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Contract Interpretation and the Parol Evidence Rule

As our posts related to contract law are among the most popular for the Hoosier Litigation Blog, I have decided to dedicate this week's post to providing a brief overview of contract interpretation. Included within the gambit of contract interpretation is the legal concept that is the parol evidence rule. By the end I hope to have made the often-confusing parol evidence rule somewhat more approachable. As I am not a more well gifted educator than my contract law professor – the late Mary Harter Mitchell – I can make no promises of ultimate success. Nevertheless, I shall endeavor to unravel this complex legal rule.

It should come as no surprise that, given the important role of contracts in the law, much time and energy has been expelled battling over what the two parties have actually agreed upon. It is amazing how at the formation of a contract the parties can seem so certain that they have everything agreed upon and figured out and a short while later be at each other's throat in arguing upon the meaning of a contract term. Though, as Robert Burns so aptly stated more than two centuries past, "The best laid schemes of mice and men go often awry." With that admonition firmly in mind, let us endeavor to unravel some of the methods by which a judge may settle squabbling over contractual terms.

A good place to begin is a summation of the approach used by Indiana courts

outlined in *Samar Inc. v. Hofferth*.

> When interpreting a contract, our paramount goal is to ascertain and effectuate the intent of the parties. This requires that the contract be read as a whole, and the language construed so as not to render any words, phrases, or terms ineffective or meaningless. When the language of a contract is clear and unambiguous, the intent of the parties is determined from the four corners of the instrument, giving the words contained therein their plain, usual, and ordinary meaning. In contrast, when the language in a contract is ambiguous or uncertain, its meaning is to be determined by extrinsic evidence. A contract is ambiguous if reasonably intelligent people could find its provisions susceptible to more than one interpretation. However, the terms of a contract are not ambiguous simply because a controversy exists between the parties concerning the proper interpretation of terms. Additionally, in the absence of anything to indicate a contrary intention, writings executed at the same time and relating to the same transaction or subject matter will be construed together.

Let us unpack this paragraph. This summary by the court combines a lot of overlapping concepts into one without dissecting them individually.

The court outlined a procedure that it must go through in order to interpret a contract. Step one: the court takes the first logical step – it reads the written document. If, after reading the contract, it is clear what the contract calls for, then the court will apply the contract as written. However, if a term or clause in the contract is ambiguous, then the court will have to go further. Thus, step two is to identify whether there is an ambiguous term, phrase, or clause. If there is such an ambiguity, then the court will allow what is called "extrinsic evidence" to be used to try to resolve the ambiguity.

In creating this procedure the court spliced together a handful of legal concepts. The first is the "plain meaning" rule. The plain meaning rule is fairly self-evident. It basically states that a court must apply the plain and ordinary meaning of a word when trying to interpret a contract. Now, of course, you can define a word to mean about anything you want it to mean in a contract. This is fairly common. However, where the word or phrase has not otherwise been defined, then it shall be read to construe the plain and ordinary meaning. In addition, the court also has to read that rule in light of the entire agreement. That is to say, the court cannot just look at one sentence and decide it means something that would make absolutely no sense in context.

Another concept is the "four corners" rule. The four corners rule is also fairly straightforward. It basically stands for the proposition that if the contract, standing alone, makes sense, then that is the only source for determining the agreement. Now this may seem a bit redundant or obvious, but it takes an understanding of the abstract reality of a contract for its existence to really make sense. You see, a contract is not a piece of paper with words on it. A contract is a promise that is enforceable by the law. Now one requirement to enforce that promise may be that it must be written. But, the "contract" is actually the promise. The written document just attempts to record the terms of that agreement. Perhaps, put more simply. A contract exists irrespective of whether it is ever written down. In theory, that contract may have been an agreement to do things that were never written down. What the four corners rule says is that despite the fact that those other terms may have been agreed upon, because they were not written down they will cannot be enforced.

With that in mind, let us delve into the "parol evidence" rule. This is a rule that by its very name is confusing. The parol evidence deals with two separate but related concepts. It comes into play by two different means. One, a party wants to use evidence outside of the words written on the document to try and interpret a part of the contract. The other time it comes into play is when a party attempts to argue that there was an additional term to the contract that was never written down. Now before we discuss the nuances of how this rule works, you need to understand what it means if the rule applies and why the rule is called the parol **evidence** rule. The word "parol" is an old French legal term that basically just means "oral." This makes sense, since we are dealing with something that is not written in the actual document evidencing the contract. Though, I caution you to not jump to too many conclusions. Such terms can also have been written down in a separate document. So it is not as clear-cut as calling it an "oral contract" rule. Now the second word in the rule–"evidence"–is every bit as important to understand. This is really a rule of evidence that can be considered by the judge or jury in interpreting a contract. This rule means that if something is "parol evidence" then it cannot be considered by a judge or jury.

So now to determining whether something is "parol evidence." Let us first address the issue when a party is attempting to add an additional term to the contract. For an additional term to be added, that term must have been agreed upon either prior to or contemporaneously with the writing of the agreement. The next step is to determine whether the writing is a complete and final integration of the contract. Typically, a contract that is a complete and final integration will have a clause that says something along the lines of "this document contains each and every term agreed upon between the parties and no further terms are a part

hereto." If the written agreement has such a clause, then attempting to add an additional term will probably be barred by the parol evidence rule – though there may be exceptions that could apply. However, if the document is not a "complete" integration, then the door may be partially opened. What this means is that nothing in the contract makes it clear that it contains each and ever single term.

If the document is a "partial" integration then evidence outside of the document *may* be admissible. However, these terms are only admissible if they are not inconsistent with the written terms. Some courts and many lawyers will state this requirement as the additional term must be "consistent." Now if the highest court in your jurisdiction has stated the rule as such, then you are locked into that language. However, the parol evidence rule at its hear is "not inconsistent" terms. That may seem like a distinction without a difference. Indeed, I had a heated debate with several fellow law students before my contract law final on this very issue. Let me illustrate this point and why this distinction has a meaningful difference.

For something to be consistent, it must fit within the logical framework of the document. So, for example, a person enters into an agreement to lease a field from a farmer. If the farmer tries to claim that there was an additional term that states that the person was also going to buy seeds from the farmer, then that term is consistent. That is because the whole concept of the agreement is a person leasing a field to farm it. Thus, the purchase of seeds fits within the logical framework of that agreement. Now if the person tries to show evidence that the farmer also agreed to use his tractor to pull up a stump at the person's house several miles away from the field then we are looking at the "not inconsistent" scenario. We have something that does not logically fit within the framework of the written agreement, but it does not contradict the terms of the agreement. Thus, it is not consistent, however, it is also not inconsistent.

This evidence may also come in under certain scenarios if the purpose is to use it to show that the written agreement is not actually final or a complete integration. Moreover, it can be used to establish that the written agreement was the product of illegality, fraud, duress, mistake, or other reasons that would invalidate the contract.

The other version of the parol evidence rule is a lot easier. If a term in written agreement is ambiguous then the court may allow the use of evidence outside of the written document to help interpret it. Remember, "a contract is ambiguous if reasonably intelligent people could find its provisions susceptible to more than one interpretation."

Now, here is another problem that can arise, what if there is an ambiguity, but we do not have some evidence to help us interpret the contract? For example, you sign a form contract and did not negotiate each term. In that situation there would be no evidence to introduce to help interpret it. Well there is a concept that covers this. As a general rule the court interprets the ambiguity against the person that wrote the agreement.

Certainly this is not the totality of everything that goes into contract interpretation. There is a whole host of things a court can do when the contract is silent on certain issues and other things the court can do. This is merely an overview of the process that courts take in trying to ascertain the meaning of a contract. Hopefully this has helped shed some light on an extremely complex area of law.

Join us again next time for another discussion on the complexities of the law and further developments.

Sources

- Susanah M. Mead, *A Tribute to Professor Mary Mitchell*, 44 I.L.R. 659 (2011).
- *Samar, Inc. v. Hofferth*, 726 N.E.2d 1286, 1290 (Ind. Ct. App. 2000).
- *See also* Parol Evidence Outline by LexisNexis, available at http://www.lexisnexis.com/lawschool/study/outlines/html/contracts/contracts07.htm