restatement (Second) of Contracts, requires not just examination of the document but an examination of all the facts and circumstances to determine whether the parties intended the writing to represent their final and complete agreement. However, even if a court determines that the writing is fully integrated, the evidence may still be admissible. A party may present the extrinsic evidence not to supplement the agreement, but to prove lack of assent. Let us now explore this exception to the parol evidence rule.

VI. THE FRAUD EXCEPTION

When Party P alleges that D promised X, P has two bites at the apple. First, P can offer to prove that the oral understanding is part of the totality of the parties' agreement by showing that the writing does not represent the entire understanding of the parties. To parry this attack, D interposes the parol evidence rule. If P is unsuccessful on this ground, P can offer to prove that he or she was induced to enter the agreement by fraud. This offer of proof does not invoke the parol evidence rule because the oral understanding is offered not to prove that it was part of the contract but to prove that no contract was formed because of lack of assent. In theory the merger clause is no defense to this claim, for Party P alleges that the entire contract—including the merger clause—is not effective.

Consider the remedial effect of this claim. If P is successful in showing that no contract was formed, the remedy is to restore both parties to their pre-contractual positions. P is not able to enforce the oral promise as part of the contract, so P will not receive expectancy damages. However, to return the parties to their pre-contractual positions, the court may award either party damages in reliance or restitution. These equitable remedies may be very similar to contract damages. For example, assume that the Sherrodd court had determined that no contract was formed because of the fraud. To restore the parties to their original positions, the court would have had to recognize the fact that Sherrodd conferred a substantial benefit on COP by moving the additional earth. In restitution, the court would have awarded Sherrodd the reasonable

154. Corbin, supra note 18, § 582.
156. See supra text accompanying notes 90-96; see also Justin Sweet, Promissory Fraud and the Parol Evidence Rule, 49 Cal. L. Rev. 877 (1961).
value of the services, which would probably be measured at $3.90 per cubic yard, the same as the contract price. Therefore, although parties alleging lack of assent and parties alleging extrinsic agreements have different theories of the case, the remedial results may not differ.

Fraud takes two basic forms: a misrepresentation of an existing fact and a promise made without intent to render the performance.158 The latter is often referred to as promissory fraud. If every false promise were considered a fraudulent promise, then indeed the fraud exception would swallow up the parol evidence rule. Party P can claim, “You orally promised me X and you did not perform. I am offering this proof not for the purpose of showing that X is part of the contract, but for the purpose of showing that your promise of X induced me to enter the contract.” Troubled by the expansiveness of the fraud exception to the parol evidence rule, the Montana court has tried to contain it.

To explore these containment efforts, it may be helpful to begin with the elements of fraud, as consistently stated by Montana courts:

In order to establish a prima facie case of actual fraud it is well settled that the party seeking to avoid the contract must prove: “(1) a representation; (2) its falsity; (3) its materiality; (4) the speaker’s knowledge of its falsity, or ignorance of its truth; (5) his intent that it should be acted upon by the person and in the manner reasonably contemplated; (6) the hearer’s ignorance of its falsity; (7) his reliance upon its truth; (8) his right to rely thereon; (9) and his consequent and proximate injury.” The final determination of whether there was actual fraud is always a question of fact.159

In one approach to limiting parol evidence, the court has focused on the state of mind of the deceiver as stated in elements (4) and (5): P must show evidence of an intent to defraud at the time the promise was made.160 P may easily prove this element with a fraudulent misrepresentation, for the fact that the present misrepresentation is at odds with existing fact is a strong indication of intent to defraud. But with promissory fraud, the fact that the speaker did not keep the promise in the future does not necessarily

prove the speaker's intent to defraud at the time the promise was made; if it did, all breach of contract claims would be fraud claims. For example, in *Dew v. Dower*, plaintiffs, purchasers of real estate, entered into written contracts for deed with defendant seller. When plaintiffs claimed that defendant orally promised them improved access roads and then did not construct the roads, defendant invoked the parol evidence rule. The trial court allowed the evidence under the fraud exception. On appeal, defendant argued that plaintiffs had not proven intent to defraud at the time the contracts were made. Referring to photographs that defendant showed plaintiffs at the time of contracting, the court observed:

According to [defendant], the photographs accurately reflect the improvements she intended when she promised the plaintiffs improved roads. If, as [defendant] testified, the rough-graded dirt roads in the photographs depict the roads that she intended when she promised county-grade roads, then it is clear that the District Court could find she had no intention of performing her promises when she told the plaintiffs she would construct county-grade roads.

Distinguishing the facts from *Sherrodd*, the court held that the parol evidence was properly admitted because it did not contradict the written contract.

The more common approach the court uses to limit parol evidence focuses on the state of mind of the deceived as stated in elements (7) and (8): P must prove not only that P relied on the false promise, but that it was reasonable for P to do so. When P offers parol evidence of promise X, the court is troubled when it finds the subject of the oral promise addressed in the writing. The court in effect asks P, "If X was so important to you that it induced you to enter the contract, then why was it not important enough for you to see that it was included in the writing?" Under Williston's approach, the writing would tell the whole story. But P always has a story to tell in answer to that question, and the outcome of a case involving the fraud exception usually turns on the quality of P's storytelling.

In *Sherrodd*, the majority turned a deaf ear to plaintiff's story because the contract directly addressed the subject matter of the

162. *Id.* at 110, 852 P.2d at 552.
163. *Id.* at 120, 852 P.2d at 552-53.
164. *Id.* at 122, 852 P.2d at 553.
165. *Id.* at 120, 852 P.2d at 552.
166. See supra text accompanying note 120.
fraud—the quantity of earth to be moved:

Here, any reliance on the alleged fraudulent statement of the Morrison-Knudsen representative is contradicted by the terms of the written contract that Sherrodd has, "by examination, satisfied himself as to the . . . character, quantity and kind of materials to be encountered." The contention that the $97,500 covered only 25,000 cubic yards of earthwork contradicts the terms of the written agreement that all "negotiations and agreements" prior to the date of the contract are merged in the writing and that the work to be done is "lump sum." We conclude that the parol evidence rule applies.167

Justice Trieweiler in his dissent found that all the elements of fraud were satisfied.168 He would have repudiated the Montana precedents that limit the fraud exception to the parol evidence rule. Moreover, he pointed out that the limitation of the fraud exception would encourage fraudulent conduct: "Based on this decision, and our previous decision in Continental Oil, all that a fraudulent party needs to do in order to avoid accountability for fraudulent conduct is to obtain the signature of his defrauded victim on a written agreement.169

The dissent in Sherrodd echoes a long line of cases that advocate a more sympathetic view of the fraud allegation.170 Those cases recognize that a party claiming fraud often had no choice but to sign the agreement that contradicted the oral understanding. Therefore, the mere fact that the alleged representations contradict the language of the contract should not be sufficient to bar P from explaining the circumstances. The tactics of defrauders are numerous, as a New York judge observed:

"[T]he ingenuity of draftsmen is sure to keep pace with the demands of wrongdoers, and if a deliberate fraud may be shielded by a clause in a contract that the writing contains every representation made by way of inducement, or that utterances shown to be untrue were not an inducement to the agreement, a fraudulent seller would have a simple method of obtaining immunity for his misconduct."171

167. Sherrodd, 249 Mont. at 285, 815 P.2d at 1137.
168. Id. at 287-89, 815 P.2d at 1138-39.
169. Id. at 289, 815 P.2d at 1139.
170. "Even a clause specifically reciting that there have been no representations of a particular kind should be ineffective as against extrinsic evidence to show fraud, although there is some authority to the contrary." Farnsworth, supra note 24, § 7.4, at 484 (footnotes omitted).
It is curious that the Montana court found Sherrodd's story less sympathetic than that told by the plaintiff in *Jenkins v. Hillard*, which did persuade the court of fraud. Jenkins, the purchaser of a hotel, alleged that the seller had made fraudulent representations about the heating system. The court was troubled by the fact that the written sales agreement directly addressed the issue of representation in the following provisions:

"Buyer has inspected and is familiar with the premises and the physical condition of all the furniture, fixtures and equipment and improvements thereon and therein, and enters into this Agreement on his own independent investigation."

and

"This contract contains the entire agreement between the parties and the Buyer affirms that neither Seller nor any agent of the Seller has made any representations or promises with respect to or affecting the property herein described on this contract not expressly contained herein and that Buyer affirms that he relies upon his own personal observation and examination of the property herein described."

The trial court granted summary judgment on the grounds that the buyer had no right to rely on the representations. On appeal, because of the procedural posture of the case, the court assumed that Jenkins' allegations were true. Reversing, the court found that a fraud claim was made out because Jenkins did not know the representation was false and could not easily find out whether it was false. The court paid little attention to the writing, stating:

"This Court has recognized the rule that "fraud vitiates every transaction and all contracts." *Bails v. Gar* (1976), 171 Mont. 342, 558 P.2d 458, 461. The reasoning behind this rule is that a party who has perpetrated fraud by inducing another to enter into a contract may not then use the contract to immunize himself from the fraud. *Bails*, 558 P.2d at 461-462. The contract provision therefore does not preclude proof that a prior oral representation was made and relied upon."

Dissenting, Justice Sheehy would have given much greater weight to the writing. He stated:

364, 369 (2d Cir. 1927)).

172. 199 Mont. 1, 647 P.2d 354 (1982).

173. *Jenkins*, 199 Mont. at 4, 647 P.2d at 356.

174. *Id.*

175. *Id.* at 4-5, 647 P.2d at 356.

176. *Id.* at 7-8, 647 P.2d at 357-58.

177. *Id.* at 5-6, 647 P.2d at 357.
Here the buyer specifically contracted that the seller made no representations to him not contained in the written agreement. If that language affords no protection to a seller under these facts, we have provided a fertile breeding ground for lawsuits in all land sale contracts. There would be civic and social benefit if we required persons signing written contracts to say what they mean or mean what they say in the language used.¹⁷⁸

Why was Justice Sheehy's plea heard in Sherrodd? The bargaining power of the defrauded parties—their ability to insist on a change in the writing—appears to be the most important factor in the story they tell. Jenkins, like Sherrodd, presumably knew that the oral representation contradicted the writing; unlike Sherrodd, however, Jenkins was in a better position to do something about it. The court did not explicitly analyze this factor in Jenkins or Sherrodd, but a federal judge did in another fraud case, United States v. Willard E. Fraser Co.¹⁷⁹ Willard E. Fraser personally guaranteed a note secured by a mortgage on a building in Billings in which the federal government leased office space.¹⁸⁰ When entering the leases, both parties anticipated that the government would continue to lease the premises for the duration of the mortgage, which was shorter than the term of the written lease. The government then constructed a new federal building in Billings and vacated the old building at the conclusion of the leases. In the foreclosure action, Fraser offered evidence of these representations by the government.¹⁸¹ Judge Jameson invoked the parol evidence rule to bar the statements.¹⁸²

In a curious postscript, Judge Jameson admitted that he was not unsympathetic to Fraser's story:

There can be little question that both Fraser and the Government representatives who negotiated the last lease in 1958 were of the opinion that the lease would continue until the loan was paid. While Fraser could not rely upon that assumption in view of the written lease and loan agreements, it would seem proper for the Government to give consideration to the oral representations and assurances in negotiating an equitable settlement with Fraser.¹⁸³

¹⁷⁸. Id. at 8, 647 P.2d at 358.
¹⁸⁰. Willard E. Fraser, 308 F. Supp. at 559; see discussion of guaranties, supra text accompanying notes 125-28.
¹⁸¹. Willard E. Fraser, 308 F. Supp. at 560-61.
¹⁸². Id. at 565.
¹⁸³. Id. at 566.
This postscript clearly resolves the fact question. As suggested in an earlier part of this Article, the fact that the agreement was made indicates that it was part of the agreement. The burden is then on P to explain why it was not included in the writing. Judges found that the agreement was in fact made. Although sympathetic to Fraser, he nevertheless felt that his hands were tied. The judge could have manipulated the rule to find a non-integrated agreement and enforced the oral understanding. Should he have?

To put it more bluntly, should courts decide some issues with their hearts instead of the cold logic of their heads? In this context, yes! In deciding whether reliance is reasonable, a court must put itself in the position of the victim of the fraud, trying to determine whether a reasonable person in those circumstances would have swallowed the representation. That process requires empathy, a legitimate factor in the rule of law.

When will a judge be persuaded by the party's story? Judge Jameson appended to the opinion in Willard E. Fraser the decision in an unreported case. In that case he indicated that a judge is less likely to be sympathetic when the testimony is offered by a sophisticated businessperson. The facts represent a classic parol evidence situation. Prior to entering the agreement, Roth, an agent of defendants, made a number of promises and representations to the partners of plaintiff. The partners examined the written agreement and found that the promises were not contained in the writing. Roth assured them that the absence "didn't mean a thing" and that defendant could be counted on to perform as promised. When plaintiffs complained that defendant did not perform as promised by Roth, defendant invoked the parol evidence rule, pointing out that the promises did not appear in the written agreement. The partners claimed fraud. Judge Jameson found that all of the elements of fraud were present except one—the right to rely on the false promise or representation. The judge concluded that the partners should not have relied on Roth's statements but should have shown better judgment, including seeking legal counsel. He stated:

As noted supra, all of the C.M.C. partners were mature men, with

184. See supra text accompanying notes 117-19.
187. Willard E. Fraser, 308 F. Supp. at 570.
188. Id.
a high school education and prior business experience, even though they had not had prior experience in bidding on a government project. They read the proposed contract and specifically protested the absence of all of the oral promises and representations upon which they now rely in support of their contention of fraud.\textsuperscript{189}

It can be inferred from Judge Jameson’s observations that a court is more likely to find fraud when the injured party is less sophisticated and has little opportunity to read and consider the contract. These factors are often present in a consumer claim or in a case similar to a consumer claim, such as Sherrodd’s.\textsuperscript{190}

Perhaps the court in \textit{Sherrodd} heard Justice Sheehy’s plea that parties should “say what they mean or mean what they say”\textsuperscript{191} because of the commercial nature of the transaction. Although the majority justified the result in \textit{Sherrodd} as furthering commercial stability, the fraud rule as enunciated in \textit{Sherrodd} is probably inefficient from an economic point of view. The goal of commercial stability is served when courts enforce contracts by preventing one party from defeating the other’s legitimate expectations. An important aspect of the enforcement process is to eliminate fraud. Courts frequently distrust testimony of oral understandings, for a party may easily invent a story. A “strong” parol evidence rule prevents a party from introducing evidence or oral understandings and thereby eliminates this species of fraud. But use of the rule to control fraud may come at too high a price. It may well be that the story is true, and the contract a court is asked to enforce includes the oral understandings. If the story is not heard, the rule may be used to perpetrate a fraud.

A party could more easily establish fraud if courts did not weaken the fraud exception to the parol evidence rule by admitting evidence only of terms that were not addressed in the contract. In \textit{Sherrodd}, the court seems to have refused to enforce an agreement it knows the parties made because parties sometimes allege agreements they did not make. Would it not make more sense for the court to assume for purposes of summary judgment that the representation was made and leave it up to the finder of fact to determine whether in the circumstances the hearer reasonably relied on the representation. If perjured testimony is believed, some real transactions may be nullified, but because more real promises will be honored, the net result will be the elimination of more fraud.

\textsuperscript{189} \textit{Id.}
\textsuperscript{190} See \textit{supra} text accompanying notes 129-37.
\textsuperscript{191} Jenkins, 199 Mont. at 8, 647 P.2d at 358.
The economic justification for this relaxation in the standard of proof in order to reduce fraud is stated by a leading economist:

It may well be that the relaxation of the standard of proof required to make out any defense will increase the number of instances where the undeserving [party] is able to defeat the [other party's] legitimate contractual expectations. But if the costs thereby created are low, then the change in the rules of proof is justified on the grounds that it reduces the total error in enforcement, even though all error is not thereby eliminated.\(^{192}\)

VII. Conclusion

I often think it's comical
    How nature always does contrive
That every boy and every gal,
    That's born into the world alive,
Is either a little Liberal,
    Or else a little Conservative!\(^{193}\)

It may be that just as Gilbert and Sullivan recognized that every person is born to be either a conservative or a liberal, so is everyone born to be either for excluding parol evidence or admitting it. As Stanley Fish said of interpretation: “[W]henever there is a dispute about the plain meaning of a contract, at some level the dispute is between two (or more) visions of what life is or should be like.”\(^{194}\) It appears that the parol evidence rule is ultimately a political choice in the broadest sense.\(^{195}\)

In one view of the world, things should function tidily. People should think before they act, seek advice when out of their depth, know what they are getting into, read all documents, and write down all their agreements. If they do not, the law will see that they suffer the consequences. People may be hurt, but they—and others who learn of their misfortune—will profit from the experience, and the world will become tidier. The drawback of this approach is that it fails to recognize the human side of the law, the need for fairness. If we expect formality every time, there is no humanity.

\(^{195}\) Even in the narrow sense, it is no coincidence that Chief Justice Turnage and Associate Justice Trieweiler squared off in an election shortly after the decision in *Sherrodd* and that *Sherrodd* was cited during the campaign as representing the kind of choice the two candidates offered. Turnage won, barely.
In the other view of the world, people screw up. They grope their way through a complex and demanding world, doing the best they can, which is often not good enough, and they fall into traps. When they do so, the law will examine the route they followed and the nature of the particular trap. If the particular story is compelling enough, they will be rescued. Whether others will also be rescued cannot be predicted—it is a function of how compelling their story is. The drawback of this approach is that it fails to recognize the stable side of the law, the need for predictability. If we look to context every time, there is no rule of law.

Although the outcome of a parol evidence issue is difficult to predict, two propositions can be tentatively offered. First, the oral promise will not be enforced if the parties entered into a negotiated agreement with a well-drafted merger clause. These are the agreements made tidily, usually by sophisticated parties often with the presence of lawyers. Second, the oral promise will be enforced if a court thinks it was made and there are no good reasons why it should not be enforced. These are the agreements made sloppily, often by a consumer lacking bargaining power or by unsophisticated parties who do not think through all the issues. In this situation, a court's function is not unlike that of the clowns who roam the rodeo ring with shovel and bucket. Principled reasons are adduced for and against cleaning up the messes of others, which is what makes a case like Sherrodd so difficult. There are "costs" associated with hearing evidence beyond that found in the writing. One such cost is the judicial resources that are required to fully hear a case. Another is the cost of erroneous decision-making should false testimony be heard. Another cost, important in the business world, is the expectation that third parties may rely on the apparent completeness of documents.

On the other hand, there is a cost when a writing is enforced that does not express the agreement of the parties, and that cost is harder to measure. Undoubtedly more erroneous decision-making results when courts bar evidence of agreements parties actually made than results when courts admit evidence that might be tainted by false testimony. It might be said that the cost of barring the evidence is in fact an investment, an inducement to parties to get the entire agreement in writing. This result would be ideal, but

196. In Baldwin v. Stuber, the court had to clean up quite a mess when the parties began their agreement by stating: "On this date 3-8-77, I, Terry L. Baldwin, here-to-fore known as sellor, and Alan D. Stuber, here-to-fore known as sellee, enter into a selling agreement, which is here-to-fore known as The Natural Look Barber Salon," and the agreement went downhill from there. 182 Mont. 501, 503, 597 P.2d 1135, 1136 (1979).
it is questionable whether that ideal can be attained in the real world.

Attorneys have an opportunity to help reach that ideal. They can practice preventive law by remembering the parol evidence rule not when they write their appellate briefs, but when they draft their contracts. Before the agreement is signed, they should ask themselves and their clients these questions:

- Does this writing contain the final and complete statement of the agreement?
- How can I protect my client against a later offer of parol evidence to supplement or contradict the agreement?
- What customs and usages of trade may be assumed to be part of the parties' agreement?

Even with these efforts, the ideal is rarely achieved. Mere mortals make contracts. They may make them orally, even sloppily, but they are entitled to have the agreement they made carried out. It is my hope that this Article presents some guidance for attorneys and courts to better achieve that goal.