

## VARIATIONS OF THE PAROL EVIDENCE RULE: AN ANALYSIS OF LEGAL INSTRUMENTS

- Rakshit Assudani\*

### Abstract

Amidst the increasing uncertainty and chaos due to the outbreak of corona virus, an escalation in contractual disputes throughout the world is inevitable. Consequently, the usually neglected field of contract interpretation comes to the forefront. Accordingly, it is pertinent to analyse the parol evidence rule, which is an integral rule pertaining to contract interpretation. This rule deals with the issue of usage of extrinsic evidence while interpreting written contracts. This article traces the evolution of the rule, and aims to argue that due to various modifications and variations, there is no uniform applicability of this rule. To do so, a plethora of domestic and international legal instruments are analysed. In furtherance, due to various reasons, this article calls for a diluted version of this rule to be applied uniformly.

### Introduction

The parol evidence rule is a rule of substantive law<sup>1</sup> that deals with the issue of extrinsic evidence in contract interpretation. According to this rule, a court cannot use extrinsic evidence while interpreting a contract. The reason being that the contract is the tool that best portrays the intention of the parties. The applicability of this rule is contingent upon the fulfillment of two conditions: (i) there should be a written contract between the parties, and (ii) either party purports to introduce extrinsic evidence in relation to the contract.<sup>2</sup> To comprehend the applicability of this rule, it is pertinent to trace its evolution through a hypothetical construct.

Consider the following scenario: A and B sign a yearlong contract for the sale of books wherein A promises to buy 100 books per month from B for 30 dollars each. For the first month, A makes a

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\* Rakshit Assudani is a student at Jindal Global Law School, O.P. Jindal University.

<sup>1</sup> CISG-AC, Opinion No. 3, *Parol Evidence Rule, Plain Meaning Rule, Contractual Merger Clause and the CISG* (Oct. 23, 2004), <https://www.cisg.law.pace.edu/cisg/CISG-AC-op3.html>.

<sup>2</sup> *Id.*

payment of 2500 dollars in cash. However, A makes the payment in Canadian dollars. Consequently, a dispute arises. *Firstly*, the written contract does not define the term ‘dollars’, and B contends that the payment was to be made in US dollars as it had been agreed during negotiations, and US dollars were used in previous transactions between the same parties. *Secondly*, the contract does not provide a mode of payment. In this regard, B contends that in the negotiations, they agreed a wire transfer to be the sole mode of payment. Moreover, A contends that B had agreed on the final price of each book to be 25 dollars.

### **Evolution of The Rule**

Traditionally, the four corners rule was the primary authority used to determine the issue of extrinsic evidence. This rule warranted a literal interpretation, and the courts could not go beyond the four corners of the contract.<sup>3</sup> The written terms were considered as the ultimate basis signifying the intent of the parties; any external evidence that was contrary to the contract or supplemented the contract could not be introduced. However, the use of external evidence was permitted only in cases where there was ambiguity.

In the factual scenario, applying the four corners rule, the court would not allow the prior negotiations and discussions to be used as evidence. Consequently, A will have to pay \$3000, and B cannot force A to make payment through a wire transfer. However, such negotiations and discussions can be used to diffuse the ambiguity pertaining to interpretation of the term ‘dollars’.

As the four corners rule was deemed too harsh<sup>4</sup>, there was a shift towards partial integration. In partial integration jurisdictions, unless something in the contract signals to the contrary, the courts would assume that the parties wanted the written contract to represent partial integration of their agreement. Consequently, extrinsic evidence can be used either in case of ambiguity or to supplement the terms of the contract. However, the courts cannot use evidence that is contradictory to the terms of the contract.

In the factual scenario, if the court is a partial integration jurisdiction, then A will have to pay \$3000 because no contradictory evidence can be used. However, as supplementary terms can be

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<sup>3</sup> Richard A. Posner, *The Law and Economics of Contract Interpretation*, 83 TEX L. REV. 1581, 1596 (2005).

<sup>4</sup> *Id.* at 1597.

used, A will have to make the payment through a wire transfer. In addition to this, the courts can use extrinsic evidence to clarify the ambiguity pertaining to the use of ‘dollars’.

In response to partial integration, drafters and lawyers started incorporating a merger clause (also known as an entire agreement clause) in contracts.<sup>5</sup> This clause serves the essential purpose of conveying that the contract is a total integration of the agreement between the parties. As a result, extrinsic evidence cannot be used to supplement the contract. It can only be used in case of ambiguity provided that it is not contradictory to the terms of the contract. Under common law, the courts presume that the contract is complete.<sup>6</sup>

In the factual scenario, if a merger clause was included in the written contract, then the outcome will be similar as in the traditional sense. The inclusion of a merger clause can be seen as an attempt to revert to the four corners rule.

In a nutshell, *firstly*, extrinsic evidence can never be used if it contradicts the terms of the contract. *Secondly*, such evidence can always be used to explain ambiguity regardless of the jurisdiction. *Thirdly*, such evidence can be used for supplementing the terms of the contract only in a partial jurisdiction regime provided that the contract does not contain a merger clause (see Annexure).

### **Analysis of Legal Instruments**

The applicability of this rule is not universally uniform<sup>7</sup>, there have been certain modifications or variations in this rule across jurisdictions. The following domestic and international instruments highlight the nature of the parol evidence rule across jurisdictions:

#### **A. Indian Evidence Act, 1872**

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<sup>5</sup> An example of a merger clause can be “This Agreement is a final and exclusive document, and represents the complete Agreement of the parties. This Agreement supersedes all previous and contemporaneous agreements between the parties regarding the subject matter, and evidence of other or different terms may not be considered.”

<sup>6</sup> CISG-AC, *supra* note 1.

<sup>7</sup> Bruno Zeller, *The parol evidence rule and the CISG - a comparative analysis*, 36 COMP. INT. LAW J. SOUTH. AFR. 308, 313 (2003).

India follows the partial integration regime. According to the proviso to section 92 of the Indian Evidence Act 1872, extrinsic evidence may be used to explain ambiguity in the contract and to supplement the terms of the contract unless a contrary intention appears.<sup>8</sup> If contrary intention in the form of a merger clause appears, then extrinsic evidence can only be used in case of ambiguity and not to supplement the contract. However, under no circumstances should the evidence be contradictory to the written contract.

## **B. United Nations Convention on Contracts For The International Sale Of Goods**

This convention does not incorporate the parol evidence rule.<sup>9</sup> On the contrary, Article 8(3) provides that all relevant circumstances should be considered to determine the intent of the parties.<sup>10</sup> Additionally, Article 11 provides that any means can be used to prove the terms of a contract.<sup>11</sup>

In *MCC-Marble v Ceramica*<sup>12</sup>, it was held that the parol evidence rule is not applicable to a contract governed by the CISG. In furtherance, if either party wants to avoid the parol evidence rule, then a merger clause must be included in the written contract.<sup>13</sup>

The convention does not explicitly contain any provision dealing with merger clauses.<sup>14</sup> Moreover, the inclusion of a merger clause in a contract conflicts with the provisions of the CISG because it does not allow the use of extrinsic evidence.<sup>15</sup> However, the merger clause is applicable only if the parties intended to bar extrinsic evidence. Furthermore, to determine the intention of the parties, all relevant circumstances are taken into consideration.<sup>16</sup>

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<sup>8</sup> The Indian Evidence Act, 1872, No.1, Acts of Parliament, 1872, sec. 92.

<sup>9</sup> CISG-AC, *supra* note 1.

<sup>10</sup> United Nations Convention on Contracts for the International Sale of Goods, Apr. 11, 1980, S. TREATY DOC. No. 98-99 (1983), 1489 U.N.T.S. 3, art. 8 [*hereinafter*, CISG].

<sup>11</sup> *Id.*, art. 11.

<sup>12</sup> *MCC-Marble Ceramic Center, Inc. v. Ceramica Nuova D'Agostino, S.p.A.*, 114 F.3d 1384, 1388-89 (11th Cir. 1998).

<sup>13</sup> *Id.*

<sup>14</sup> Article 6 of CISG provides that parties may derogate from or vary the effect of any of the provisions. A merger clause can be one of the ways to do so.

<sup>15</sup> CISG-AC, *supra* note 1.

<sup>16</sup> Thus, the merger clause will apply only if the parties intended it to apply. Such intention has to be gathered from all circumstances *see* CISG, *supra* note 8, art. 8.

### **C. Unidroit Principles of International Commercial Contracts**

Under the UNIDROIT Principles, the applicability of the parol evidence rule is diluted. To interpret the contract or to discern the intention of the parties, all circumstances can be used.<sup>17</sup> In essence, it allows the use of extrinsic evidence.

Furthermore, Principle 2.1.17 explicitly provides for merger clauses.<sup>18</sup> If a merger clause is incorporated in a contract, then extrinsic evidence cannot contradict or supplement the terms of the contract. However, such evidence may be used to interpret the terms.<sup>19</sup>

### **D. Uniform Commercial Code**

The UCC incorporates a liberal version of the parol evidence rule. Section 2-202 provides that if the written contract is intended to be the final expression of their agreement, then extrinsic evidence cannot be used to contradict the terms of the contract.<sup>20</sup>

However, a course of dealing, usage of trade, or course of performance can be admitted as evidence to supplement or explain the contract.<sup>21</sup> A course of dealing essentially means previous conduct between the same parties that may assist in establishing intent. A usage of trade is the trade practice for the transaction in the contract. A course of performance is the action of parties in case of contracts that require repeated performance. Moreover, evidence of consistent additional terms is also admissible, unless the court finds that the written contract is intended to be a complete and exclusive document.<sup>22</sup>

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<sup>17</sup> UNIDROIT Principles of International Commercial Contracts 2004, principle 4.3, <http://www.unidroit.org/english/principles/contracts/principles2004/blackletter2004.pdf>.

<sup>18</sup> *Id.*, Principle 2.1.17.

<sup>19</sup> *Id.*

<sup>20</sup> UNIFORM COMMERCIAL CODE § 2-202 [*hereinafter*, UCC].

<sup>21</sup> *Id.*

<sup>22</sup> *Id.*

In essence, if there is a merger clause in the contract, even then any of the three<sup>23</sup> may be used to supplement or explain the contract provided that they do not contradict the terms of the agreement.

### **E. Restatement (Second) Of Contracts**

This treatise provides a detailed account regarding the applicability of the parol evidence rule. Before applying this rule, the court needs to determine two preliminary questions.<sup>24</sup> *Firstly*, whether the contract is an integrated agreement or not; to determine this, all relevant evidence must be taken into consideration.<sup>25</sup> *Secondly*, whether the integrated agreement is partial or complete. A completely integrated agreement means that the parties intended it to be a complete and exclusive statement of their terms.<sup>26</sup>

After determining the above-mentioned questions, the parol evidence rule is applied under Section 213. In case of a partially integrated agreement, only the evidence contrary to the terms is excluded. On the other hand, in case of a completely integrated agreement, apart from contradictory evidence, even the consistent additional terms are excluded. However, the court must determine that the prior agreement is within the scope of the subsequent agreement.<sup>27</sup>

In simple terms, any evidence inconsistent with the terms of the contract is excluded in partially and completely integrated agreements. However, a partially integrated agreement does not exclude consistent additional terms i.e. it does not exclude terms that may supplement the contract.

### **F. Principles of European Contract Law**

The PECL defangs the parol evidence rule. Article 5:101 (1) provides for the interpretation of a contract according to the intention of the parties.<sup>28</sup> However, such intention may differ from the

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<sup>23</sup> A course of dealing, usage of trade or course of performance.

<sup>24</sup> CISG-AC, *supra* note 1.

<sup>25</sup> RESTATEMENT (SECOND) OF CONTRACTS § 209 (1981) [*hereinafter*, Restatement].

<sup>26</sup> *Id.* § 210.

<sup>27</sup> *Id.* § 213.

<sup>28</sup> Commission on European Contract Law, The Principles of European Contract Law, art. 5:101.

literal meaning of the contract.<sup>29</sup> Furthermore, it is explicitly provided in Article 5:102 that the circumstances in which the contract was concluded can be used while interpreting a contract.<sup>30</sup>

The incorporation of an individually negotiated merger clause precludes the use of any extrinsic evidence.<sup>31</sup> However, if the merger clause is not individually negotiated, then a rebuttable presumption that the prior statements are not a part of the contract is raised.<sup>32</sup>

In essence, the parol evidence rule finds no place in the PECL, except if the contract contains an individually negotiated merger clause.

## Conclusion

These legal instruments evidence the inconsistency relating to the parol evidence rule across jurisdictions. In this light, there is a need for a uniform applicability of the parol evidence rule that should be restricted, and extrinsic evidence should be allowed. The reason being: *firstly*, the underlying basis of a contract is the meeting of minds of the parties. Apart from the written terms, the extrinsic evidence further elaborates and clarifies the precise nature of the meeting of minds. Such evidence assists in understanding the criteria behind the formulation of the contract. Analogously, in international law, it is a frequent practice to consider the *travaux préparatoires* while interpreting a treaty. *Secondly*, in the contemporary context, contracts are made for long periods. As the future is uncertain, it is not possible to predict all possibilities concerning the transaction.<sup>33</sup> In this light, the written terms of the contract cannot be considered complete in all aspects. Moreover, from a practical perspective, most contracts are characterized by ambiguous terms. *Thirdly*, due to the emergence of pre-printed contracts, the mere inclusion of a merger clause should not be a bar to extrinsic evidence. If this is allowed, it can lead to unfair outcomes. Hence, the merger clause should be applicable only if the parties intended it to apply.<sup>34</sup> For example, if evidence proves that both the parties negotiated the merger clause, it is highly probable that the parties intended the clause to bar extrinsic evidence. In conclusion, extrinsic evidence must be

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<sup>29</sup> *Id.*

<sup>30</sup> *Id.*, art. 5:102.

<sup>31</sup> *Id.*, art. 2:105.

<sup>32</sup> *Id.*

<sup>33</sup> Posner, *supra* note 3, at 1582.

<sup>34</sup> The position entailed in the CISG.

allowed to aid in interpretation and to supplement the terms of the contract unless the evidence is contrary to the written terms or the parties specifically intend to bar extrinsic evidence.



See page 3, 'Evolution of the rule', paragraph 7.

|                            | Ambiguity in the contract | Supplementing the terms of the contract | Contradictory Terms |
|----------------------------|---------------------------|---|---------------------|
| <b>Four Corners Rule</b>   | Yes                       | No                                      | No                  |
| <b>Partial Integration</b> | Yes                       | Yes                                     | No                  |
| <b>Total Integration</b>   | Yes                       | No                                      | No                  |