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# On Parol: The Construction and Interpretation of Written Agreements and the Role of Extrinsic Evidence in Contract Litigation

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# ON PAROL: THE CONSTRUCTION AND INTERPRETATION OF WRITTEN AGREEMENTS AND THE ROLE OF EXTRINSIC EVIDENCE IN CONTRACT LITIGATION

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## I. INTRODUCTION

As a general rule, extrinsic evidence, whether written or oral, is not admissible to prove either the intent of the parties to a contract or the meaning of contractual terms when the parties have executed an unambiguous, fully-integrated (*i.e.*, final and all-inclusive) written agreement. The trial court may consider various types of extrinsic evidence, however, in determining whether a particular agreement is fully integrated or ambiguous, and even in choosing among rival interpretations of an agreement where ambiguity is not present. If the trial court determines that an agreement is not fully integrated, then the trier of fact may consider extrinsic proof that supplements it. If the trial court determines that an agreement is ambiguous, then the trier of fact may consider extrinsic proof of the parties' contractual intent.

This Article identifies and examines the rules of construction used by Texas courts in determining contractual intent under Texas law, as well as the circumstances under which extrinsic evidence may be admitted either to supplement existing contractual terms or to demonstrate contractual intent. Practitioners responsible for drafting contracts and their colleagues who handle contract litigation should benefit from this examination. Part II of this Article discusses the fundamental common-law tenets of construction and interpretation applicable to all contract disputes. Part III

addresses the concepts of ambiguity and integration, the common-law parol evidence rule, the parol evidence provisions of the Uniform Commercial Code, and the circumstances under which extrinsic evidence may be considered by Texas courts and juries.

## II. THE CONSTRUCTION AND INTERPRETATION OF WRITTEN AGREEMENTS GOVERNED BY TEXAS LAW[1]

As modern commercial agreements become increasingly complex, the potential for misunderstanding among the parties to those agreements also seems to grow. When litigation results, the threshold issues for the parties, their counsel, and the court are often the same: What are the complete terms of the parties' agreement, and what was the parties' intent in entering into it?

In Texas, as in every jurisdiction, a considerable body of law guides the resolution of these questions. Texas courts also utilize many precisely-articulated—if not consistently applied—interpretational rules and evidentiary principles. These rules and principles impose context upon practically every negotiation, drafting session, and lawsuit involving the written word. For that reason, no lawyer should draft a contract or adopt a contract litigation strategy without accounting for the effect of these rules and principles.

### *A. A Prefatory Note on Construction and Interpretation*

Courts and commentators frequently treat contract construction and contract interpretation as if the distinction between the two were either crystal clear and essential, or nonexistent and immaterial. While many of the judicial opinions and learned treatises cited herein use the terms "interpretation" and "construction" interchangeably, the two terms have different meanings. To paraphrase Professor Corbin, *interpretation* of a contract is the process of determining the meaning of the words and symbols used in the contract, while *construction* of a contract is the process of determining the legal effect of those words and symbols in light of many

[1]Because the rules of contract construction and interpretation and the parol evidence rule are rules of substantive law, federal courts are bound by Texas contract law when construing and interpreting contracts subject to Texas law. *See* Canutillo Indep. Sch. Dist. v. National Union Fire Ins. Co., 99 F.3d 695, 700 (5th Cir. 1996); Beijing Metals & Minerals Import/Export Corp. v. American Bus. Ctr., Inc., 993 F.2d 1178, 1182 n.9 (5th Cir. 1993). *See generally* HOWARD O. HUNTER, MODERN LAW OF CONTRACTS 7.03, at 7-8 n.49 (rev. ed. 1993).

factors external to the contract itself.[2] Both processes regularly require the trial court to consider extrinsic evidence—that is, evidence beyond the "four corners" of the written agreement—in order to ascertain the parties' true intentions and to give proper effect to the understanding memorialized by the written agreement.

Some contracts must be interpreted by courts of law, others need not. All contracts that come before a court must be construed. Thus, even if a written contract requires no interpretation because the objective meaning of the words and symbols used in the contract is sufficiently clear, the

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[2]Professor Corbin states:

> Before attempting to lay down any rules of interpretation, however tentative and variable they may be, we must first give some thought to the word "interpretation" itself, and also to the word "construction." Without doubt, these two words are often used in the same sense; but they are also used in different senses, the difference between them being variable. . . .
>
> It may be helpful to note that the word interpretation is commonly used with respect to *language* itself—to the symbols (the words and acts) of expression. In about the same degree, we speak of the construction of a *contract*. It is true that we also speak of construing language and of interpreting a contract; but by the latter phrase is certainly meant interpreting the *words* of a contract. The word "contract" has been variously defined; but it is seldom identified with mere symbols of expression. By "interpretation of language" we determine what ideas that language induces in other persons. By "construction of the contract" . . . we determine its legal operation—its effect upon the action of courts and administrative officials. If we make this distinction, then the construction of a contract starts with the interpretation of its language but does not end with it; while the process of interpretation stops wholly short of a determination of the legal relations of the parties.

3 ARTHUR L. CORBIN, CORBIN ON CONTRACTS § 534, at 7-9 (1960) (citations omitted) (footnotes omitted); *see also* Wahlenmaier v. American Quasar Petroleum Co., 517 S.W.2d 390, 393 (Tex. Civ. App.—El Paso 1974, writ ref'd n.r.e.); RESTATEMENT (SECOND) OF CONTRACTS § 200 note (1981); 14 TEX. JUR. 3D *Contracts* § 184, at 303 (1981). *See generally* Robert Braucher, *Interpretation and Legal Effect in the Second Restatement of Contracts*, 81 COLUM. L. REV. 13 (1981); Edwin W. Patterson, *The Interpretation and Construction of Contracts*, 64 COLUM. L. REV. 833 (1964). *But see* RESTATEMENT (SECOND) OF CONTRACTS ch. 9, intro. note ("[S]tating separately rules with respect to various aspects of the process [of interpreting and applying agreements] may convey an erroneous impression of the psychological reality of the judicial process in which many elements are typically combined in a single ruling."); Mark L. Movsesian, *Severability in Statutes and Contracts*, 30 GA. L. REV. 41, 52 n.79 (1995) (remarking that the distinction between construction and interpretation "proves difficult to maintain, and courts have largely ignored it . . . .") (citation omitted).

court must still construe the contract before giving it effect.[3]

## B. The Goal of Contract Construction and Interpretation

> *Words are the clothes that thoughts wear—only the clothes.*
>
> —Samuel Butler[4]

In construing a written agreement, a court's primary concern is to ascertain and give effect to the true intent of the contracting parties as expressed in the written instrument.[5] Texas courts, which for purposes of this Article will also include any federal court considering a written agreement subject to Texas law, must give effect to the objective intent of the parties as it is expressed or apparent in writing.[6] In so doing, the court

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[3]*See, e.g.*, KMI Continental Offshore Prod. Co. v. ACF Petroleum Co., 746 S.W.2d 238, 241 (Tex. App.—Houston [1st Dist.] 1987, writ denied) ("Both parties argue that the contract is unambiguous, and we agree with their conclusions . . . . Their disagreement is over the proper construction of the option provision."). However, a number of early decisions by Texas courts suggested that "if the provisions of a contract are clear and unambiguous, there is then nothing in the agreement that will require construction by a court." 14 TEX. JUR. 3D *Contracts* § 184, at 304 (1981) (footnote omitted). Since the promulgation of the second Restatement of Contracts in 1981, Texas courts have taken a position more consistent with the notion that all contracts must be construed. *See KMI Continental*, 746 S.W.2d at 243 (stating that "[w]hen an option provision fails to impose a time limitation, courts will construe the provision").

[4]ROBERT ANDREWS, THE CONCISE COLUMBIA DICTIONARY OF QUOTATIONS 288 (1989).

[5]*See* Lenape Resources Corp. v. Tennessee Gas Pipeline Co., 925 S.W.2d 565, 574 (Tex. 1996); Forbau v. Aetna Life Ins. Co., 876 S.W.2d 132, 133 (Tex. 1994); Coker v. Coker, 650 S.W.2d 391, 393 (Tex. 1983); Sidelnik v. American States Ins. Co., 914 S.W.2d 689, 691 (Tex. App.—Austin 1996, writ denied).

[6]*See* American Guar. & Liab. Ins. Co. v. Shel-Ray Underwriters, Inc., 844 F. Supp. 325, 331 (S.D. Tex. 1993) (applying Texas law); Westwind Exploration, Inc. v. Homestate Sav. Ass'n, 696 S.W.2d 378, 382 (Tex. 1985); Cherokee Water Co. v. Forderhouse, 641 S.W.2d 522, 525 (Tex. 1982).

In *City of Pinehurst v. Spooner Addition Water Co.*, after agreeing with the parties that the contractual provisions at issue were unambiguous, the Texas Supreme Court quoted with approval the following passage from the Restatement of Contracts:

> [The] standard of interpretation of an integration, except where it produces an ambiguous result, or is excluded by a rule of law establishing a definite meaning, is the meaning that would be attached to the integration by a reasonably intelligent person acquainted with all operative usages and knowing all the circumstances prior to and contemporaneous with the making of the integration, other than oral statements by the parties of what they intended it to mean.

432 S.W.2d 515, 518 (Tex. 1968) (quoting RESTATEMENT OF CONTRACTS § 230 (1932)). More recently, a narrow majority of the Texas Supreme Court proclaimed further: "Even if the court

must consider not only the meaning given to the terms of the agreement by the parties to it (*i.e.*, interpretation), but also the legal effect that the parties intended the agreement to have (*i.e.*, construction). The Texas Supreme Court has also instructed courts to "construe a contract from a utilitarian standpoint, bearing in mind the particular business activity sought to be served"; however, they "need not embrace strained rules of construction that would avoid ambiguity at all costs."[7]

### C. *Primary Rules of Construction and Interpretation*

> *Rules? . . . In a knife fight?*
> —from *Butch Cassidy and the Sundance Kid*[8]

Over time, a set of rules of construction and interpretation has developed. These rules exist to guide courts and litigants in their efforts to construe contracts so as to give effect to the parties' intentions at the time of contracting. These rules are not codified, and less than universal agreement exists among Texas courts or commentators as to whether all of the rules set forth below are legitimate guides to construction, or as to what priorities, if any, courts are to observe among the various rules.

The rules that follow do not require a court to find ambiguity or less-than-full integration before they may be applied. Rather, courts are to use the rules in ascertaining the existence of an ambiguity or a less-than-fully integrated agreement, as well as in resolving any such ambiguity or filling the "gaps" created by partial integration. In the words of the Restatement, courts should use the rules "in determining what meanings are reasonably possible as well as in choosing among possible meanings."[9]

#### 1. Surrounding Circumstances

> *A word is not a crystal, transparent and unchanged; it is the skin of a living thought and may vary greatly in color*

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could discern the actual intent [of the parties to the contract], it is not the actual intent of the parties that governs, but the actual intent of the parties *as expressed in the instrument as a whole* . . . ." Luckel v. White, 819 S.W.2d 459, 462 (Tex. 1991).

[7]*Lenape Resources*, 925 S.W.2d at 574 (citing Reilly v. Rangers Management, Inc., 727 S.W.2d 527, 530 (Tex. 1987)).

[8]BUTCH CASSIDY AND THE SUNDANCE KID (Twentieth Century Fox 1969).

[9]RESTATEMENT (SECOND) OF CONTRACTS § 202 cmt. a (1981).

> *and content according to the circumstances and the time in which it is used.*
>
> —Justice Oliver Wendell Holmes, Jr.[10]

In applying the terms of a contract—even a fully integrated and facially unambiguous contract—to the subject of the contract, courts should take the circumstances surrounding the contract into account.[11] In the words of the Texas Supreme Court:

> [T]he words of a legal instrument are simply indices to external things, and words always need interpretation. It is always necessary to determine their association with external objects, and all circumstances should be considered that go to make clear the sense in which they were used, *i.e.*, their association with things.[12]

In *City of Pinehurst v. Spooner Addition Water Co.*, the court found the

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[10]Towne v. Eisner, 245 U.S. 418, 425 (1918) (citing Lamar v. United States, 240 U.S. 60, 65 (1916)).

[11]*See* RESTATEMENT (SECOND) OF CONTRACTS § 209 cmt. a. The Restatement explains further:

> In interpreting the words and conduct of the parties to a contract, a court seeks to put itself in the position [the parties] occupied at the time the contract was made. When the parties have adopted a writing as a final expression of their agreement, interpretation is directed to the meaning of that writing in the light of the circumstances. The circumstances for this purpose *include the entire situation, as it appeared to the parties, and in appropriate cases may include facts known to one party of which the other had reason to know.*

*Id.* § 202 cmt. b (emphasis added) (internal reference omitted).

[12]Stewart v. Selder, 473 S.W.2d 3, 7 (Tex. 1971). In *Murphy v. Dilworth*, the court stated:

> It is true that, even though a written contract be unambiguous on its face, parol evidence is admissible for the purpose of applying the contract to the subject with which it deals. . . . [This] merely permits proof of the then existing circumstances, in order to enable the court to apply the language used therein to the facts as they then existed.

151 S.W.2d 1004, 1005 (Tex. 1941) (citations omitted); *see also* Fort Worth Nat'l Bank v. Red River Nat'l Bank, 19 S.W. 517, 518 (Tex. 1892) ("Written descriptions are to be interpreted in the light of the facts known to and in the minds of the parties at the time. They are not prepared for strangers, but for those they are to affect—the parties and their privies."); RESTATEMENT (SECOND) OF CONTRACTS § 201 cmt. b ("Uncertainties in the meaning of words are ordinarily greatly reduced by the context in which they are used. . . . In general, the context relevant to interpretation of a bargain is the context common to both parties.").

contract to be unambiguous and wrote:

> It is the general rule of the law of contracts that where an unambiguous writing has been entered into between the parties, the Courts will give effect to the intention of the parties as expressed or as is apparent in the writing. In the usual case, the instrument alone will be deemed to express the intention of the parties for it is objective, not subjective, intent that controls.[13]

In considering what the parties intended by the words used in the contract, the *City of Pinehurst* court said: "Where a question relating to the construction of a contract is presented, as here, we are to take the wording of the instrument, considering the same in the light of the surrounding circumstances, and apply the pertinent rules of construction thereto and thus settle the meaning of the contract."[14]

In *Sun Oil Co. v. Madeley*, the Texas Supreme Court considered the role of extrinsic evidence in construing an admittedly unambiguous written contract:

> In addition to their difference of opinion on the proper interpretation of the contract, the parties also dispute the role of extrinsic evidence in construing an unambiguous contract. Sun argues the courts may only consider extrinsic evidence after the instrument itself is first found to be ambiguous. Lessors argue that when the construction of a contract is at issue, the court must first consult surrounding circumstances to determine *whether or not* the contract is ambiguous.[15]

Having recited the above-quoted passages from *City of Pinehurst*, the *Madeley* court concluded: "Lessors state the proper rule. Evidence of surrounding circumstances may be consulted. If, in the light of surrounding circumstances, the language of the contract appears to be capable of only a single meaning, the court can then confine itself to the writing."[16]

Courts are to construe commercial contracts in accordance with the customs and practices of the industry and locale(s) to which the contract

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[13]432 S.W.2d 515, 518 (Tex. 1968).

[14]*Id.* at 519 (emphasis omitted).

[15]626 S.W.2d 726, 731 (Tex. 1981) (emphasis added).

[16]*Id.* (footnotes omitted).

relates.[17] As a consequence, unless the parties' contrary intent is clearly manifested,[18] "surrounding circumstances" may include the course of dealing between the parties,[19] operative usages of trade,[20] or the course of the parties' performance of the contract.[21]

*Hanssen v. Qantas Airways Ltd.* involved a dispute between a tour operator (Hanssen) and Qantas Airways regarding the extent to which group package seats were "guaranteed" as a result of paying a 10% deposit for each seat reserved.[22] At the heart of the dispute was the following passage from a December 2, 1985, letter from Qantas:

> Further to our previous discussions, Halley's comet has created an enormous amount of interest in the South Pacific. In order to *protect* the group space for those who have *solid commitments*, we are requiring a 10% deposit to Qantas for all groups during this time period. . . . Please forward your MCO [deposit] to this office by 05 DEC 85,

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[17]*See* RESTATEMENT (SECOND) OF CONTRACTS § 202(5).

[18]*See* Luling Oil & Gas Co. v. Humble Oil & Ref. Co., 191 S.W.2d 716, 724 (Tex. 1945); Gulf Prod. Co. v. Cruse, 271 S.W. 886, 887 (Tex. Comm'n App. 1925); S.K.Y. Inv. Corp. v. H.E. Butt Grocery Co., 440 S.W.2d 885, 891 (Tex. Civ. App.—Corpus Christi 1969, no writ). *But see* Texas Gas Exploration Corp. v. Broughton Offshore Ltd. II, 790 S.W.2d 781, 785-86 (Tex. App.—Houston [14th Dist.] 1990, no writ) (holding that custom and usage are not relevant when the contract is clear and unambiguous and that custom and usage cannot "vary, control, impair, restrict or enlarge the express language of the contract").

[19]A "course of dealing is a sequence of previous conduct between the parties to an agreement which is fairly to be regarded as establishing a common basis of understanding for interpreting their expressions and other conduct." RESTATEMENT (SECOND) OF CONTRACTS § 223(1). For a more thorough discussion of the role of course-of-dealing evidence in construing and interpreting contracts under Texas common law and under the Uniform Commercial Code, see *infra* Parts III.C.11 and III.F.1.a, respectively.

[20]A "usage of trade" can refer either to a habitual or customary *practice* in a particular trade or location, or to a *meaning* ascribed to a word or phrase that is commonly understood by those in a particular trade or location. *See* RESTATEMENT (SECOND) OF CONTRACTS § 219 cmt. a. For a more thorough discussion of the role of trade usages in construing and interpreting contracts under Texas common law and under the Uniform Commercial Code, see *infra* Parts III.C.12 and III.F.1.b, respectively.

[21]The parties' actions pursuant to a written agreement, *after* the agreement is finalized, constitutes their course of performance. *See* TEX. BUS. & COM. CODE ANN. § 2.208 cmt. 1 (Vernon 1994) (discussing the parties' actions under the agreement); *see also* Krupp v. Belin Communities, Inc., 582 S.W.2d 514, 519 (Tex. Civ. App—Houston [1st Dist.] 1979, writ ref'd n.r.e.). For a more thorough discussion of the role of course of performance in construing and interpreting contracts under Texas common law and under the Uniform Commercial Code, see *infra* Parts III.C.11 and III.F.1.c, respectively.

[22]904 F.2d 267, 268 (5th Cir. 1990).

> *or we will have to release the seats you have blocked, whether confirmed or not.*[23]

On December 5, 1985, Hanssen paid Qantas a 10% deposit for 406 seats.[24] On January 13, 1986, Hanssen met with representatives of Qantas and a domestic Australian carrier whose airline was to provide "shuttle" transportation for Hanssen's group.[25] During that meeting, both representatives told Hanssen that they had not yet been able to confirm all 406 seats, but that they were still working on it.[26] On January 15, 1986, Hanssen, who by that time had sold only 117 of his allotted 406 tour packages, wrote Qantas that he "was discontinuing all of his marketing efforts because his seats had not been confirmed."[27] Hanssen then sued Qantas for, inter alia, the revenues that he reasonably expected to make from selling 406 tour packages.[28] The trial court granted summary judgment in Hanssen's favor, and Qantas appealed.[29]

The Fifth Circuit reversed the summary judgment, finding that the December 2, 1985, letter was reasonably susceptible to two meanings: (1) as the district court reasoned, that Qantas agreed to confirm or guarantee all seats on which a deposit was made; and (2) that Hanssen may lose his requested seats, even those already confirmed, unless those reservations were guaranteed by a deposit.[30] Finding that ample evidence of industry practice supported the second reading, the Fifth Circuit remanded the case for "a full trial considering standard airline practice and other extrinsic evidence to determine the meaning and intent of the parties' agreement."[31]

The importance of the "surrounding circumstances" rule cannot be overemphasized. Unlike all other primary rules of construction, this rule affirmatively invites the trial court to consider extrinsic proof *even in the absence of a pleading of, much less a finding of, ambiguity, and even in those cases in which the parties stipulate that the contract is fully integrated.*[32] Indeed, *Hanssen* indicates that Texas courts will look to sur-

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[23]*Id.* at 268-69 (emphasis added) (second alteration in original).

[24]*See id.* at 269.

[25]*See id.*

[26]*See id.*

[27]*Id.*

[28]*See id.*

[29]*See id.*

[30]*See id.* at 270.

[31]*Id.* at 271.

[32]Evidence of surrounding circumstances is sometimes said to be "simply an aid in the construction of the contract's language." Sun Oil Co. v. Madeley, 626 S.W.2d 726, 731 (Tex.

rounding circumstances to construe a written agreement even if doing so creates ambiguity.[33] Thus, while the "surrounding circumstances" rule still does not permit proof of the parties' subjective intent, it does substantially undercut the exclusionary effect of the parol evidence rule and any notion that ambiguity must be pleaded or found in order to permit the court to consider certain forms of extrinsic proof.

### 2. Construing the Contract as a Whole

The rules of contract construction and interpretation also require that courts read all parts of a contract as a whole.[34] No single provision taken alone should have controlling effect; rather, courts must consider all provisions with reference to the whole agreement.[35] Moreover, courts should reconcile those provisions that appear to be in conflict as needed to reflect the true intentions of the parties.[36]

> [The intent of the parties] must be deduced not from specific provisions or fragmentary parts of the instrument, but from the entire agreement, because the intent is not evi-

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1981); *accord* Staff Indus. v. Hallmark Contracting, Inc., 846 S.W.2d 542, 546 (Tex. App.—Corpus Christi 1993, no writ) (paraphrasing KMI Continental Offshore Prod. Co. v. ACF Petroleum Co., 746 S.W.2d 238, 241 (Tex. App.—Houston [1st Dist.] 1987, writ denied)); Advertising & Policy Comm. of the Avis Rent A Car Sys. v. Avis Rent A Car Sys., 780 S.W.2d 391, 396 (Tex. App.—Houston [14th Dist.] 1989), *vacated on other grounds*, 796 S.W.2d 707 (Tex. 1990); *KMI Continental Offshore*, 746 S.W.2d at 241 ("[T]he circumstances to be considered are not the parties' statements of what they intended the contract to mean, but circumstances known to the parties at the time they entered into the contract, such as what the industry considered to be the norm or reasonable and prudent."); *see also* Hettig & Co. v. Union Mut. Life Ins. Co., 781 F.2d 1141, 1143 (5th Cir. 1986) ("[T]he court must examine the wording of the contract in the light of circumstances existing at the time of the contract's making, excluding statements of the parties as to what they intended.") (citing Vendig v. Traylor, 604 S.W.2d 424, 427 (Tex. Civ. App.—Dallas 1980, writ ref'd n.r.e.)).

[33]*Hanssen*, 904 F.2d at 271; *see also* National Union Fire Ins. Co. v. CBI Indus., 907 S.W.2d 517, 521 (Tex. 1995) (differentiating between proof of surrounding circumstances and proof of the parties' intentions and stating, inter alia, that ambiguity must become evident when the contract is read in light of surrounding circumstances, not after parol proof of intent is admitted to create ambiguity).

[34]*See* Forbau v. Aetna Life Ins. Co., 876 S.W.2d 132, 133 (Tex. 1994); RESTATEMENT (SECOND) OF CONTRACTS § 202(2) (1981).

[35]*See* Coker v. Coker, 650 S.W.2d 391, 393 (Tex. 1983); Bush v. Brunswick Corp., 783 S.W.2d 724, 728 (Tex. App.—Fort Worth 1989, writ denied).

[36]*See* Ogden v. Dickinson State Bank, 662 S.W.2d 330, 332 (Tex. 1983); *accord KMI Continental Offshore*, 746 S.W.2d at 241 (citing McMahon v. Christmann, 303 S.W.2d 341 (Tex. 1957)).

> denced by any part or provision of it, nor by the instrument without any part or provision, but by every part and term so construed as to be consistent with every other part and with the entire contract. The actual intent of the parties when thus ascertained must prevail over the dry words, inapt expressions, and careless recitations in the contract, unless that intention is directly contrary to the plain sense of the binding words of the agreement.[37]

In *Concord Oil Co. v. Pennzoil Exploration & Production Co.*, the Texas Supreme Court considered the propriety of the district court's construction of fractional conveyances in an oil and gas lease that appeared, on its face, to convey different fractions to the same parties.[38] Citing *Luckel v. White*[39] and a body of related cases, Justice Owen, for the majority, wrote:

> The principal import of our decision in *Luckel* is that the document must be read as a whole to see what actually has been granted. While we have not always articulated this precept, the result in each case . . . has been consistent with the directives in *Luckel* that the conveyance must be considered as a whole to determine the intent of the parties and that seemingly conflicting positions are to be harmonized if possible.[40]

Finding that "[t]he granting clause contains classic language used in granting an interest in minerals,"[41] and "[b]earing in mind that our objective is to determine the intent of the parties in light of all the provisions of the deed,"[42] the majority concluded that the grant of 1/12 of rents and royalties indicated that the grantor also conveyed a possessory mineral estate of a 1/12 interest in the minerals, notwithstanding contrary specific language that the conveyance was only a 1/96 interest in the minerals.[43]

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[37]Witherspoon Oil Co. v. Randolph, 298 S.W. 520, 522 (Tex. Comm'n App. 1927, judgm't adopted) (quoting United States Fidelity & Guar. Co. v. Board of Comm'rs, 145 F. 145, 148 (8th Cir. 1906)), *cited with approval in KMI Continental Offshore*, 746 S.W.2d at 241.

[38]40 Tex. Sup. Ct. J. 33 (Oct. 18, 1996).

[39]819 S.W.2d 459 (Tex. 1991).

[40]*Concord Oil*, 40 Tex. Sup. Ct. J. at 37.

[41]*Id.* at 38.

[42]*Id.*

[43]*See id.* at 39; *compare id.* at 33.

### 3. The "Plain Meaning" Rule

Courts should give each word and phrase in a written agreement its plain, grammatical meaning unless it definitely appears that such meaning would defeat the parties' intent, as evidenced by the entire agreement.[44] Put another way: wherever possible, courts should give words and phrases in agreements their ordinary, popular, and common meaning.[45]

However, this rule should yield if following it would cause a result that is contrary to the clearly manifested intention of the parties.[46] For instance, if the parties stipulate to the meaning of a particular term, the stipulated meaning, rather than the "plain" meaning, will prevail.[47] Likewise, a technical term or term of art will prevail over a common-usage definition where the circumstances so dictate.[48]

### 4. Presumption that Each Provision Has Meaning and Purpose

Courts are to construe contractual provisions, if possible, in such a way as to give each provision meaning and purpose so that no provision is rendered meaningless or moot.[49] If a contract or contractual provision is susceptible to two reasonable constructions, one of which would render it meaningful and the other moot, the construction making the contract or

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[44]*See* Reilly v. Rangers Management, Inc., 727 S.W.2d 527, 529 (Tex. 1987); Lyons v. Montgomery, 701 S.W.2d 641, 643 (Tex. 1985); Belmont Constructors, Inc. v. Lyondell Petrochemical Co., 896 S.W.2d 352, 357 (Tex. App.—Houston [1st Dist.] 1995, no writ); Hussong v. Schwan's Sales Enters., 896 S.W.2d 320, 324 (Tex. App.—Houston [1st Dist.] 1995, no writ); GT & MC, Inc. v. Texas City Ref., Inc., 822 S.W.2d 252, 256 (Tex. App.—Houston [1st Dist.] 1991, writ denied).

[45]*See* Phillips v. Union Bankers Ins. Co., 812 S.W.2d 616, 618 (Tex. App.—Dallas 1991, no writ).

[46]*See* Stahl Petroleum Co. v. Phillips Petroleum Co., 550 S.W.2d 360, 366 (Tex. Civ. App.—Amarillo 1977), *aff'd*, 569 S.W.2d 480 (Tex. 1978); *see also* RESTATEMENT (SECOND) OF CONTRACTS § 202(3)(a) (1981) ("Unless a different intention is manifested, where language has a generally prevailing meaning, it is interpreted in accordance with that meaning . . . .").

[47]*See, e.g.*, City of Ranger v. Hagaman, 4 S.W.2d 597, 598 (Tex. Civ. App.—Eastland 1928, no writ).

[48]*See, e.g.*, Lone Star Gas Co. v. McCarthy, 605 S.W.2d 653, 656-57 (Tex. Civ. App.—Houston [1st Dist.] 1980, writ ref'd n.r.e.).

[49]*See* Lenape Resources Corp. v. Tennessee Gas Pipeline Co., 925 S.W.2d 565, 574 (Tex. 1996); Coker v. Coker, 650 S.W.2d 391, 393 (Tex. 1983); Southland Royalty Corp. v. Pan Am. Petroleum Corp., 378 S.W.2d 50, 53 (Tex. 1964); Universal C.I.T. Credit Corp. v. Daniel, 243 S.W.2d 154, 158 (Tex. 1951); Advertising & Policy Comm. of the Avis Rent A Car Sys. v. Avis Rent A Car Sys., 780 S.W.2d 391, 395 (Tex. App.—Houston [14th Dist.] 1989), *vacated on other grounds*, 796 S.W.2d 707 (Tex. 1990).

provision meaningful must prevail.[50]

For example, in *KMI Continental Offshore Production Co. v. ACF Petroleum Co.*, the contract at issue contained a purchase option.[51] The two parties offered competing interpretations of the contract, one of which would render the purchase option meaningless in certain circumstances.[52] Because appellee's interpretation of the contract would defeat the purchase option under certain circumstances, the court adopted the appellant's interpretation, by which the purchase option was always available.[53]

In *Coker v. Coker*, the Texas Supreme Court considered a property settlement agreement incorporated into a decree of divorce.[54] Paragraph 5 of the agreement provided, in relevant part:

> 5. Wife shall receive as her sole and separate property, free and clear of any claim, right or title of husband, . . . that certain right, commission or account receivable heretofore earned by husband during his employment with the firm of Majors & Majors in connection with the sale of the "Jinkens ranch property in Tarrant County, Texas," such future commission or account receivable being in the approximate sum of $25,000.00.[55]

Paragraph 8 of the agreement further provided:

> 8. Husband represents and warrants to the wife that, to the best of his knowledge, approximately $25,000.00 remains due and owing to him as his portion of commissions earned in connection with the sale of the "Jinkens

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[50]*See* Harris v. Rowe, 593 S.W.2d 303, 306 (Tex. 1979); Dahlberg v. Holden, 238 S.W.2d 699, 701 (Tex. 1951); KMI Continental Offshore Prod. Co. v. ACF Petroleum Co., 746 S.W.2d 238, 241-42 (Tex. App.—Houston [1st Dist.] 1987, writ denied); Loe v. Murphy, 611 S.W.2d 449, 452 (Tex. Civ. App.—Dallas 1980, writ ref'd n.r.e.); *see also* RESTATEMENT (SECOND) OF CONTRACTS § 203(a) ("[A]n interpretation which gives a reasonable, lawful, and effective meaning to all the terms is preferred to an interpretation which leaves a part unreasonable, unlawful, or of no effect . . . ."); *id.* § 203 cmt. b ("Since an agreement is interpreted as a whole, it is assumed in the first instance that no part of it is superfluous."). For additional cases evidencing the desire of Texas courts to read meaning and purpose into all contractual provisions, see the discussions of the *Daniel* and *Hettig & Co.* cases, *infra* Part III.A.1.

[51]746 S.W.2d 238, 240 (Tex. App.—Houston [1st Dist.] 1987, writ denied).

[52]*See id.* at 241-43.

[53]*See id.* at 243.

[54]650 S.W.2d 391 (Tex. 1983).

[55]*Id.* at 392-93.

> property in Tarrant County, Texas," and he hereby guarantees to wife that she will receive the said sum of $25,000.00, from Majors & Majors, or from any other payor of such commissions receivable. Such commission is payable to her as payments are made by purchasers to sellers .... In the event, for any reason she fails to receive such installments of commission exactly as husband would have prior to his assignment of his rights thereto to wife, husband agrees to pay to wife in Dallas County, Texas all such sums of money, which she has failed to receive, up to the guaranteed sum of $25,000.00.[56]

Before Majors & Majors received $25,000.00 in commissions payable through the husband's assignment to his ex-wife, the purchaser defaulted on its payment obligations to the seller.[57] The wife sued her ex-husband for the difference between what she had received and $25,000.[58] The issue before the Texas Supreme Court was whether the husband had agreed to pay his ex-wife a minimum of $25,000.00, or whether she was only entitled to such commissions as he would have received if he had not assigned his interest to her.[59]

The trial court construed paragraph 8 as an absolute guarantee that the husband would pay the wife at least $25,000.00, granted her motion for summary judgment, and ordered her ex-husband to pay her the difference between $25,000.00 and the amount of commissions she had received prior to the buyer's default.[60] The court of appeals affirmed in an unpublished opinion.[61] The supreme court reversed the summary judgment, holding that paragraphs 5 and 8, when read together as they must be in order to give meaning to both provisions, created an ambiguity as to the parties' intent.[62] Ironically, as did the Fifth Circuit in *Hanssen v. Qantas Airways Ltd.*,[63] the court found ambiguity as a consequence of its adherence to a primary rule of construction, the rule that "[c]ourts must favor an interpretation that affords some consequence to each part of the instrument

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[56]*Id.* at 393.

[57]*See id.*

[58]*See id.*

[59]*See id.* at 392.

[60]*See id.*

[61]*See id.*

[62]*See id.* at 394-95.

[63]904 F.2d 267, 270 (5th Cir. 1990); *see supra* text accompanying notes 22-31.

so that none of the provisions will be rendered meaningless."[64]

Similarly, in *Advertising & Policy Committee of the Avis Rent A Car System v. Avis Rent A Car System*, the court of appeals rejected appellant's proposed reading of an Executive Licensing Agreement (ELA), reasoning that

> [n]ot only does the ELA not expressly provide for the binding effect of A & P Committee decisions [as argued by appellant], but to construe Section 5 in accordance with appellant's interpretation would render ineffective other provisions of the ELA that unquestionably recognize Avis' ownership of, and right to control and change, the Avis system.[65]

In *Lenape Resources Corp. v. Tennessee Gas Pipeline Co.*, the Texas Supreme Court reiterated the importance of construing a contract so as to give meaning to each provision, as well as the primacy of general rules of construction over the more arcane "secondary" rules discussed below.[66] The gas purchase contract at issue contained the following provision:

> 8. Prices:
>
> (a) The price to be paid by Buyer to Seller from the effective date hereof for all gas delivered hereunder, or for the contract quantity if available and not taken by Buyer, shall be $2.067 per Mcf, escalating on the first day of January, 1979 and the first day of each month thereafter for the term of this Agreement to the product obtained by multiplying the price in effect hereunder for the preceding month by the monthly equivalent of the annual inflation adjustment factor applicable for such month, as such factor is defined in Section 102(b)(2) of the Natural Gas Policy Act of 1978, Public Law 95-621.[67]

The price provision seems clear enough. Unfortunately, the "annual inflation adjustment factor" in the Natural Gas Policy Act (NGPA) is

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[64]*Coker*, 650 S.W.2d at 394.

[65]780 S.W.2d 391, 395 (Tex. App.—Houston [14th Dist.] 1989), *vacated on other grounds*, 796 S.W.2d 707 (Tex. 1990).

[66]925 S.W.2d 565, 574 (Tex. 1996); *see infra* Part II.D.

[67]*Lenape*, 925 S.W.2d at 573.

contained in section 101(a), not in section 102(b)(2).[68] The adjustment factor set forth in section 102(b)(2) applies only to gas subject to section 102, and includes both the section 101(a) adjustment and a second adjustment unique to section 102 gas.[69] The buyer (Tennessee) took the position that the price due for appellants' gas should be adjusted only by the section 101(a) factor because appellants' gas was not otherwise subject to section 102.[70] Lenape and the other sellers (appellants), on the other hand, sought to have the price of their gas "doubly" escalated, using the section 102(b)(2) adjustment.[71]

The court considered each of the rules of construction proffered by Tennessee in support of its reading of section 8(a), but found that "[e]ach application of these rules of construction . . . leads to the complete negation of the line 'defined in Section 102(b)(2) of the Natural Gas Policy Act of 1978.' "[72] In the spirit of giving meaning and purpose to each provision of the contract, the court concluded that section 8(a) was ambiguous as a matter of law and, therefore, the trial court's consideration of parol evidence was proper.[73] Then, after reviewing the proffered parol evidence regarding industry custom and the course of negotiations leading to the contract at issue, the court found no error in the trial court's finding that the parties intended the price of appellants' gas to be adjusted in accordance with section 102(b)(2) of the NGPA.[74]

Most recently, in *American Stone Diamond, Inc. v. Lloyds of London*, the district court held that the insured's reading of the subject policy exclusion rendered it meaningless, while the reading proffered by the insurer

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[68]*See id.* at 573 nn.3-4 (citations omitted).

[69]*See id.* at 573-74 & n.4.

[70]*See id.* at 574.

[71]*See id.*

[72]*Id.*

> Tennessee argues that when there is a variance between unambiguous written words ("annual inflation adjustment factor") and figures ("§ 102(b)(2)"), the written words control. In addition, it argues that terms stated earlier in a contract ("annual inflation adjustment factor") are favored over subsequent terms ("§ 102(b)(2)"). Moreover, the language used by the parties ("factor," not "factors," modified by "defined in") should be accorded its plain, grammatical meaning unless it definitely appears the parties' intent would thereby be defeated.

*Id.* (citations omitted).

[73]*See id.*

[74]*See id.* at 574-75.

did not.[75] The district court found that the insurer's reading was the only acceptable one, entitling the insurer to summary judgment.[76]

### 5. Presumption Against Illegality

If a contract or contractual provision is susceptible to two reasonable constructions, one of which comports with statutory law, regulation, or common law, and one of which does not, the court should construe the contract or contractual provision in such a way as to make it legal.[77]

### 6. Presumption Favoring Express Terms over Implied Terms or Subsequent Conduct

As noted above, course of performance, course of dealing, and usage of trade are among the "surrounding circumstances" that courts should consider when construing or interpreting a written contract.[78] Nevertheless, these considerations yield to contrary express terms in a writing.[79]

Historically, Texas courts have not favored implying provisions into agreements.[80] Implied provisions are permitted only when necessary to

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[75]934 F. Supp. 839, 843-44 (S.D. Tex. 1996) (citing Praeger v. Wilson, 721 S.W.2d 597 (Tex. App.—Fort Worth 1986, writ ref'd n.r.e.)).

[76]*See id.*

[77]*See* Smart v. Tower Land & Inv. Co., 597 S.W.2d 333, 340 (Tex. 1980); Harris v. Rowe, 593 S.W.2d 303, 306 (Tex. 1979); Franklin v. Jackson, 847 S.W.2d 306, 309 (Tex. App.—El Paso 1992, writ denied); Conte v. Greater Houston Bank, 641 S.W.2d 411, 418 (Tex. App.—Houston [14th Dist.] 1982, writ ref'd n.r.e.); Ford Motor Credit Co. v. McDaniel, 613 S.W.2d 513, 518 (Tex. Civ. App.—Corpus Christi 1981, writ ref'd n.r.e.); *see also* RESTATEMENT (SECOND) OF CONTRACTS § 203(a) & cmt. c (1981) (favoring "lawful" constructions over "unlawful" ones); *id.* § 207 ("In choosing among the reasonable meanings of a promise or agreement or a term thereof, a meaning that serves the public interest is generally preferred.").

[78]*See supra* Part II.C.1.

[79]*See* RESTATEMENT (SECOND) OF CONTRACTS § 203(b) ("[E]xpress terms are given greater weight than course of performance, course of dealing, and usage of trade . . . ."). The commentary to section 203 explains:

> Just as parties to agreements often depart from general usage as to the meaning of words or other conduct, so they may depart from a usage of trade. Similarly, they may change a pattern established by their own prior course of dealing. Their meaning in such cases is ordinarily to be ascertained as a fact; no penalty is attached by the law of contracts to their failure to conform to the usages of others or to their own prior usage.

*Id.* § 203 cmt. d.

[80]*See* Thornton v. D.F.W. Christian Television, Inc., 925 S.W.2d 17, 24 (Tex. App.—Dallas 1995), *rev'd*, 933 S.W.2d 488 (Tex. 1996); Sumrall v. Russell, 255 S.W. 239, 240 (Tex. Civ. App.—El Paso 1923, writ dism'd w.o.j.).

effectuate the intent of the parties as evidenced by the agreement as a whole.[81] In order to imply a provision not explicitly set forth in an instrument, it must appear that the implied provision was "so clearly within the contemplation of the parties that they deemed it unnecessary to express it."[82] It is not enough that an implied provision is necessary to make an agreement "fair," or that without such a provision the agreement would be improvident, unwise, or unjust.[83] Moreover, Texas courts will generally refrain from any construction that requires the insertion of a qualifying phrase to alter the ordinary meaning of the literal text.[84]

Arguably, any prior course of dealing between the parties, routine usages of trade, and technical or specialized terms used in the industry or location in which the parties do business should be "so clearly within the contemplation of the parties that they deemed it unnecessary" to include specific terms in the contract memorializing these implied terms.[85] However, this argument probably does not apply to the parties' course of performance under the agreement being scrutinized. Performance that occurs after the parties entered into the agreement seems less likely to have been clearly within the parties' contemplation at the time they entered into the agreement because, unlike the parties' prior course of dealing and existing trade usage, such performance often involves future events that are unknown at the time of the agreement.

Consider the Texas Supreme Court's relatively hostile treatment of course of performance evidence in *East Montgomery County Municipal Utility District No. 1 v. Roman Forest Consolidated Municipal Utility District*.[86] In *Roman Forest*, a dispute arose over the county's obligation

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[81]*See* Danciger Oil & Ref. Co. v. Powell, 154 S.W.2d 632, 635 (Tex. 1941); Calvin V. Koltermann, Inc. v. Underream Piling Co., 563 S.W.2d 950, 957 (Tex. Civ. App.—San Antonio 1977, writ ref'd n.r.e.).

[82]*Danciger*, 154 S.W.2d at 635; *Calvin*, 563 S.W.2d at 957. In such a case, the Restatement suggests that the trial court supply a term "which is reasonable [under] the circumstances." RESTATEMENT (SECOND) OF CONTRACTS § 204.

[83]*See Danciger*, 154 S.W.2d at 635.

[84]*See* Praeger v. Wilson, 721 S.W.2d 597, 601 (Tex. App.—Fort Worth 1986, writ ref'd n.r.e.); *see also* RESTATEMENT (SECOND) OF CONTRACTS § 204 cmt. c (discussing the circumstances under which "omitted" terms should be impliedly read into a written agreement that does not contain them, and concluding that "interpretation may result in the conclusion that there was in fact no agreement on a particular point, and that conclusion should be accepted even though the omitted term could be supplied by giving agreed language a meaning different from the meaning or meanings given it by the parties").

[85]*Danciger*, 154 S.W.2d at 635.

[86]620 S.W.2d 110 (Tex. 1981).

to pay for water service and sewage treatment under separate, contemporaneous contracts.[87] Notwithstanding fairly clear language in the water service contract that the county was only obligated to pay a share of operating expenses for a water well used both by the county and by Roman Forest, Roman Forest attempted to include in its charges to the county a portion of the cost of operating its own internal water distribution system.[88] Likewise, notwithstanding relatively clear language in the sewage treatment contract that the county was only obligated to pay for "waste treatment and disposal services to be rendered by [Roman Forest] to [the county],"[89] Roman Forest attempted to include the cost of its own internal sewer collection system in the operating budget from which it charged the county.[90]

East Montgomery County sought a declaratory judgment that it was not obligated to pay for any or all of the costs of Roman Forest's internal water and sewage systems.[91] However, the county brought suit only after it had accepted and paid invoices from Roman Forest, including those costs incurred, for several years.[92] The court of civil appeals found the county's repeated acceptance and payment of these invoices for charges not included in the express terms of the contract to be decisive:

> The interpretation placed upon a contract by the parties to it is the highest evidence of their intent. [The county] without objection paid the bills prepared by [Roman Forest] for a period of over two years, and only when [the county] encountered financial difficulty did they dispute the interpretation of the contract.[93]

The Supreme Court did not agree: "The conduct of the parties is only relevant after the court has determined [as a matter of law] that the contract is ambiguous. Neither party contends that the contract is ambiguous. The conduct of the parties is therefore irrelevant."[94]

An excellent example of the conflicting results that may occur when

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[87]*See id.* at 111.

[88]*See id.* at 111-12.

[89]*Id.* at 112 (quoting the sewage contract).

[90]*See id.* at 111-12.

[91]*See id.*

[92]*See* Roman Forest Consol. Mun. Util. Dist. v. East Montgomery County Mun. Util. Dist. No. 1, 619 S.W.2d 1, 2 (Tex. Civ. App.—Beaumont), *rev'd*, 620 S.W.2d 110 (Tex. 1981).

[93]*Roman Forest*, 619 S.W.2d at 2 (citations omitted).

[94]*Roman Forest*, 620 S.W.2d at 112.

different courts purport to rely on the same "rules" of construction and interpretation is provided by *Thornton v. D.F.W. Christian Television, Inc.*, in which the Dallas Court of Appeals considered the proper construction of an agreement that was never alleged by either party to be ambiguous.[95] The dispute concerned the parties' disagreement over who had the right to some $600,000 in escrowed funds pursuant to the terms of their contract.[96] Opal Thornton obtained a permit from the FCC to build a television station.[97] D.F.W. Christian Television (DFW) agreed to pay $600,000 into escrow and to construct the physical facilities in exchange for Thornton's agreement to form a corporation (TV-55), obtain consent from the FCC to assign the construction permit to TV-55, and sell 49% of TV-55's stock to DFW.[98] The written agreement provided that "the $600,000 would be released to Thornton upon her delivery of 49% of TV-55 stock to the escrow agent. If Thornton failed to deliver the stock within 90 days of execution of the agreement, the escrow agent was to return the $600,000 to DFW."[99] If DFW failed to build the facilities as agreed, DFW was to return its 49% share of the stock to Thornton.[100] Thornton was not required to return DFW's $600,000 "if [DFW's] failure to construct the television station was due to DFW's breach of the agreement."[101]

After DFW deposited the $600,000 into escrow, Thornton then incorporated TV-55 and deposited all of TV-55's stock into the escrow account.[102] The escrow agent paid the $600,000 to Thornton as agreed.[103] However, DFW did not procure a site and never built the station.[104] Thornton therefore refused to return DFW's $600,000 and sued DFW, claiming that DFW's failure to build the station amounted to breach of contract and fraud.[105] DFW then counterclaimed, "alleging that Thornton breached the purchase agreement by failing to obtain a construction site for the station and by failing to return the $600,000."[106]

After a bench trial, at which the trial court apparently considered no

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[95]925 S.W.2d 17, 23-25 (Tex. App.—Dallas 1995), *rev'd*, 933 S.W.2d 488 (Tex. 1996).

[96]*See* D.F.W. Christian Television, Inc. v. Thornton, 933 S.W.2d 488, 489 (Tex. 1996).

[97]*See id.* at 488.

[98]*See id.* at 488-89.

[99]*Id.* at 489.

[100]*See id.*

[101]*Id.*

[102]*See id.*

[103]*See id.*

[104]*See id.*

[105]*See id.*

[106]*Id.*

extrinsic evidence of the contract's meaning, "the trial court concluded as a matter of law that Thornton was entitled to retain the $600,000 only in the event [that] DFW's failure to construct the facilities was due to its breach of contract."[107] The trial court further "concluded that DFW's failure to build the station was not a breach of the parties' agreement and that Thornton breached the agreement by failing to return DFW's $600,000."[108]

Thornton appealed, and the court of appeals held that "the trial court's interpretation of the agreement to require the return of DFW's $600,000 if Thornton failed to obtain a valid construction permit was in error."[109] The court of appeals explained:

> In this case, neither party pleaded that the purchase agreement was ambiguous. When there is no pleading of ambiguity with respect to an agreement, all questions relating to the agreement's construction are questions of law. Because ambiguity has not been pleaded and construction is a question of law, we independently construe the purchase agreement in determining the correctness of the trial court's conclusions of law relating to the construction of that agreement.
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> In construing an unambiguous agreement, this Court's primary concern is to ascertain and give effect to the intentions of the parties as expressed in the agreement. To achieve this objective, we must construe the meaning of the language used in the agreement. When the language is plain, it must be enforced as written. We consider the entire agreement in an effort to harmonize and give effect to all its terms so that none will be rendered meaningless. No single provision of the agreement taken alone will be given controlling effect; rather, all the provisions must be considered with reference to the whole agreement. Words and phrases in agreements should be given their ordinary, popular, and common meaning. Language in an agreement should be accorded its plain, grammatical meaning unless the parties intended otherwise as such intent is evidenced from the agreement.

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[107] *Id.*
[108] *Id.*
[109] *Id.*

> When we apply these rules of construction, the plain language of the purchase agreement provides that if DFW does not build the station, then appellant receives DFW's forty-nine percent share of the stock in TV-55. If DFW's failure to build the station constitutes a breach under the agreement, then the plain language of the agreement provides appellant does not have to return the $600,000 paid in escrow by DFW. The language of the agreement is clear that the $600,000 was to be paid into escrow by DFW as consideration for appellant forming TV-55 and depositing its stock into escrow. The agreement specifically provides the $600,000 would be returned to DFW only in the event appellant did not form TV-55 and deposit its stock into escrow.
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> . . . .
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> . . . The purchase agreement as a whole shows no intent of the parties to provide as a specific remedy to DFW the return of the $600,000 if appellant breached the agreement in such a manner. To the contrary, the agreement provides the $600,000 is to be returned to DFW *only* in the event appellant failed to form TV-55 and deposit its stock in escrow.[110]

The Texas Supreme Court granted DFW's application for writ of error and reversed the court of appeals, but did not cite a single authority in its brief, per curiam opinion.[111] The supreme court held that the trial court had correctly determined that Thornton was required to return DFW's $600,000:

> We agree with DFW that the express language of the parties' agreement limits the circumstances under which Thornton may retain the $600,000. Because DFW did not breach the agreement, the contract requires Thornton to return the money.
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> The contract specifically addresses what was to happen if DFW failed to construct the station. First, Thornton

[110]Thornton v. D.F.W. Christian Television, Inc., 925 S.W.2d 17, 23-24 (Tex. App.—Dallas 1995), *rev'd*, 933 S.W.2d 488 (Tex. 1996) (emphasis added) (citations omitted).

[111]*See D.F.W. Christian Television*, 933 S.W.2d 488 (Tex. 1996).

> was entitled to the return of DFW's 49% share of the stock. This was to occur regardless of whether DFW breached the agreement in failing to build the station. In contrast, Thornton's right to the $600,000 was not unconditional if the station was not constructed. The provision of the agreement at issue states that "[i]f [DFW's] failure to construct is due to a breach by [DFW], [Thornton] will not be required to return the escrow money previously paid hereunder." This provision expressly contemplates that Thornton is required to return the $600,000 in the event that DFW's failure to construct the station is not due to DFW's breach.[112]

Thus, looking at the same contract, which the parties stipulated to be unambiguous, the trial court and the Texas Supreme Court both concluded that Thornton was entitled to keep DFW's $600,000 only if DFW's failure to construct the facilities was due to DFW's breach of the contract,[113] whereas the court of appeals concluded that DFW was entitled to recover its $600,000 from Thornton only if Thornton failed to form TV-55 and deposit its stock in escrow.[114] Although both appellate courts presumably sought to effectuate the parties' intent based upon the conventional rules of construction, they reached different conclusions.[115] Results such as these tend to support a view of the rules of construction as somewhat improvisational.[116]

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[112]*Id.* at 490.

[113]*See id.* at 489-90.

[114]*See Thornton*, 925 S.W.2d at 24.

[115]*See id.*; *see also D.F.W. Christian Television*, 933 S.W.2d at 489-90.

[116]*See* JOHN D. CALAMARI & JOSEPH M. PERILLO, THE LAW OF CONTRACTS § 3-16, at 177 (3d ed. 1987) ("It would, however, be a mistake to suppose that the courts follow any of these rules blindly, literally or consistently. As often as not they choose the standard or rule that they think will give rise to a just result in the particular case.").

Nor is *Thornton* even the most recent example of this phenomenon. In *Heritage Resources, Inc. v. NationsBank*, the trial court, the court of appeals, and the supreme court all agreed that the oil and gas leases in question were unambiguous. 939 S.W.2d 118, 121 (Tex. 1996). However, the trial court and court of appeals agreed on one interpretation of the royalty clause, and the supreme court insisted on another. *See id.* at 120. Even this was not the end of the controversy because, as Justice Gonzalez noted, the majority and concurrence agreed that the lease in question was unambiguous, but still reached opposite results. *See id.* at 132 (Gonzalez, J., dissenting).

### D. Secondary Rules of Construction and Interpretation

In addition to, or sometimes in conjunction with, the foregoing primary rules of construction and interpretation, Texas courts also rely from time to time upon a number of "secondary" rules. These secondary rules are easier both to define and to apply than the foregoing, more general principles. However, they are applicable to far fewer disputes, and courts are therefore much less likely to use them to decide an issue of contract interpretation or construction than their favored and more general counterparts.[117]

A court may apply any of the following secondary rules of construction, but should do so only if two or more provisions of a contract, or two or more reasonable readings of the provisions of a contract, remain in "irreconcilable conflict" after the court has applied the foregoing rules.[118]

#### 1. Presumption Favoring the Nondrafting Party (*Contra Proferentem*)

Generally, contract terms are construed against the party responsible for drafting the contract or contractual provision.[119] In *Temple-Eastex Inc.*

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[117]Writing about these secondary maxims of construction and interpretation, Professor Patterson has observed:

> There is some doubt whether they have reliable guidance value for judges, or are merely justifications for decisions arrived at on other grounds, which may or may not be revealed in the opinion. This rather cynical view is supported by two observations. One is that for any given maxim that would persuade a judge to a certain conclusion a contrary maxim may be found that would persuade him to the opposite (or contradictory) conclusion. . . .
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> . . . .
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> The second reason . . . for believing that the [secondary] maxims of interpretation are ceremonial rather than persuasive is that in many instances the court will set forth in its opinion the whole battery of maxims and then proceed to decide the case on the basis of an analysis of the terms of the contract and the facts of the dispute, *without indicating which maxim or maxims, if any, were applied or invoked in reaching that decision.*

Patterson, *supra* note 2, at 852-53(emphasis added).

[118]*See* 9 WILLIAM V. DORSANEO, III ET AL., TEXAS LITIGATION GUIDE § 210A.28[1], at 210A-71 (1996) (citing Exxon Corp. v. Eastman Kodak Co., 589 S.W.2d 473, 478 (Tex. Civ. App.—Texarkana 1979), *rev'd on other grounds*, 603 S.W.2d 208 (Tex. 1980), and Hegar v. Tucker, 274 S.W.2d 752, 755 (Tex. Civ. App.—Galveston 1955, writ ref'd n.r.e.)).

[119]*See* Chase Manhattan Bank v. First Marion Bank, 437 F.2d 1040, 1049 (5th Cir. 1971) ("Application of [the parol evidence rule] is especially appropriate when, as here, the complain-

*v. Addison Bank*, a bank refused to honor its letter of credit in favor of Temple-Eastex.[120] The bank contended that it was not required to pay Temple-Eastex because the letter of credit provided that it was payable upon the submission of a "sight draft," whereas Temple-Eastex had attempted to collect by demand letter.[121] The trial court found that Temple-Eastex's method of presentment was consistent with industry custom and practice.[122] The court of appeals reversed the trial court's judgment, holding that, inter alia, Temple-Eastex failed to comply with the terms of the letter of credit.[123]

Reversing the court of appeals, the Texas Supreme Court extensively analyzed the meaning of the term "sight draft" as used within the industry.[124] The court stated: " 'While comprehensive, the word ["draft"] is not ambiguous and has a well-understood meaning.' "[125] The Texas Supreme Court ruled against the bank, explaining:

> In Texas, a writing is generally construed most strictly against its author and in such a manner as to reach a reasonable result consistent with the apparent intent of the parties. . . . As a result, the bank's letter of credit is construed most strictly against the bank because it drafted the letter of credit.[126]

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ing party has drafted the agreement in question."); Austin Co. v. Vaughn Bldg. Corp., 643 S.W.2d 113, 115 (Tex. 1982); Republic Nat'l Bank v. Northwest Nat'l Bank, 578 S.W.2d 109, 115 (Tex. 1978); Thompson v. Preston State Bank, 575 S.W.2d 312, 315 (Tex. Civ. App.—Dallas 1978, writ ref'd n.r.e.); Monesson v. Champion Int'l Corp., 546 S.W.2d 631, 637 (Tex. Civ. App.—Tyler 1976, writ ref'd n.r.e.); *see also* RESTATEMENT (SECOND) OF CONTRACTS § 206 (1981) ("In choosing among the reasonable meanings of a promise or agreement or a term thereof, that meaning is generally preferred which operates against the party who supplies the words . . . .").

For obvious reasons, the presumption against the drafter is less pronounced when the other party has taken an active role in the drafting process or is particularly knowledgeable. *See* RESTATEMENT (SECOND) OF CONTRACTS § 206 reporter's note, at 105-06 (1981), and cases cited therein.

[120]672 S.W.2d 793, 794 (Tex. 1984).

[121]*Id.* at 797.

[122]*See id.* at 798.

[123]*See* Addison Bank v. Temple-Eastex, Inc., 665 S.W.2d 550, 553 (Tex. App.—El Paso), *rev'd*, 672 S.W.2d 793 (Tex. 1984).

[124]*Temple-Eastex*, 672 S.W.2d at 797.

[125]*Id.* (quoting Travis Bank & Trust v. State, 660 S.W.2d 851, 854-55 (Tex. App.—Austin 1983, no writ)).

[126]*Id.* at 798 (citation omitted).

At least one Texas court of appeals has held that this rule applies to unambiguous contracts. In *Hill Constructors, Inc. v. Stonhard, Inc.*, the trial court granted summary judgment in favor of a construction subcontractor (Stonhard) who sued the general contractor (Hill) on a flooring tile subcontract.[127] The general contractor had prepared the subcontract and the related change-order contract.[128] The subcontract required that the subcontractor " 'not proceed until unsatisfactory conditions have been corrected.' "[129] The tile floor installed by the subcontractor was faulty because the concrete subfloor—which a different subcontractor, over which Stonhard did not exercise any control, had installed—contained invisible depressions that the subcontractor did not call to Stonhard's attention prior to performing its work.[130] The court of appeals affirmed, construing the subcontract to mean that the subcontractor was not to begin work until the contractor had corrected all known unsatisfactory conditions. In so doing, the court strictly construed the subcontract against Hill because Hill had drafted it.[131]

However, the Texas Supreme Court has previously held that a court should resort to strict construction against the drafter only when the contract is ambiguous.[132] Likewise, the Fifth Circuit recently chastised a district court for relying on the presumption against the drafting party (*contra proferentem*) when construing a contract that the Fifth Circuit determined to be unambiguous:

> The district court further erred by relying, at the outset, on the rule of strict construction against the drafter . . . . We note that the rule *contra proferentem* "is not one of the favored rules of construction. Indeed, it is said that it is to be resorted to only when the other rules fail." Certainly, "the rule has no application where . . . the intent of the

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[127]833 S.W.2d 742, 744 (Tex. App.—Houston [1st Dist.] 1992, writ denied).

[128]*See id.* at 743-44.

[129]*Id.* at 743 (quoting the contract between the general contractor and the subcontractor).

[130]*See id.*

[131]*See id.* at 745-46 (citing Gonzales v. Mission Am. Ins. Co., 795 S.W.2d 734, 737 (Tex. 1990)).

[132]*See* Universal C.I.T. Credit Corp. v. Daniel, 150 Tex. 513, 243 S.W.2d 154, 157 (1951) ("[T]he rule of strong construction against the author . . . . is applied *only* where a contract is open to two reasonable constructions." (emphasis added)).

> parties is clear and a resort to the rule will defeat that intent."[133]

### 2. Presumption Favoring Specific Terms over General Terms

Specific language in a contract will prevail over general provisions.[134] However, this preference will yield if the parties clearly manifest a contrary intent.[135]

### 3. Presumption Favoring Terms Stated Earlier in the Agreement over Terms Stated Later

In harmonizing the provisions of a written agreement, "terms stated earlier in an agreement must be favored over subsequent terms."[136] However, Texas courts will give deference to a later provision or reservation that disclaims the effects of any prior terms on its effect. In *N.M. Uranium, Inc. v. Moser*, the court of civil appeals considered the terms of the following royalty agreement:

> Lessor, whose royalty interest shall never bear costs of production or marketing[,] hereby reserves as royalty sums equal to the following:
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> . . . .

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[133]Clardy Mfg. Co. v. Marine Midland Bus. Loans, Inc., 88 F.3d 347, 355 (5th Cir. 1996) (quoting Smith v. Davis, 453 S.W.2d 340, 344 (Tex. Civ. App—Fort Worth 1920, writ ref'd n.r.e.) and Modular Tech. Corp. v. Lubbock, 529 S.W.2d 273, 276 (Tex. Civ. App.—Amarillo 1975, writ ref'd n.r.e.)); *see also* Canutillo Indep. Sch. Dist. v. National Union Fire Ins. Co., 99 F.3d 695, 701 (5th Cir. 1996) (noting that the rule that insurance policy exclusions are construed against the insurer, even if the insurer's proffered reading "appears to be a more reasonable or a more accurate reflection of the parties' intent," applies only when the exclusions are subject to more than one reasonable construction).

[134]*See* Guadalupe-Blanco River Auth. v. City of San Antonio, 145 Tex. 611, 200 S.W.2d 989, 1001 (1947); City of San Antonio v. Heath & Stich, Inc., 567 S.W.2d 56, 60 (Tex. Civ. App.—Waco 1978, writ ref'd n.r.e.); *see also* RESTATEMENT (SECOND) OF CONTRACTS § 203(c) & cmt. e (1981).

[135]*See* RESTATEMENT (SECOND) OF CONTRACTS § 203 cmt. e.

[136]Coker v. Coker, 650 S.W.2d 391, 393 (Tex. 1983); *see also* Southland Royalty Co. v. Pan Am. Petroleum Corp., 378 S.W.2d 50, 57 (Tex. 1964); Hughes v. Aycock, 598 S.W.2d 370, 376 (Tex. Civ. App.—Houston [14th Dist.] 1980, writ ref'd n.r.e.). *But see* Mid Plains Reeves, Inc. v. Farmland Indus., 768 S.W.2d 318, 321 (Tex. App.—El Paso 1989, writ denied) (holding that if the first of two irreconcilable clauses is written in general terms and the second is specific, the second controls the first).

> B. For uranium bearing ores extracted by solution mining the royalty shall be (1/16th) one-sixteenth of the sales revenue received for the uranium oxide ($U_3O_8$) attributable to the production produced and sold from the Leased Premises . . . . However, for five (5) years from January 1, 1975, lessor's royalty for the first 450,000 pounds of uranium oxide produced and sold from the Leased Premises during a calendar year will not exceed $1.50 per pound. . . .
>
> . . . .
>
> The following shall apply to the royalties reserved in paragraphs A, B, C and D above:
>
> . . . .
>
> Any provision herein to the contrary notwithstanding, Lessor, at Lessor's expense, shall have the continuing right and option at any time and from time to time to take Lessor's royalty in kind. Lessor may exercise such option by giving sixty (60) days' advance written notice to Lessee.[137]

Faced with these two royalty provisions, the first for $1.50 per pound, and the second for royalty in kind, the court of civil appeals construed the disclamatory language of the later provision in favor of the Lessor: "[W]e hold that the lease . . . is not ambiguous. The introductory words 'Any provision herein to the contrary notwithstanding,' which appear in the concluding paragraph in the royalty section . . . , is [sic] directed to the royalty reserved in paragraph B and the limitation contained therein."[138] Therefore, the court of civil appeals found, as a matter of law, that Lessors were entitled to a 1/16th in-kind royalty.[139]

### 4. Presumption Favoring Words over Numbers or Symbols

"When there is a variance between unambiguous written words and

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[137]587 S.W.2d 809, 812 (Tex. Civ. App.—Corpus Christi 1979, writ ref'd n.r.e.) (omissions in original).

[138]*Id.* at 814-15 (citing Gulf Oil Corp. v. Southland Royalty Co., 496 S.W.2d 547 (Tex. 1973)).

[139]*See id.* at 815.

[numbers or symbols], the written words control."[140]

### 5. Presumption Favoring Handwriting over Typing and Typing over Printing

Except where the parties clearly manifest a contrary intent, handwritten contract provisions are favored when compared to typewritten or printed provisions, and typewritten provisions are favored when compared to printed provisions.[141] In *Raney v. Uvalde Wool & Mohair Co.*, appellant (Raney) contracted to sell appellee (Uvalde) 25,000 fleeces of spring kid and adult mohair at a price, respectively, of $1.75 per pound and $1.47 per pound.[142] When Raney delivered only 41,000 pounds of mohair, Uvalde complained that it was entitled to an additional 46,500 pounds, which it had to buy at a higher price on the open market to fulfill its contractual commitments to a third party.[143] Following judgment for Uvalde at the trial court, Raney appealed, arguing, inter alia,[144] that the written contract "was clear and unambiguous on its face and called for 'number of head' and not for fleeces."[145] The court of civil appeals rejected this argument:

> While it is true that the contract was a printed form contract and contained a blank column that was titled "Number Head," this blank was filled in in longhand and read "25,000 fleeces Spring Adult and Kid Mohair." Where the written and printed word[s] in a contract are in conflict, the written word[s] control.[146]

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[140]Guthrie v. National Homes Corp., 394 S.W.2d 494, 496 (Tex. 1965).

[141]*See* Southland Royalty Co. v. Pan Am. Petroleum Corp., 378 S.W.2d 50, 57 (Tex. 1964); McMahon v. Christmann, 157 Tex. 403, 303 S.W.2d 341, 344 (1957); Raney v. Uvalde Producers Wool & Mohair Co., 571 S.W.2d 199, 201 (Tex. Civ. App.—San Antonio 1978, writ ref'd n.r.e.). *See generally* RESTATEMENT (SECOND) OF CONTRACTS § 203 cmt. f (1981) ("It is sometimes said generally that handwritten terms control typewritten and printed terms, and typewritten control printed.").

[142]571 S.W.2d 199, 199 (Tex. Civ. App.—San Antonio 1978, writ ref'd n.r.e.).

[143]*See id.* at 200.

[144]For further discussion of the facts of this case and the UCC-based issues raised therein, see *infra* Part III.F.1.b.

[145]*Raney*, 571 S.W.2d at 201.

[146]*Id.* (citing McMahon v. Christmann, 157 Tex. 403, 303 S.W.2d 341 (1957)).

## E. Other Rules Applicable to Specific Types of Agreements

### 1. Guaranty Agreements

"A guarantor is entitled to have his agreement strictly construed so that it is limited to his undertakings, and it will not be extended by construction or implication."[147] Where the meaning of a guaranty agreement is uncertain, a court should give its terms "a construction which is most favorable to the guarantor."[148]

### 2. Promissory Notes

Under Texas law, a promissory note will normally appear integrated in order that it may be negotiable, even though the parties may have collateral agreements.[149] To reconcile the policy that a court must presume that a negotiable instrument is integrated with the reality that the instrument may not truly represent the parties' entire agreement, the courts and the legislature have recognized certain exceptions to the parol evidence rule.[150] "[T]he rule does not preclude enforcement of prior or contemporaneous agreements which . . . are not inconsistent with and do not vary or contradict the express or implied terms or obligations thereof."[151] Likewise, a party may show that a condition of delivery, as opposed to a condition of payment, exists.[152]

### 3. Purchase Options

Courts are to construe agreements creating a purchase option in favor of the prospective buyer.[153]

### 4. Grants of Real Property or Other Property Rights

If a court finds uncertainty as to the scope or terms of an agreement

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[147]Coker v. Coker, 650 S.W.2d 391, 394 n.1 (Tex. 1983); *see also* Reece v. First State Bank, 566 S.W.2d 296, 297 (Tex. 1978).

[148]*Coker*, 650 S.W.2d at 394 n.1; *see also* Commerce Savs. Ass'n v. GGE Management Co., 539 S.W.2d 71, 78 (Tex. Civ. App.—Houston [1st Dist.]), *aff'd as modified per curiam*, 543 S.W.2d 862 (Tex. 1976).

[149]*See* Hubacek v. Ennis State Bank, 159 Tex. 166, 317 S.W.2d 30, 34 (1958); Loe v. Murphy, 611 S.W.2d 449, 451 (Tex. Civ. App.—Dallas 1980, writ ref'd n.r.e.).

[150]*See Loe*, 611 S.W.2d at 451.

[151]*Hubacek*, 317 S.W.2d at 32; *accord Loe*, 611 S.W.2d at 451-52.

[152]*See* Kuper v. Schmidt, 161 Tex. 189, 338 S.W.2d 948, 952 (1960); *Loe*, 611 S.W.2d at 452.

[153]*See* KMI Continental Offshore Prod. Co. v. ACF Petroleum Co., 746 S.W.2d 238, 241 (Tex. App.—Houston [1st Dist.] 1987, writ denied).

granting property rights to another, the court will generally construe that uncertainty against the grantor.[154]

5. Reservations of Rights

If a court finds uncertainty as to the scope or terms of a reservation of rights, the court will generally construe that uncertainty against the party whom the parties intended the reservation to benefit.[155]

6. Restrictive Covenants or Restraints on Alienation

Texas law generally disfavors restrictive covenants, including restraints on alienation.[156] Therefore, courts will strictly construe restrictive clauses in written instruments concerning the use or disposition of real property, and courts should resolve all doubts in favor of free and unrestricted use or disposition of real property.[157]

7. Insurance Policy Provisions[158]

"Exceptions and limitations in an insurance policy are strictly con-

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[154]*See* Garrett v. Dils Co., 157 Tex. 92, 299 S.W.2d 904, 906 (1957); Temple-Inland Forest Prods. Co. v. Henderson Family Partnership, Ltd., 911 S.W.2d 531, 535 (Tex. App.—Beaumont 1995, no writ). Put another way, grants of real property and other property rights "are construed to confer upon the grantee the greatest [interest] that the terms of the [granting] instrument will permit." Russell v. City of Bryan, 919 S.W.2d 698, 705 (Tex. App.—Houston [14th Dist.] 1996, writ denied) (citing Lott v. Lott, 370 S.W.2d 463, 465 (Tex. 1963)). This rule of construction applies only if the grant is ambiguous. *See, e.g.*, Luckel v. White, 792 S.W.2d 485, 488 (Tex. App.—Houston [14th Dist.] 1990), *rev'd on other grounds*, 819 S.W.2d 459 (Tex. 1991).

[155]*See, e.g.*, CMS Indus. v. L.P.S. Int'l, Ltd., 643 F.2d 289, 294 (5th Cir. 1981) (holding that, when considering the scope of a reservation of patent rights, unclear language "must be resolved against the party for whose benefit the language is used"). For a specific application of this principle, see *Temple-Inland Forest Products Corp. v. United States*, 988 F.2d 1418, 1421-22 (5th Cir. 1993) (applying the principle to reservations of rights under Texas law: "When interpreting the terms of a reservation, courts construe the language against the grantor. . . . The need to clearly state a reservation arises from the fact that a conveyance ordinarily passes to the grantee all of the grantor's interest in [the conveyed] property.") (citations omitted). *See also* Craddock v. Greenhut Constr. Co., 423 F.2d 111, 114 (5th Cir. 1970) (applying the same standard in considering the scope of a grant under Florida law).

[156]*See, e.g.*, North Point Patio Offices Venture v. United Benefit Life Ins. Co., 672 S.W.2d 35, 36-37 (Tex. App.—Houston [14th Dist.] 1984, writ ref'd n.r.e.). *See generally* Sonny Arnold, Inc. v. Sentry Savs. Ass'n, 633 S.W.2d 811 (Tex. 1982).

[157]*See* Davis v. Skipper, 125 Tex. 365, 83 S.W.2d 318, 321 (1935).

[158]Under Texas law, the same rules applying to contracts in general govern the construction and interpretation of insurance policies. *See* Forbau v. Aetna Life Ins. Co., 876 S.W.2d 132, 133 (Tex. 1994).

strued against the insurer."[159] Therefore, Texas courts "must adopt the construction of an exclusionary clause urged by the insured as long as that construction [itself] is not unreasonable, even if the construction [offered] by the insurer appears to be more reasonable or a more accurate reflection of the parties' intent."[160]

## III. THE PERMISSIBLE USES OF EXTRINSIC EVIDENCE IN CONSTRUING AND INTERPRETING WRITTEN AGREEMENTS GOVERNED BY TEXAS LAW

*Few things are darker than [the parol evidence rule], or fuller of subtle difficulties.*

—James B. Thayer[161]

The parol evidence rule generally bars the admissibility of extrinsic evidence regarding prior or contemporaneous agreements when it is offered to alter, add to, or contradict the terms of a fully integrated, unambiguous, written agreement.[162] Extrinsic evidence is admissible to clarify,

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[159]Canutillo Indep. Sch. Dist. v. National Union Fire Ins. Co., 99 F.3d 695, 701 (5th Cir. 1996); *see* Kelly Assocs. v. Aetna Cas. & Sur. Co., 681 S.W.2d 593, 596 (Tex. 1984).

[160]National Union Fire Ins. Co. v. Hudson Energy Co., 811 S.W.2d 552, 555 (Tex. 1991); *accord Canutillo I.S.D.*, 99 F.3d at 701. This rule of strict construction against an insurer applies *only* if the exclusion or other provision in question is susceptible to more than one reasonable construction. *See Hudson Energy*, 811 S.W.2d at 555. "When the terms of an insurance policy are clear and unambiguous[,] a court may not vary those terms." *Canutillo I.S.D.*, 99 F.3d at 700 (citing Royal Indem. Co. v. Marshall, 388 S.W.2d 176, 181 (Tex. 1965)).

[161]JAMES B. THAYER, A PRELIMINARY TREATISE ON EVIDENCE AT COMMON LAW 390 (1898), *quoted in* JOHN D. CALAMARI & JOSEPH M. PERILLO, CONTRACTS § 3-1, at 133-34 (3d ed. 1987).

[162]*See* Lewis v. East Tex. Fin. Co., 136 Tex. 149, 146 S.W.2d 977, 980 (1941); Pan Am. Bank v. Nowland, 650 S.W.2d 879, 884 (Tex. App.—San Antonio 1983, writ ref'd n.r.e.), *disapproved of on other grounds by* Crimmins v. Lowry, 691 S.W.2d 582 (Tex. 1985); McPherson v. Johnson, 436 S.W.2d 930, 932 (Tex. Civ. App.—Amarillo 1968, writ ref'd n.r.e.); *see also* Beijing Metals & Minerals Import/Export Corp. v. American Bus. Ctr., Inc., 993 F.2d 1178, 1182-83 (5th Cir. 1993) (citing Tripp Village Joint Venture v. MBank Lincoln Centre, N.A., 774 S.W.2d 746, 749 (Tex. App.—Dallas 1989, writ denied)); Motorola, Inc. v. Chapman, 761 F. Supp. 458, 463 (S.D. Tex. 1991) (applying Texas law).

One commentator offers the following "working definition" of the parol evidence rule:

> When the parties to an agreement have reduced their agreement to a writing intended by them, or treated by the court, as a final and complete statement of the entire agreement, the writing may not be contradicted, varied, or even supplemented by prior oral or written understandings of the parties. If the parties intended, or the court believes, that the writing was to be merely a final expression of some of the terms of

explain, or give meaning to a writing that is ambiguous or facially incomplete, but only insofar as the evidence does not vary or contradict those terms of the writing that *are* unambiguous, complete, and final.[163]

In order to better understand the body of common and statutory law permitting or proscribing the use of extrinsic evidence to construe and interpret written agreements, it may be helpful to distinguish between (1) extrinsic evidence offered to prove the intent of the contracting parties at the time the contract was executed, and (2) extrinsic evidence offered to add to, subtract from, or otherwise modify the terms of a written agreement. The former "interpretive" type of evidence is not subject to the parol evidence rule, and a party may bring it to the trial court's attention (although, for reasons discussed later, the jury may never consider this interpretive evidence). The latter "supplementary" type of evidence is subject to the parol evidence rule, and the trier of fact may not consider it until the trial court first finds that a written agreement is either not fully integrated or is ambiguous.[164]

### *A. Ambiguity and the Role of "Interpretive" Evidence*

> *Words, like eyeglasses, blur everything that they do not make clearer.*
>
> —Joseph Joubert[165]

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the agreement, the writing may be supplemented but not varied or contradicted by prior oral and written understandings of the parties.

George I. Wallach, *The Declining "Sanctity" of Written Contracts—Impact of the Uniform Commercial Code on the Parol Evidence Rule*, 44 MO. L. REV. 651, 651 (1979).

[163]*See* First Victoria Nat'l Bank v. Briones, 788 S.W.2d 632, 635 (Tex. App.—Corpus Christi 1990, writ denied); Patterson v. Patterson, 679 S.W.2d 621, 625 (Tex. App.—San Antonio 1984, no writ); Warren Bros. Co. v. A.A.A. Pipe Cleaning Co., 601 S.W.2d 436, 438-39 (Tex. Civ. App.—Houston [1st Dist.] 1980, writ ref'd n.r.e.).

[164]Historically, the common law tended to insulate written agreements from both forms of extrinsic proof. *See generally* 3 CORBIN, *supra* note 2, §§ 555-80 (1960 & Supp. 1997). However, more recent case law, bolstered considerably by the Restatement (Second) of Contracts and the Uniform Commercial Code, supports a more expansive use of evidence outside the "four corners" of the written agreement to prove *both* the parties' intent and understanding at the time they entered into the written agreement and the existence or meaning of terms not necessarily reflected in the written agreement. *See* RESTATEMENT (SECOND) OF CONTRACTS §§ 209, 211, 212, 214, 216, 218, 220 (1981); TEX. BUS. & COM. CODE ANN. § 2.202 (Vernon 1994). For commentary on the parol evidence rule under the UCC, see 2 JAMES J. WHITE & ROBERT S. SUMMERS, UNIFORM COMMERCIAL CODE: PRACTITIONER TREATISE SERIES §§ 2-9 to -11 (1995 & Supp. 1996).

[165]ANDREWS, *supra* note 4, at 288.

### 1. What Is, and Is Not, Ambiguous?

An instrument is ambiguous if its terms are "uncertain and doubtful or it is reasonably susceptible to more than one meaning, taking into consideration circumstances present when the particular writing was executed . . . ."[166] In such a case, the trier of fact must determine the meaning of the terms.[167] On the other hand, if a written instrument "is so worded that it can be given a certain or definite legal meaning or interpretation, then it is not ambiguous and it can be construed as a matter of law."[168]

In the words of the Texas Supreme Court in *Universal C.I.T. Credit Corp. v. Daniel*:

> [A] contract is ambiguous only when the application of pertinent rules of interpretation to the face of the instrument leaves it genuinely uncertain which one of two or more meanings is the proper meaning. . . . In other words, if after applying the established rules of interpretation to the contract it remains reasonably susceptible to more than one meaning it is ambiguous, but if only one reasonable meaning clearly emerges it is not ambiguous.[169]

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[166]Lenape Resources Corp. v. Tennessee Gas Pipeline Co., 925 S.W.2d 565, 574 (Tex. 1996); *accord* Reilly v. Rangers Management, Inc., 727 S.W.2d 527, 529 (Tex. 1987); Coker v. Coker, 650 S.W.2d 391, 394 (Tex. 1983); Glover v. National Ins. Underwriters, 545 S.W.2d 755, 761 (Tex. 1977); Texas Utils. Elec. Co. v. City of Waco, 919 S.W.2d 436, 439 (Tex. App.—Waco 1995, writ denied); Cavalcade Oil Corp. v. Samuel, 746 S.W.2d 842, 844 (Tex. App.—El Paso 1988, writ denied); Skyland Developers, Inc. v. Sky Harbor Assocs., 586 S.W.2d 564, 568 (Tex. Civ. App.—Corpus Christi 1979, no writ); Walter E. Heller & Co. v. Allen, 412 S.W.2d 712, 718 (Tex. Civ. App.—Corpus Christi 1967, writ ref'd n.r.e.). *See generally* HUNTER, *supra* note 1, ¶ 7.03[2][a], at 7-13). In other words, a written instrument may be ambiguous if it is "difficult to comprehend or distinguish, [or] of doubtful import," San Antonio Life Ins. Co. v. Griffith, 185 S.W. 335, 337 (Tex. Civ. App.—Fort Worth 1916, no writ), or there is "doubt as to [its] true meaning." O'Shea v. Coronado Transmission Co., 656 S.W.2d 557, 561 (Tex. App.—Corpus Christi 1983, writ ref'd n.r.e.).

[167]*See* Harris v. Rowe, 593 S.W.2d 303, 306 (Tex. 1979); *accord* American Guar. & Liab. Ins. Co. v. Shel-Ray Underwriters, Inc., 844 F. Supp. 325, 330 (S.D. Tex. 1993).

[168]*Lenape Resources*, 925 S.W.2d at 574 (citing *Coker*, 650 S.W.2d at 393); *accord* Westwind Exploration, Inc. v. Homestate Sav. Ass'n , 696 S.W.2d 378, 381 (Tex. 1985); Lewis v. East Tex. Fin. Co., 136 Tex. 149, 146 S.W.2d 977, 980 (1941); Sidelnik v. American States Ins. Co., 914 S.W.2d 689, 691 (Tex. App.—Austin 1996, writ denied); *Texas Utils. Elec. Co.*, 919 S.W.2d at 439.

[169]150 Tex. 513, 243 S.W.2d 154, 157 (1951). An ambiguity in a contract may be either "patent" or "latent." A "patent" ambiguity is evident on the face of the contract. *Sidelnik*, 914 S.W.2d at 691 (citing Universal Home Builders, Inc. v. Farmer, 375 S.W.2d 737, 742 (Tex. Civ.

The *Daniel* court considered the proper interpretation of an agreement whereby an automobile dealer (Daniel), would sell and assign (by indorsement) promissory notes and mortgages on automobiles bought on credit to Universal.[170] Daniel's assignments to Universal would be either "full recourse" or "without recourse."[171] At issue was Daniel's obligation to purchase from Universal, at a price equal to the outstanding balance on the promissory note, vehicles that Universal repossessed due to the purchaser's failure to repay the promissory note.[172]

The court of civil appeals determined that the agreement was ambiguous and adopted an interpretation favoring Universal.[173] The Texas Supreme Court found that the interpretation of the agreement offered by Universal and accepted by the court of civil appeals was unreasonable because it would have the effect of rendering two key paragraphs of the agreement superfluous, and would permit Universal to change Daniel's endorsement from "without recourse" to "full recourse."[174] On the other hand, the Texas Supreme Court found that Daniel's proffered reading of the agreement rendered none of the provisions meaningless and permitted the entire contract to "take[] on meaning and become[] harmonious."[175] The court concluded that only Daniel's proffered reading was reasonable, reversed the court of civil appeals's judgment, which the intermediate court had based on a finding of ambiguity and on a reading of the contract that the supreme court disavowed, and affirmed the judgment of the trial court in Daniel's favor.[176]

In *Hettig & Co. v. Union Mutual Life Insurance Co.*, the promissory note at issue contained the following "limiting clause":

> Notwithstanding the foregoing, however, in the event of acceleration of the Note at any time and subsequent invol-

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App.—Tyler 1964, no writ)). A "latent" ambiguity, by comparison, is one that only arises when a facially unambiguous contract is applied to the subject matter of the contract. *Id.* (citing Murphy v. Dilworth, 137 Tex. 32, 151 S.W.2d 1004, 1005 (1941)); *see also* Vineberg v. Brunswick Corp., 391 F.2d 184, 188-89 (5th Cir. 1968) (defining a latent ambiguity as one arising "if the writing or contract in question is susceptible of either of the divergent meanings contended for by the parties"). *See generally* National Union Fire Ins. Co. v. CBI Indus., 907 S.W.2d 517 (Tex. 1995).

[170]*Daniel*, 243 S.W.2d at 156.

[171]*Id.*

[172]*See id.* at 156-57.

[173]*See id.* at 158.

[174]*Id.*

[175]*Id.* at 159.

[176]*See id.* at 159-60.

> untary or voluntary prepayment, the premium payable in respect thereof shall in no event exceed an amount equal to the excess, if any, of (i) interest calculated at the highest applicable rate permitted by the usury laws of the State of Texas, as construed by courts having jurisdiction thereof, on the principal balance of the Note from time to time outstanding from the date hereof to the date of such acceleration, over (ii) interest theretofore paid and accrued on the Note.[177]

The court of appeals framed the dispute between the borrowers (Hettig & Co. et al.) and the lender (Union Mutual) as follows:

> The dispute over the proper prepayment premium rests on conflicting interpretations of the . . . language [quoted above], or limiting clause, in the second subparagraph. The lender does not dispute that if the limiting clause applies, the premium due was $431,034.38 as claimed by borrowers. Similarly, borrowers do not dispute that if the limiting clause is inapplicable, the higher amount demanded by the lender was correct.
>
> Borrowers argue that "acceleration" in the limiting clause can be effected either by the lender as a penalty for the borrowers' default, or by the borrowers' notice of intent to prepay the note. Thus, after borrowers "accelerate" the note by giving such notice, as here, the payment is a "voluntary prepayment," so that the limiting clause is applicable.
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> The lender, in contrast, argues that "acceleration" is a term of art commonly understood as a right that can be exercised only by the holder of a note. Because the lender did not accelerate the note, and the limiting clause applies only to accelerations, the limiting clause does not apply to borrowers' prepayment.[178]

After rejecting Union Mutual's "term of art" argument because it rendered the term "voluntary prepayment" meaningless,[179] the Fifth Circuit

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[177]781 F.2d 1141, 1143 (5th Cir. 1986) (emphasis omitted).

[178]*Id.*

[179]*See id.* at 1144-45.

turned to the question of the clause's meaning in light of Texas usury law:

> Absent other considerations, we would be inclined to agree with borrowers that the limiting clause applies on its face to both voluntary prepayments initiated by borrowers and involuntary prepayments following default. The lender, however, argues that the limiting clause's obvious purpose is to escape Texas usury law. A note which allows acceleration upon default and provides for collection of unearned interest is usurious if the amount of total interest collected exceeds the allowable rate for the accelerated period of the note. In contrast, a prepayment penalty is not regarded as "interest" within the meaning of the usury statutes, so that a voluntary prepayment which calls for a prepayment premium exceeding the allowable interest rates does not constitute usury.
>
> The lender therefore argues that the limiting clause, necessary to prevent the note from being usurious upon prepayment after default, is unnecessary when prepayment is voluntary. This argument is supported by the placement of the limiting clause at the end of the second subparagraph, where by implication it would apply only to prepayments upon default as covered in that subparagraph. The lender concludes that the only sensible purpose of the limiting clause is to prevent prepayments after default from being usurious, and that it should be read to fulfill this purpose. Borrowers respond that the limiting clause may have been intended to cover voluntary prepayments as a hedge against change in Texas usury law. We are unpersuaded. The note . . . contains a usury "savings clause" which explicitly covers such a change in law.[180]

The Fifth Circuit concluded that, while Union Mutual's proffered interpretation was unsatisfying because it left the "voluntary prepayment" term in the limiting clause meaningless, Hettig & Co.'s interpretation, "while more syntactically defensible, ignores a plain commercially reasonable purpose for the limiting clause"—namely, avoiding the operation

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[180] *Id.* at 1145 (citations omitted).

of Texas usury law.[181] Therefore, "[b]ecause the note is as reasonably susceptible to one interpretation as the other," the court "remand[ed] the case for trial to consider any extrinsic evidence which sheds light on the actual meaning of" the limiting clause.[182]

Ambiguity does not exist simply because the parties offer conflicting interpretations of the same contract or contractual provision.[183] Nor is an instrument ambiguous because it requires a careful reading,[184] or because a fair reading of it does not comport with the desires of one party.[185] Additionally, a contract is not rendered ambiguous by obscurity in its language, or by the fact that, in places, it is of doubtful meaning.[186]

Recently, in *Columbia Gas Transmission Co. v. New Ulm Gas, Ltd.*, the Texas Supreme Court considered a dispute over which of two pricing provisions in a natural gas contract was applicable under the facts of the case.[187] Both parties moved for summary judgment.[188] The trial court denied both motions for summary judgment, found the agreement to be ambiguous, and submitted to the jury the question of which party's interpretation of the contract was correct.[189] The jury found for New Ulm, awarding roughly $4 million in damages and fees.[190] Columbia appealed, and the court of appeals agreed with the trial court that the contract was ambiguous, but reversed and remanded due to the improper exclusion of evidence, which constituted harmful error.[191] New Ulm and Columbia both sought a

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[181] *Id.* at 1145-46.

[182] *Id.* at 1146.

[183] *See* Praeger v. Wilson, 721 S.W.2d 597, 600 (Tex. App.—Fort Worth 1986, writ ref'd n.r.e.); Maxwell v. Lake, 674 S.W.2d 795, 801 (Tex. App.—Dallas 1984, no writ).

[184] *See* Gomez v. Hartford Co., 803 S.W.2d 438, 442 (Tex. App.—El Paso 1991, writ denied); LaBatt Co. v. Hartford Lloyd's Ins. Co., 776 S.W.2d 795, 800 (Tex. App.—Corpus Christi 1989, no writ).

[185] *See Gomez*, 803 S.W.2d at 442; Guthrie v. Republic Nat'l Ins. Co., 682 S.W.2d 634, 640 (Tex. App.—Houston [1st Dist.] 1984, writ ref'd n.r.e.).

[186] A contract is ambiguous "[i]f its meaning is uncertain and doubtful or it is reasonably susceptible to more than one meaning . . . ." Lenape Resources Corp. v. Tennessee Gas Pipeline Co., 925 S.W.2d 565, 574 (Tex. 1996) (citing Coker v. Coker, 650 S.W.2d 391, 394 (Tex. 1983)); *see supra* note 166. However, even though a contract is of doubtful meaning in certain places, it does not necessarily follow that the entire contract is of doubtful meaning or reasonably susceptible to more than one meaning. *See supra* note 163 and accompanying text.

[187] 940 S.W.2d 587, 588 (Tex. 1996).

[188] *See id.* at 589.

[189] *See id.*

[190] *See id.*

[191] *See id.*

writ of error.[192]

The Texas Supreme Court reversed the court of appeals and rendered judgment in Columbia's favor, holding that the agreement *was not* ambiguous because Columbia's proffered interpretation was the only reasonable one.[193] In so holding, Justice Abbott reiterated the court's long-standing mantra: "In determining the parties' agreement, we are to examine all parts of the contract and the circumstances surrounding the formulation of the contract."[194] Justice Abbott continued:

> When this contract was signed in 1980, it is undisputed that the parties knew that a huge volume of gas would be deregulated on January 1, 1985. The effect this deregulation would have on the price of gas was not known, however. It is therefore not surprising that the parties incorporated a market-out provision (section 3.1.3) that established a complex procedure to adjust the section 3.1.1 price to the market price of gas. The interpretation of 3.1.3 proffered by New Ulm would frustrate the intent of this provision.
>
> . . . .
>
> Moreover, New Ulm's interpretation ignores the contract language. . . . The only way these otherwise conflicting provisions can be harmonized is by concluding that 3.1.3 is the controlling price mechanism once it is invoked.[195]

Thus, "[t]he contract is not ambiguous and . . . the parties' intent should not have been submitted to the jury."[196]

At issue in *Clardy Manufacturing Co. v. Marine Midland Business Loans, Inc.* was whether a signed letter of intent constituted an unambiguous, fully-integrated agreement that one party to the letter could enforce against the other—not simply to the extent of the recitations in the letter, but to the full extent of the not-yet-formalized agreement contemplated by the letter.[197] The trial court found that Marine Midland had obligated it-

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[192]*See id.*

[193]*See id.* at 589, 591.

[194]*Id.* at 591.

[195]*Id.*

[196]*Id.* at 592.

[197]88 F.3d 347, 351-52 (5th Cir. 1996), *cert. denied*, 117 S. Ct. 740 (1997).

self, by the letter of intent, to make a loan to Clardy once Clardy had met certain preconditions.[198] Citing many of the leading authorities on the meaning of ambiguity, the enforcement of unambiguous contracts, and the rules of construction, the Fifth Circuit reversed, holding that a letter setting forth "the financial accommodations that Marine *would be willing to consider*," was "neither so definite nor so all inclusive as to warrant . . . a conclusion" that Marine *would* make the accommodations.[199]

> There is nothing in this agreement which suggests that Marine was binding itself to issue a commitment letter upon the successful completion of the due diligence outlined in the letter. . . . The letter states, "If the Credit Facilities close," any remaining deposit after costs will be applied to the facilities fee. However, "If Marine declines to close the Credit Facilities," the deposit will be returned less costs. If the issuance of a commitment letter was guaranteed upon the successful completion of due diligence, Marine would have no power to *decline* to close the credit facilities.
>
> Having considered the entire writing, we conclude that the language of the letter agreement between Clardy Manufacturing and Marine is reasonably susceptible to only one meaning. In part, the proposal letter serves to set out the terms and conditions of the credit facilities, or loans, that Marine is considering extending to Clardy Manufacturing. Beyond this, the letter also contains an agreement by Marine to undertake further efforts to assess whether Clardy Manufacturing satisfied its credit criteria by conducting due diligence as outlined in the letter. The letter does not, however, constitute a satisfaction contract. We find that the letter agreement between Clardy Manufacturing and Marine is unambiguous and does not require us to consider extrinsic evidence to determine its meaning.[200]

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[198] *See id.* at 350.

[199] *Id.* at 353.

[200] *Id.* at 354 (citations omitted). The Fifth Circuit elaborated on its departure from the district court's decision:

2. Ambiguity Is an Issue of Law to Be Determined by the Court

Whether a written agreement is ambiguous is a question of law that the court decides by looking at the contract as a whole in light of the circumstances present at the time the parties executed the contract.[201]

3. Pleading and Evidentiary Considerations

*a. A Party Need Not Plead Ambiguity in Order for the Trial Court to Consider Certain Kinds of Extrinsic Evidence*

The Texas Supreme Court has stated in both *City of Pinehurst v. Spooner Addition Water Co.* and *Sun Oil Co. v. Madeley* that ambiguity *need not* be pleaded by either party in order to permit the trial court to look at extrinsic evidence of circumstances surrounding the formation and execution of the agreement.[202]

The Texas Supreme Court's recent decision in *Columbia Gas Transmission Corp. v. New Ulm Gas, Ltd.* reaffirmed the use of evidence of surrounding circumstances to choose between competing constructions

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> The district court concluded that the letter agreement was ambiguous as to "what, if anything, was Marine obligated to do if it became satisfied with Clardy Manufacturing's demonstration of creditworthiness?" This conclusion, however, flows from the faulty assumption that the letter agreement was intended to address each and every step leading up to the issuance of the commitment letter. As we have found, the proposal letter unambiguously memorializes the agreement that Marine should undertake further due diligence as part of its effort to evaluate Clardy Manufacturing's loan application. The letter agreement's failure to address what further steps Marine would undertake as part of its internal credit approval process once it had become satisfied with Clardy Manufacturing's creditworthiness does not necessarily render ambiguous the agreement to undertake due diligence. As the letter agreement did not obligate Marine to take further steps upon the successful completion of due diligence, the writing had no need to speak to this issue. While it may seem unfair to suggest that Marine was free to simply walk away following the completion of due diligence, *the letter agreement's silence on this issue does not destabilize the letter's clear and unambiguous language.*

*Id.* (emphasis added).

[201]*See* Lenape Resources Corp. v. Tennessee Gas Pipeline Co., 925 S.W.2d 565, 574 (Tex. 1996); Coker v. Coker, 650 S.W.2d 391, 394 (Tex. 1983); R & P Enters. v. LaGuarta, Gavrel & Kirk, Inc., 596 S.W.2d 517, 518 (Tex. 1980); Sidelnik v. American States Ins. Co., 914 S.W.2d 689, 691 (Tex. App.—Austin 1996, writ denied).

[202]Sun Oil Co. v. Madeley, 626 S.W.2d 726, 731-32 (Tex. 1981); City of Pinehurst v. Spooner Addition Water Co., 432 S.W.2d 515, 518-19 (Tex. 1968).

of an unambiguous contract.[203] In *Columbia Gas*, the trial court and the court of appeals found the contract to be ambiguous, although they reached different conclusions as to the consequence of that finding.[204] The supreme court found that, in light of the evidence of circumstances surrounding the contract's formation, the contract was not reasonably susceptible to more than one meaning, and therefore it was not ambiguous.[205] Nonetheless, the Texas Supreme Court fully considered the proffered extrinsic evidence before (and despite) finding that the contract was unambiguous.[206]

Thus, considering *Columbia Gas*, *Madeley*, and *City of Pinehurst*, a trial court may (1) hear and consider evidence of the circumstances surrounding the formation and execution of the contract and (2) apply the rules of construction whenever the parties disagree as to the proper construction of a writing.[207] Neither a pleading nor a finding of ambiguity is required.

### b. *Ambiguity Must Be Pleaded in Order to Create a Fact Issue for the Jury*

While no rules require the pleading of ambiguity in order to present extrinsic evidence of surrounding circumstances to the court, a party who challenges a proffered reading of a written contract must normally plead that the contract is ambiguous in order to create an issue for the trier of fact.[208] When there is no pleading of ambiguity with respect to the writing, all questions relating to the agreement's construction become questions of law for the trial court to determine.[209]

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[203]940 S.W.2d 587, 591 (Tex. 1996).

[204]*Id.* at 589.

[205]*See id.* at 591-92.

[206]*See id.* at 591.

[207]*See supra* Part II.C.

[208]*See* Gulf & Basco Co. v. Buchanan, 707 S.W.2d 655, 656 (Tex. App.—Houston [1st Dist.] 1986, writ ref'd n.r.e.).

[209]*See* Phillips v. Union Bankers Ins. Co., 812 S.W.2d 616, 617 (Tex. App.—Dallas 1991, no writ); MJR Corp. v. B & B Vending Co., 760 S.W.2d 4, 10 (Tex. App.—Dallas 1988, writ denied); Praeger v. Wilson, 721 S.W.2d 597, 600 (Tex. App.—Fort Worth 1986, writ ref'd n.r.e.); *see also* Park Creek Assocs. v. Walker, 754 S.W.2d 426, 429 (Tex. App.—Dallas 1988, writ denied) (Kinkeade, J., concurring). However, a court may conclude that a contract is ambiguous even in the absence of such a pleading by either party. *See* Sage St. Assocs. v. Northdale Constr. Co., 863 S.W.2d 438, 445 (Tex. 1993) (holding that the trial court properly submitted an unpleaded ambiguity issue to the jury because the parties tried the issue by consent);

### c. *Ambiguity Must Be Found in Order to Create a Fact Issue for the Jury*[210]

Even if a party who challenges a proffered reading of a written contract pleads that the contract is ambiguous, thereby permitting the court to consider extrinsic evidence beyond that allowed when no ambiguity is pleaded, ambiguity is still an issue of law for the court to decide.[211] If the trial court finds that the contract is unambiguous as a matter of law, the trier of fact may not consider *any* extraneous evidence of the parties' intent with regard to the contract.[212] On the other hand, if the trial court finds that the written instrument is ambiguous, the trier of fact may then look to parol evidence to determine the parties' intent.[213] In summary, if ambiguity is not pleaded, or pleaded but not found to exist, the court (not the trier of fact) determines as a matter of law the rights of the parties and their probable intention under the agreement.

## 4. Summary Judgment Considerations

While it is true that ambiguity must be pleaded and proved before a jury may hear extrinsic evidence, any time the parties offer rival constructions or interpretations of an agreement, the trial court may consider substantial amounts of extrinsic proof *even if* neither party pleads ambigu-

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Coker v. Coker, 650 S.W.2d 391, 392-94 (Tex. 1983) (holding that a contract was ambiguous despite assertions by both parties that the agreement was unambiguous).

[210]See the discussion *infra* Part III.F.1 regarding the admissibility of parol evidence despite the determination that the contract is facially unambiguous, pursuant to section 2.202 of the Uniform Commercial Code.

[211]*See* Sidelnik v. American States Ins. Co., 914 S.W.2d 689, 691 (Tex. App.—Austin 1996, writ denied).

[212]*See Sidelnik*, 914 S.W.2d at 691-92 (citing R & P Enters. v. LaGuarta, Gavrel & Kirk, Inc., 596 S.W.2d 517, 518 (Tex. 1980); Birdwell v. Birdwell, 819 S.W.2d 223, 229 (Tex. App.—Fort Worth 1991, writ denied)); *see also* Hycarbex, Inc. v. Anglo-Suisse, Inc., 927 S.W.2d 103, 108-10 (Tex. App.—Houston [14th Dist.] 1996, no writ) (holding that where an agreement to pay commissions from sales of offshore oil and gas working interests was not ambiguous, the trial court properly refused to permit the jury to hear evidence of the parties' interpretations of the agreement).

Of course, as discussed previously, the court most likely will have already considered some extrinsic evidence—particularly evidence of "surrounding circumstances"—in determining *whether* the written contract was integrated and unambiguous. *See supra* Parts II.C.1 and III.A.3.a.

[213]*See* Lenape Resources Corp. v. Tennessee Gas Pipeline Co., 925 S.W.2d 565, 574 (Tex. 1996); Sun Oil Co. v. Madeley, 626 S.W.2d 726, 732 (Tex. 1981); *R & P Enters.*, 596 S.W.2d at 519; *Sidelnik*, 914 S.W.2d at 691-92.

ity.[214] In such cases, the trial court exercises an important fact-finding role in making a legal determination: whether there is sufficient (conflicting) factual evidence to permit the jury to interpret the contract.

The interpretation of a written agreement becomes an issue for the trier of fact only when, after application of the pertinent rules of construction, there remains a genuine uncertainty as to which of two (or more) meanings is proper.[215] "If the contract is worded so that it can be given a certain and definite meaning or interpretation, it is not ambiguous; [therefore,] the court will construe [it] as a matter of law."[216] In such a case, summary judgment on the contract is proper.[217] On the other hand, when a contract contains an ambiguity, summary judgment is improper because the interpretation of the ambiguous instrument becomes a fact issue.[218]

*Coker v. Coker* is a typical case.[219] There, the district court granted the wife's summary judgment against the husband with regard to a property settlement agreement incorporated into a divorce decree.[220] As detailed earlier, the property settlement contained two separate provisions that recited the husband's obligations with respect to commissions due him from the sale of certain property and payable over to the wife as part of the agreement.[221] After determining that the two provisions of the agreement, taken together and in light of the circumstances surrounding the agreement, did in fact create an ambiguity, the Texas Supreme Court reversed

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[214]*See supra* Part III.A.3.a.

[215]*See supra* note 169 and accompanying text.

[216]Hussong v. Schwan's Sales Enters., 896 S.W.2d 320, 324 (Tex. App.—Houston [1st Dist.] 1995, no writ) (citing GT & MC, Inc. v. Texas City Ref., Inc., 822 S.W.2d 252, 255-56 (Tex. App.—Houston [1st Dist.] 1991, writ denied)).

[217]*See* RGS, Cardox Recovery, Inc. v. Dorchester Enhanced Recovery Co., 700 S.W.2d 635, 638 (Tex. App.—Corpus Christi 1985, writ ref'd n.r.e.); *see also* Sharp v. State Farm Fire & Cas. Ins. Co., 938 F. Supp. 395, 396-98 (W.D. Tex. 1996) (granting summary judgment on an admittedly unambiguous insurance policy); American Stone Diamond, Inc. v. Lloyds of London, 934 F. Supp. 839, 846-47 (S.D. Tex. 1996) (granting summary judgment for insurer where policy exclusion could only reasonably be read as proffered by the insurer).

[218]*See* Coker v. Coker, 650 S.W.2d 391, 394-95 (Tex. 1983); *Hussong*, 896 S.W.2d at 324; *see also* Southern Natural Gas Co. v. Pursue Energy, 781 F.2d 1079, 1081 (5th Cir. 1986) (applying analogous Mississippi law) ("[A] district court may properly grant summary judgment when a contract is unambiguous, but may not grant summary judgment when a contract is ambiguous and the parties' intent presents a genuine issue of material fact." (citing Union Planters Nat'l Leasing, Inc. v. Woods, 687 F.2d 117, 120 (5th Cir. 1982); Freeman v. Continental Gin Co., 381 F.2d 459, 465 (5th Cir. 1967))).

[219]650 S.W.2d 391 (Tex. 1983).

[220]*See id.* at 392.

[221]*See supra* Part II.C.4.

and remanded the court of appeals's decision affirming the summary judgment.[222]

Trial counsel should carefully consider whether pleading ambiguity is required in order to proffer the desired extrinsic proof. If the trial court may consider the evidence without a pleading of ambiguity, counsel may be well advised to forego a pleading of ambiguity and rely instead upon the rules of construction to support the desired reading of the contract. By pleading ambiguity when it is not required, counsel may unwittingly permit the court or jury to consider unfavorable evidence that would be otherwise inadmissible, and the availability of summary judgment may be unnecessarily lost.[223]

### 5. The Legal Effect of the Trial Court's Finding of (Un)ambiguity[224]

The district court's determination of whether a contract is ambiguous is

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[222]*See Coker*, 650 S.W.2d at 394-95.

[223]The proper allocation of responsibility as between court and jury in considering conflicting extrinsic proof, including proof of surrounding circumstances, is not without uncertainty. The Texas Supreme Court, in *City of Pinehurst v. Spooner Addition Water Co.*, 432 S.W.2d 515 (1968), apparently resolved conflicting evidence of surrounding circumstances as a matter of law, and hence concluded that the contract was unambiguous as a matter of law. In *Hanssen v. Qantas Airways Ltd.*, 904 F.2d 267 (5th Cir. 1990), the Fifth Circuit concluded that conflicting proof of surrounding circumstances created an issue to be resolved by the trier of fact, but the court also made it relatively clear that it was its finding of ambiguity that created the jury issue. The problem is compounded by such cases as *Bloom v. Hearst Entertainment, Inc.*, 33 F.3d 518 (5th Cir. 1994), in which the Fifth Circuit alluded to three levels of inquiry in determining ambiguity under the Uniform Commercial Code. The court concluded that while the question of whether the express terms of a contract are ambiguous is a question of law, the question of whether contract terms are ambiguous after considering *all* extrinsic evidence, including, but not limited to, course of dealing, uses of trade, and course of performance, is clearly a question of fact. *See id.* at 522-23. The court did not resolve the question of whether an ambiguity inquiry that is limited to the consideration of conflicting proof of course of dealing, uses of trade, and course of performance, *and no other*, is a question of law or fact. No case law seems to directly address this issue under Texas common law, and it may be that under common law, as under the Uniform Commercial Code, this remains an open question. *See* discussion *infra* Part III.F.1. But no case has been found in which a court has held that the existence of conflicting proof of surrounding circumstances requires the submission of any issue to the jury, whether the question before the court is ambiguity *vel non*, or the interpretation of an agreement that is admittedly unambiguous.

[224]Unlike integration, which may exist in degrees, *see infra* Part III.B.2, a contract is either ambiguous or it is not. A finding of "partial ambiguity" is, therefore, not an acceptable result of the trial court's initial determination.

a conclusion of law that an appellate court will review de novo.[225]

### B. *Integration and the Role of "Supplementary" Evidence*

> The parties to an agreement often reduce all or part of it to writing. Their purpose in so doing is commonly to provide reliable evidence of [the agreement's] making and its terms and to avoid trusting to uncertain memory. . . . In the interest of certainty and security of transactions, the law gives special effect to a writing adopted as a final expression of an agreement.[226]

If the parties to a written contract intend it to serve as a final and complete expression of their agreement, then the contract is integrated.[227] "An *integrated* agreement is a writing or writings constituting a final expression of one or more terms of an agreement."[228]

Why does it matter whether a particular contract is or is not integrated? It matters because "[w]hen parties have concluded a valid integrated agreement with respect to a particular subject matter, the [parol evidence] rule precludes the enforcement of inconsistent prior or contemporaneous agreements" regarding the subject matter of the integrated agreement.[229] More importantly for the purposes of this discussion, Professor Corbin stated the rule as follows: "When two parties have made a contract and have expressed it in a writing to which they have both assented as the complete and accurate integration of that contract, *evidence*, whether parol or otherwise, *of antecedent understandings and negotiations will not be admitted for the purpose of varying or contradicting the writing.*"[230]

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[225]*See* MJR Corp. v. B & B Vending Co., 760 S.W.2d 4, 10 (Tex. App.—Dallas 1988, writ denied); *see also* Southern Natural Gas Co. v. Pursue Energy, 781 F.2d 1079, 1081 (5th Cir. 1986) (applying analogous Mississippi law); Paragon Resources, Inc. v. National Fuel Gas Distrib. Corp., 695 F.2d 991, 995 (5th Cir. 1983) (applying analogous Louisiana law).

[226]RESTATEMENT (SECOND) OF CONTRACTS ch. 9, pt. 3 intro. note (1981).

[227]*See id.*

[228]RESTATEMENT (SECOND) OF CONTRACTS § 209(1), at 125 (emphasis added); *see also* RESTATEMENT OF CONTRACTS § 228, at 307 (1932) ("An agreement is integrated where the parties thereto adopt a writing or writings as the *final and complete expression* of the agreement." (emphasis added)).

[229]Hubacek v. Ennis State Bank, 159 Tex. 166, 317 S.W.2d 30, 32 (1958).

[230]3 CORBIN, *supra* note 2, § 573, at 357 (emphasis added), *quoted with approval in* Loe v. Murphy, 611 S.W.2d 449, 451 (Tex. Civ. App.—Dallas 1980, writ ref'd n.r.e.); *see also* RESTATEMENT (SECOND) OF CONTRACTS ch. 9, pt. 3 intro. note. The Second Restatement of Contracts states the following:

While it is true that, in the passages quoted above, the Texas Supreme Court and Professor Corbin state the rule differently, both statements are correct and significant. According to the *Hubacek* court, if the written contract is fully integrated, then any other prior or contemporaneous agreement between the same parties, regarding the same subject matter, is unenforceable to the extent that it varies or contradicts the written contract.[231] Second, and perhaps more important for the purposes of this discussion, Professor Corbin states that, if the written contract is fully integrated, then any evidence of any other prior or contemporaneous agreement between the same parties, regarding the same subject matter, is inadmissible for purposes of varying or contradicting the written agreement.[232]

The parol evidence rule *does not* bar either evidence regarding or the enforcement of *subsequent* agreements among the parties to a fully integrated written contract,[233] nor does it bar proof of understandings offered for a purpose other than to vary or contradict the integrated written agreement.

> Both the parol evidence rule and the doctrine of integration exist so that parties may rely on the enforcement of agreements that have been reduced to writing. If it were not for these established principles, even the most carefully considered written documents could be destroyed by "proof" of other agreements not included in the writing. The importance of these principles is well established in Texas law, and in contract law generally. True, Texas law recognizes a number of exceptions to the parol

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> The principal effects of a binding integrated agreement are to focus interpretation on the meaning of the terms embodied in the writing . . . , to discharge prior inconsistent agreements, and, in a case of complete integration, to discharge prior agreements within its scope regardless of consistency. . . . [T]he admissibility of evidence to contradict an integrated agreement or to add to a completely integrated agreement is restricted, and a limit is thus placed on the power of the trier of fact . . . .

*Id.*

[231] *Hubacek*, 317 S.W.2d at 32.

[232] *See* text accompanying *supra* note 230. Thus, in the words of the Fifth Circuit, "parol evidence allegedly elucidating intent but contradicting the express terms of a written agreement is never admissible." Chase Manhattan Bank v. First Marion Bank, 437 F.2d 1040, 1049 (5th Cir. 1971).

[233] *See infra* Part III.C.5.

> evidence rule. We believe, however, that these exceptions are carefully and narrowly crafted to permit a court to consider parol evidence only in certain well-defined circumstances. If it were otherwise, the exceptions would become the rule, and the general prohibition against parol evidence would cease to have any legal effect.[234]

This Article discusses the many exceptions to the parol evidence rule at greater length below. However, there are a number of questions that a court should answer before reaching the point of ruling on the admissibility of parol evidence. As the court in *Loe v. Murphy* correctly commented:

> The mere statement of the parol evidence rule . . . does not aid us in the determination of this cause, for it can be seen from both of the above-stated expressions of the rule [referring to the passages from Corbin and *Hubacek* quoted above] that *the first question with which we are faced is whether the note here involved is the integrated agreement of the parties.*[235]

### 1. Integration Is an Issue of Law to Be Determined by the Court

"Whether there is an integrated agreement is to be determined by the court *as a question preliminary to determination of a question of interpretation or to application of the parol evidence rule.*"[236] "Whether a writing has been adopted as an integrated agreement is . . . to be determined in accordance with all relevant evidence."[237] Thus, while the court must determine whether the agreement is integrated before admitting parol evidence for the trier of fact's consideration, the trial court is free to rely on the very same parol evidence in reaching its threshold determination that the agreement is or is not integrated.[238]

The parol evidence rule is a rule of substantive law that denies efficacy to prior or contemporaneous expressions relating to the identical subject matter encompassed in the final written contract between the parties.[239]

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[234]Jack H. Brown & Co. v. Toys "R" Us, Inc., 906 F.2d 169, 176 (5th Cir. 1990).

[235]611 S.W.2d 449, 451 (Tex. Civ. App.—Dallas 1980, writ ref'd n.r.e.) (emphasis added).

[236]RESTATEMENT (SECOND) OF CONTRACTS § 209(2) (1981) (emphasis added).

[237]*Id.* § 209 cmt. c.

[238]*See id.* § 209 reporter's note to cmt. c; *id.* § 213 cmt. b.

[239]*See* Pan Am. Bank v. Nowland, 650 S.W.2d 879, 884 (Tex. App.—San Antonio 1983, writ ref'd n.r.e.); *see also* RESTATEMENT (SECOND) OF CONTRACTS § 213 cmt. a. Because the

Accordingly, evidence admitted in violation of the rule has no probative force, even if admitted without objection, and cannot support a verdict or judgment.[240]

### 2. Written Contracts May Be Fully or Partially Integrated

There are various degrees of integration. Therefore, once a threshold determination has been made that a written contract, to some extent at least, represents an integrated agreement between the parties, the next step in construing the contract is to determine whether the written contract is fully integrated or only partially integrated.[241]

> A *[fully] integrated* contract is one that is a final and complete expression of all the terms agreed upon between (or among) the parties. A *partially integrated* contract is one that is a final and complete expression of all the terms contained in that agreement, but not a final and complete expression of all the terms agreed upon between [or among] the parties.[242]

However, according to the Second Restatement, "[a]n agreement is not completely integrated if the writing omits a consistent additional agreed term which is (a) agreed to for separate consideration, or (b) such a term as in the circumstances might naturally be omitted from the writing."[243]

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parol evidence rule is a matter of substantive law, a federal court sitting in diversity will construe a Texas contract in accordance with Texas law, and, therefore, will apply the parol evidence rule in accordance with Texas law. *See supra* note 1.

[240]*See* Wilkins v. Bain, 615 S.W.2d 314, 315 (Tex. App.—Dallas 1981, no writ).

[241]David R. Dow, *The Confused State of the Parol Evidence Rule in Texas*, 355 TEX. L. REV. 457, 459 (1994).

[242]*Id.* at 459-60 (emphasis added); *see also* RESTATEMENT (SECOND) OF CONTRACTS § 210(1)-(2) (defining "completely" and "partially" integrated agreements somewhat less artfully than Professor Dow).

[243]RESTATEMENT (SECOND) OF CONTRACTS § 216(2). The Restatement provides the following illustration:

> *A* and *B* in an integrated writing promise to sell and buy [respectively] a specific automobile. As part of the transaction they orally agree that *B* may keep the automobile in *A*'s garage for one year, paying $15 a month [above and beyond the selling price of the car]. The oral agreement *is not* within the scope of the integration and is not superseded.

*Id.* § 216 illus. 3 (emphasis added). The Restatement counsels that "[t]his situation is especially likely to arise when the writing is in a standardized form which does not lend itself to the insertion of additional terms," such as negotiable instruments, leases and conveyances, and the like.

### 3. The Extent to Which a Written Contract Is Integrated Is an Issue of Law to Be Determined by the Court

"Whether an agreement is [fully] or partially integrated is to be determined by the court as a question preliminary to determination of a question of interpretation or to application of the parol evidence rule."[244]

A party may prove complete or partial integration on the basis of "any relevant evidence."[245] While a written, facially integrated, and unambiguous contract signed by both parties *may* be decisive of the extent of integration, "a writing cannot of itself prove its own completeness, and wide latitude must be allowed for inquiry into circumstances bearing on the intention of the parties."[246] The Second Restatement offers the following illustration:

> *A*, a college, owns premises which have no toilet or plumbing facilities or heating equipment. In negotiating a lease to *B* for use of the premises as a radio station, *A* orally agrees to permit the use of [toilet and plumbing] facilities in an adjacent building and to provide heat. The parties subsequently execute a written lease agreement which makes no mention of [the use of the adjacent] facilities or heat. *The question [of] whether the written lease was adopted as a completely integrated agreement is to be decided on the basis of all relevant evidence of the*

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*Id.* § 216 cmt. d. Also, certain terms collateral to a negotiable instrument would, if included in the terms of the instrument, destroy its negotiability; therefore, it is "natural" to leave such terms off the face of the instrument. *See id.*

[244]RESTATEMENT (SECOND) OF CONTRACTS § 210(3). Professor Adams notes:

> [I]t is exclusively up to the trial judge, even in a jury trial, to decide whether a written contract is fully or partially integrated. This is because the parol evidence rule applies to exclude contradictory evidence only if the disputed terms are integrated. . . . "[A] rule allowing the jury to consider any relevant evidence in deciding whether the writing was intended to be a complete integration 'without any limitations, would emasculate, if not "repeal," the parol evidence rule.' "

Charles F. Adams, *Contract Litigation: The Roles of Judge and Jury and the Standards of Review on Appeal*, 28 WILLAMETTE L. REV. 223, 230 (1992) (citation, footnotes, and emphasis omitted).

[245]RESTATEMENT (SECOND) OF CONTRACTS § 210 cmt. b.

[246]*Id.*

*prior and contemporaneous conduct and language of the parties.*[247]

### *a. Texas Law Presumes that a Written Contract Is Fully Integrated*

"[A] written agreement presumes that all prior agreements of the parties relating to the transaction have been merged into the written instrument."[248] In other words, courts presume that written agreements are fully integrated.[249] This presumption of full integration does not apply to contracts governed by the Uniform Commercial Code,[250] and is rebuttable in cases governed by Texas common law.[251] The rationale for presuming full integration is fairly straightforward: "Once the parties have reduced their agreement to writing 'they are presumed to have selected from [prior] negotiations only the promises and agreements for which they choose to be

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[247]*Id.* § 210 illus. 1 (emphasis added).

[248]Thompson v. Chrysler First Bus. Credit Corp., 840 S.W.2d 25, 33 (Tex. App.—Dallas 1992, no writ); *see* Weinacht v. Phillips Coal Co., 673 S.W.2d 677, 679 (Tex. App.—Dallas 1984, no writ); *see also* Beijing Metals & Minerals Import/Export Corp. v. American Bus. Ctr., Inc., 993 F.2d 1178, 1183 (5th Cir. 1993) (citing *Weinacht*, 673 S.W.2d at 679).

[249]*See* Jack H. Brown & Co. v. Toys "R" Us, Inc., 906 F.2d 169, 173 (5th Cir. 1990) (citing Hubacek v. Ennis State Bank, 159 Tex. 166, 317 S.W.2d 30, 32 (1958)); *Beijing Metals*, 993 F.2d at 1183 (citing *Hubacek*, 317 S.W.2d at 32). This presumption, still embraced by Texas common law, is at odds with both the Uniform Commercial Code and the Restatement (Second) of Contracts—both of which reject the presumption that, simply because a writing is integrated as to some terms, it is fully integrated as to all terms. *See* TEX. BUS. & COM. CODE ANN. § 2.202 cmt. 1 (Vernon 1994); RESTATEMENT (SECOND) OF CONTRACTS § 210 cmt. a; *see also* Braucher, *supra* note 2, at 16 & n.23.

[250]*See* TEX. BUS. & COM. CODE ANN. § 2.202 cmt. 1 ("This section definitely rejects: (a) Any assumption that because a writing has been worked out which is final on some matters, it is to be taken as including all the matters agreed upon."); *see also Beijing Metals*, 993 F.2d at 1183 n.10; Bob Robertson, Inc. v. Webster, 679 S.W.2d 683, 688 (Tex. App.—Houston [1st Dist.] 1984, no writ) (paraphrasing Official Comment 1). Parties may vary the provisions of the UCC by explicit agreement. *See, e.g.*, Lenape Resources Corp. v. Tennessee Gas Pipeline Co., 925 S.W.2d 565, 570 (Tex. 1996). Therefore, parties to a written agreement subject to the UCC could easily include language in the operative provision(s) or the merger or integration provisions that has the effect of creating a presumption of full integration, as well as precluding the resort to extrinsic evidence of the types that the UCC otherwise makes admissible. *See infra* Part III.F.

[251]*See Beijing Metals*, 993 F.2d at 1183; *Jack H. Brown & Co.*, 906 F.2d at 173-74; *see also* RESTATEMENT (SECOND) OF CONTRACTS § 209 illus. 3 ("In the absence of contrary evidence, the writing is taken to be an integration; whether it is a complete integration is decided on the basis of all relevant evidence.").

bound.' "[252]

### b. The Significance of "Merger" or "Integration" Clauses

Typically, to manifest their intention of creating a completely integrated agreement, parties will include a clause stating something to the effect that "there are no representations, promises, or agreements between the parties except those found in the writing."[253] Such clauses are called "merger" or "integration" clauses.[254]

> Merger, with respect to the law of contracts, refers to the extinguishment of one contract by its absorption into another contract and is largely a matter of the intention of the parties. Before one contract is merged into another, the last contract must be between the same parties as the first, must embrace the same subject matter, and must have been . . . intended by the parties [to extinguish the prior agreement]. A written agreement is not superseded . . . by a subsequent integration relating to the same subject matter if the [subsequent] agreement is such that it might naturally be made as a separate agreement. Parties to a contract may adjust the details of a transaction without abrogating the entire agreement. However, if the parties to one contract execute another whose terms are so inconsistent with the first that they cannot both stand, the first agreement is conclusively presumed to have been superseded by the second. An integration clause is in essence the merger doctrine memorialized.[255]

In *Advertising & Policy Committee of the Avis Rent A Car System v.*

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[252]*Jack H. Brown & Co.*, 906 F.2d at 173 (quoting Harville Rose Serv. v. Kellogg Co., 448 F.2d 1346, 1349 (5th Cir. 1971)).

[253]Dow, *supra* note 241, at 618; *see also* RESTATEMENT (SECOND) OF CONTRACTS § 216 cmt. e.

[254]Merger and integration clauses serve essentially the same purpose, have essentially the same effect, and are often used and referred to interchangeably. They do, however, have differences. An *integration clause* recites that the subject written contract constitutes the sole and complete agreement between or among the parties, while a *merger clause* recites that the subject written contract supersedes all prior oral or written agreements, leaving the subject contract the sole remaining, and therefore complete, agreement between or among the parties.

[255]Smith v. Smith, 794 S.W.2d 823, 827-28 (Tex. App.—Dallas 1990, no writ) (citations omitted).

*Avis Rent A Car System*, the contract at issue contained the following merger language: "[T]his Agreement supercedes all prior agreements whether written or oral between the parties hereto and contains the entire agreement of the parties and no representations, inducements, promises or agreements, oral or otherwise, between the parties not embodied herein shall be of any force or effect."[256] This language prompted the court of appeals to, rather matter-of-factly, recite that the agreement was wholly integrated.[257]

Similarly, the lease agreement at issue in *Weinacht v. Phillips Coal Co.* included the following language:

> This Lease merges the prior negotiations and understandings of the parties hereto and embodies the entire agreement of the parties and there are not other agreements, assurances, conditions, covenants (express or implied) or other terms with respect to the [subject matter of the lease agreement], whether written or verbal or antecedent or contemporaneous with the execution hereof.[258]

Rejecting, as did the trial court, appellant's claim that the written contract did not extinguish an alleged oral agreement regarding royalty interests, the court of appeals concluded that the written agreement was fully integrated.[259]

However, the mere fact that a written contract contains a merger or integration provision does not guarantee full integration.[260] In *Bob Robertson, Inc. v. Webster*, the sales contract might have appeared at first glance to be fully integrated because of the following "integration" provision: "THE FRONT AND BACK HEREOF COMPRISE THE ENTIRE AGREEMENT AFFECTING THIS ORDER AND NO OTHER AGREEMENT OR UNDERSTANDING OF ANY NATURE CONCERNING SAME HAS BEEN MADE OR ENTERED INTO."[261] Upon further reflection, the court of appeals concluded that the sales contract was not fully integrated, reasoning that "this merger clause is con-

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[256]780 S.W.2d 391, 394 (Tex. App.—Houston [14th Dist.] 1989), *vacated on other grounds*, 796 S.W.2d 707 (Tex. 1990).

[257]*See id.* at 394, 396 ("Section 11 of the ELA renders the ELA an integrated contract.").

[258]673 S.W.2d 677, 679 (Tex. App.—Dallas 1984, no writ).

[259]*See id.* at 678, 679.

[260]*See* Bob Robertson, Inc. v. Webster, 679 S.W.2d 683, 688-89 (Tex. App.—Houston [1st Dist.] 1984, no writ).

[261]*Id.*

tradicted by the instrument itself, which refers to delivery numerous times and yet contains no delivery date. It cannot be said that an oral agreement regarding time of delivery is inconsistent with the terms of the [written] agreement . . . ."[262]

4. Bases for Finding Partial Integration

For a court to determine that a written agreement is not fully integrated, it must decide as a matter of law that (1) the writing is facially incomplete and requires extrinsic evidence to clarify, explain, or give meaning to its terms,[263] or (2) when viewed in light of the circumstances surrounding its execution, the writing does not appear to be the complete embodiment of the terms relating to the subject matter of the writing.[264]

*a. Facially Incomplete Contracts*

> It is often clear from the face of a writing that it is incomplete and cannot be more than a partially integrated agreement. Incompleteness may also be shown by other writings, which may or may not become part of a completely or partially integrated agreement. Or it may be shown by *any relevant evidence*, oral or written, that an

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[262]*Id.* at 689; *see also* RESTATEMENT (SECOND) OF CONTRACTS § 209 cmt. b (1981) ("Written contracts, signed by both parties, may include an explicit declaration that there are no other agreements between the parties, but *such a declaration may not be conclusive*." (emphasis added)).

Those responsible for revising Article 2 of the UCC considered, but then rejected, invalidating merger clauses in contracts for the sale of goods. The current proposed revisions to Article 2 "reflect the actual approach taken by courts in determining whether the parties intended an integration. . . . [T]he courts, as before, are left to decide whether a merger clause is conclusive and when extrinsic evidence should be admitted to interpret language in the record." Henry D. Gabriel & Katherine A. Barski, *Updating the UCC: Revisions in the Works Affect Consumers*, 6 BUS. LAW TODAY, Sep./Oct. 1996, at 16, 19.

[263]*See* Magnolia Warehouse & Storage Co. v. Davis & Blackwell, 108 Tex. 422, 195 S.W. 184, 185 (1917); M.C. Winters, Inc. v. Cope, 498 S.W.2d 484, 488-89 (Tex. Civ. App.—Texarkana 1973, no writ).

[264]*See* Garner v. Redeaux, 678 S.W.2d 124, 128 (Tex. App.—Houston [14th Dist.] 1984, writ ref'd n.r.e.) (quoting 2 CHARLES T. MCCORMICK & ROY R. RAY, TEXAS LAW OF EVIDENCE, CIVIL AND CRIMINAL § 1611 (1st ed. 1937)); Warren Bros. Co. v. A.A.A. Pipe Cleaning Co., 601 S.W.2d 436, 438 (Tex. Civ. App.—Houston [1st Dist.] 1980, writ ref'd n.r.e.).

> apparently complete writing never became fully effective, or that it was modified after initial adoption.[265]

An agreement may be facially incomplete because, inter alia, (1) numerous blanks in the written agreement are not filled in,[266] (2) the written agreement explicitly refers to and incorporates another document,[267] or (3) the agreement omits necessary terms.[268]

In *First National Bank v. Walker*, Walker, who owned fifteen percent of Instant Ice, was asked to sign a personal guaranty for a $30,000 loan from the bank to Instant Ice.[269] Walker went to the bank, which gave him a blank guaranty form and asked him to sign it.[270] Walker indicated that he would sign the blank guaranty upon the condition, inter alia, that the extent of Walker's guaranty would be limited to the amount of his ownership interest in Instant Ice.[271] Walker testified that the bank's officer agreed to his conditions, whereupon Walker executed the blank form of guaranty and left it for the bank's officer to complete it as was agreed.[272]

The printed form of guaranty executed by Walker contained two blanks in addition to the date. Paragraph 1 provided that "[u]nless a different definition is stated in paragraph twelve hereof, the expression 'guaranteed indebtedness,' as that term is used herein, means 'all indebtedness of every kind and character . . . limited to [$30,000] at any one time . . . .' "[273] Paragraph 12 provided:

> Unless specific indebtedness is described in the space below, the express "guaranteed indebtedness," as used herein shall have the meaning stated in paragraph one, but if the space below is filled in, such expression shall mean the indebtedness described below, together with all renewals or extensions of such indebtedness, or any part thereof:

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[265]RESTATEMENT (SECOND) OF CONTRACTS § 210 cmt. c (emphasis added).

[266]*See, e.g.*, City of Beaumont v. Excavators & Constructors, Inc., 870 S.W.2d 123, 146 (Tex. App.—Beaumont 1993, writ denied).

[267]*See id.*

[268]*See, e.g.*, Texas Builders v. Keller, 928 S.W.2d 479, 481-82 (Tex. 1996).

[269]544 S.W.2d 778, 782-83 (Tex. Civ. App.—Dallas 1976, no writ).

[270]*See id.*

[271]*See id.* at 783.

[272]*See id.*

[273]*Id.*

The space following this colon remained blank on the guaranty executed by Walker.[274]

Noting that

> careful examination of the written guaranty agreement fails to reveal the existence of a merger clause or any other statement which would indicate the intention of the parties that any and all statements and agreements made prior to the execution of the instrument should be merged into the instrument itself,

the court of civil appeals held that the trial court did not err in permitting Walker to offer parol evidence to establish the oral agreement regarding the extent of his liability.[275]

The court further explained:

> [T]he bank argues that even if the amount of the guaranty was blank when the instrument was signed and delivered, the document was nevertheless complete because it expressly provides that the guaranty is unlimited if no amount is inserted. Thus, the bank insists that parol evidence was not admissible to show that the parties agreed otherwise. We do not accept that argument because, according to the undisputed evidence, *neither of the parties treated the instrument as complete in this form.* The document sued on shows on its face that the figure "$30,000" was inserted, and since there is evidence tending to show that the insertion was made *after* delivery, we must hold that parol evidence was admissible to show that the document was not completed in accordance with the agreement of the parties.[276]

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[274] *Id.*

[275] *Id.* at 784-85.

[276] *Id.* at 785 (emphases added). As for the ramifications of the bank's failure to complete the guaranty as agreed on Walker's liability, the court of civil appeals stated:

> When a party signs an instrument containing blanks and entrusts it to another under an agreement that the blanks will be filled in a certain manner, the party to whom the instrument is entrusted has a duty to fill the blanks strictly in accordance with the agreement, and, in the absence of negotiation[] to an innocent holder, the party signing the instrument is not bound to the terms subsequently inserted in the blanks if the instrument . . . does not reflect the true agreement.

### b. Collateral Agreements

Similarly, where the written agreement does not include the entire agreement of the parties, parol evidence is admissible to show collateral agreements that are not inconsistent with and do not vary or contradict the integrated, unambiguous terms of the writing.[277] A collateral agreement "may and must be such as the parties might naturally make separately and would not ordinarily be expected to embody in the writing; and it must not be so clearly connected with the principal transaction to be part and parcel thereof."[278]

In *Bob Robertson, Inc. v. Webster*, for example, the court of appeals found that a written new car sales contract was not fully integrated, despite the inclusion of an integration clause, because the written contract referred repeatedly to "delivery," but made no provision for the date of delivery.[279] In light of the omission of the delivery date from the contract, the court concluded that "[i]t cannot be said that an oral agreement regarding time of delivery is inconsistent with the terms of the [written] agreement . . . ."[280]

In *Weinacht v. Phillips Coal Co.*, appellant alleged that appellee had orally promised to increase appellant's royalty if appellee paid a higher royalty than that provided for in the written contract to any other landowner in appellant's county.[281] Appellant argued that this oral agreement was "collateral" to the written royalty agreement because the merger clause in the written agreement addressed only agreements with respect to "the surface of the Premises or the coal situated in on or under the premises."[282] Appellant argued that his royalty payments had nothing to do with the parties' written agreement and, therefore, the merger clause did not reach the alleged oral agreement.[283] The court of appeals disagreed, holding that, because the subject matter of the alleged oral agreement was encompassed by the written agreement, and because the alleged oral agree-

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*Id.* at 784; *see also infra* notes 387-89.

[277]*See* Jack H. Brown & Co. v. Toys "R" Us, Inc., 906 F.2d 169, 175 (5th Cir. 1990); *see* Hubacek v. Ennis State Bank, 159 Tex. 166, 317 S.W.2d 30, 32 (1958); Weinacht v. Phillips Coal Co., 673 S.W.2d 677, 680 (Tex. App.—Dallas 1984, no writ).

[278]*Weinacht*, 673 S.W.2d at 680 (citing Leyendecker v. Strange, 204 S.W.2d 845, 847 (Tex. Civ. App.—Galveston 1947, writ ref'd n.r.e.)).

[279]679 S.W.2d 683, 688-89 (Tex. App.—Houston [1st Dist.] 1984, no writ).

[280]*Id.* at 689.

[281]*Weinacht*, 673 S.W.2d at 678.

[282]*Id.* at 679.

[283]*See id.*

ment contained terms inconsistent with those of the written contract, the alleged oral agreement could not be collateral to the written agreement.[284]

5. The Consequences of Partial Integration

A finding that a written agreement is incomplete does not necessarily warrant wholesale introduction of parol evidence.

> An agreement might be incomplete in some respects but perfectly clear and complete in others. Extrinsic evidence necessary to . . . give meaning to an agreement cannot be admitted to vary or contradict those portions of the agreement that are complete and unambiguous. Therefore, we must look to the particular parol evidence at issue and the purpose for which it was offered to see if it falls within an exception to the parol evidence rule.[285]

Nonetheless, extrinsic evidence may not supply essential terms of an otherwise incomplete written agreement. In *Texas Builders v. Keller*, the Texas Supreme Court considered a dispute over the fee owed to a commercial real estate broker under a solicitation to assist the defendant, Texas Builders, in leasing part of a tract of commercial property.[286] Holding that the description of the property in the solicitation letter was not sufficiently specific to require Texas Builders to pay Keller a commission, the court, per curiam, wrote:

> A writing need not contain a metes and bounds property description to be enforceable; however, it must furnish the data to identify the property with reasonable certainty. Parol evidence may be used to explain or clarify the written agreement, but not to supply the essential terms. For example, a contract that provides for sale of "my ranch of 2200 acres" is sufficient, where extrinsic evidence shows that the grantor owned one ranch, which indeed contained 2200 acres.

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[284]*See id.* at 679-80.

[285]Jack H. Brown & Co. v. Toys "R" Us, Inc., 906 F.2d 169, 174 (5th Cir. 1990) (citation omitted).

[286]928 S.W.2d 479, 480 (Tex. 1996).

> But we have long held that a contract providing for the sale or lease of an unidentified portion of a larger, identifiable tract is not sufficient.[287]

### 6. A Note on Parol Evidence and the Statute of Frauds

The statute of frauds may prevent the enforcement of parol agreements that might otherwise supplement or modify an ambiguous or partially integrated contract or contractual provision. For contracts covered by the statute of frauds, "[t]he general rule is that the required memorandum must contain all the essential terms of the agreement, so that parol evidence is not required to supply any substantive feature which has been omitted."[288]

> The statute is not satisfied where essential details of the promise or agreement . . . are established by parol evidence and by documents not signed by the party to be charged, nor authenticated by his signature. It has also been held that parol evidence is not admissible to show that even signed writings relate to the same transaction; the connection between such instruments must be evident from the writing itself. Oral evidence can only bring together the different writings. It cannot connect them for the purpose of satisfying the Statute of Frauds.[289]

## *C. Exceptions to the Parol Evidence Rule*

There are, in the words of one commentator, "a number of ways in which litigants can avoid the application of the parol evidence rule."[290] If one or more of the following exceptions applies, the parol evidence rule will not prevent the introduction of oral testimony or other extrinsic evidence to explain, expand, or modify the written provisions of an otherwise integrated and unambiguous contract.[291]

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[287]*Id.* at 481-82 (citations omitted).

[288]Gruss v. Cummins, 329 S.W.2d 496, 499 (Tex. Civ. App.—El Paso 1959, writ ref'd n.r.e.).

[289]*Id.* at 502.

[290]HUNTER, *supra* note 1, 7.03[2], at 7-12.

[291]*See id.*

### 1. Nonexistent, or "Sham," Contracts

Parol evidence is always competent to show the nonexistence of a contract.[292] That is to say, parol evidence is admissible to show that "a writing which apparently constituted a contract was never intended or understood by either party to be binding,"[293] or, more generally, that "a valid contract never, in fact, existed."[294] Likewise, parol evidence is admissible to show that, despite the existence of a written instrument purporting on its face to be a contract, the parties never intended it to be such, or that the purported contract is a "sham" agreement.[295] Oral testimony in the case of a nonexistent or sham agreement is admissible because it "does not vary the terms of the writing but shows that it was never intended to be a contract or to be of binding force between the parties."[296]

In *King v. Fordice*, Fordice indicated to King that he was interested in either selling his Cessna 340 aircraft and purchasing a Cessna 414, or alternatively, in trading the 340 and cash for a 414.[297] Some time later, King indicated to Fordice that he had located a Cessna 414, but that he would require Fordice to send him an "offer" for the plane before King could convince its current owner to bring the plane to Texas for Fordice's inspection.[298] At King's instructions, Fordice and King exchanged "mailgrams" whereby, on their faces, King informed Fordice that King would sell the Cessna 414 to Fordice for $400,000 and credit Fordice $150,000 for his trade-in if it was in "good condition," and Fordice indicated he would "accept" King's "offer."[299] King brought the plane to Texas for Fordice's inspection.[300] Following this inspection, Fordice sent

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[292]*See* Baker v. Baker, 143 Tex. 191, 183 S.W.2d 724, 728 (1944); Bellaire Kirkpatrick Joint Venture v. Loots, 826 S.W.2d 205, 213 (Tex. App.—Fort Worth 1992, writ denied); Rincones v. Windberg, 705 S.W.2d 846, 847 (Tex. App.—Austin 1986, no writ); Muhm v. Davis, 580 S.W.2d 98, 101 (Tex. Civ. App.—Houston [1st Dist.] 1979, writ ref'd n.r.e.).

[293]King v. Fordice, 776 S.W.2d 608, 610 (Tex. App.—Dallas 1989, writ denied).

[294]*Loots*, 826 S.W.2d at 213.

[295]*See King*, 776 S.W.2d at 610; Bell v. Mulkey, 7 S.W.2d 115, 116-17 (Tex. Civ. App.—Amarillo 1928), *aff'd*, 16 S.W.2d 287 (Tex. Comm'n App. 1929, judgm't adopted); *see also* Ross v. Stinnett, 540 S.W.2d 493, 495-96 (Tex. Civ. App.—Tyler 1976, no writ) (reciting the rule from *Bell* but concluding that the agreement at bar was not a "sham" and, therefore, the proffered evidence of the "real" oral agreement was barred by the parol evidence rule).

[296]*King*, 776 S.W.2d at 610 (citing Burke v. Dulaney, 153 U.S. 228 (1894); 29A AM. JUR. 2D *Evidence* § 1034 (1994)).

[297]*Id.* at 608.

[298]*See id.* at 609.

[299]*Id.*

[300]*See id.*

King a telex indicating that he was unsatisfied with the Cessna 414 and would not purchase it.[301] King then sued Fordice for breach of the "contract" evidenced by the mailgram and the subsequent telex.[302]

At trial, and over King's objection, Fordice testified that, inter alia, there was no intention on the part of either King or himself that the mailgram and telex would constitute a binding contract to purchase the Cessna 414 for $400,000.[303] The trial court entered a judgment in King's favor.[304] King appealed, arguing that the trial court erred by permitting Fordice to testify regarding the parties' intentions regarding the "deal" set forth in the mailgram and telex.[305]

The court of appeals, applying both the common-law parol evidence rule and the parol evidence rule as set forth in Article 2 of the Texas Uniform Commercial Code,[306] affirmed the trial court's judgment, concluding that

> parol evidence is always competent to show the nonexistence of a contract, or the invalidity of a contract *even if there is a writing purporting to be an integration*, and that such [evidence is] outside the scope of the common law parol evidence [rule] and the ambit of Texas Business and Commerce Code, § 2.202, with regard to the sale of goods.[307]

### 2. Fraudulent Inducement to Contract

"Extrinsic evidence may be admissible for the purpose of vitiating [or avoiding] a written contract where there has been fraud in the inducement."[308] Proving fraud in the inducement sufficient to allow the consideration of parol evidence requires pleading and proof of some type of

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[301] *See id.*

[302] *See id.*

[303] *See id.*

[304] *See id.* at 609-10.

[305] *See id.* at 610.

[306] *See* TEX. BUS. & COM. CODE ANN. § 2.202 (Vernon 1994). See *infra* Part III.F.1 for a detailed discussion of the UCC version of the parol evidence rule.

[307] *King*, 776 S.W.2d at 612 (emphasis added).

[308] Pan Am. Bank v. Nowland, 650 S.W.2d 879, 885 (Tex. App.—San Antonio 1983, writ ref'd n.r.e.), *disapproved of on other grounds by* Crimmins v. Lowry, 691 S.W.2d 582 (Tex. 1985); *see also* Anderson v. Havins, 595 S.W.2d 147, 153 (Tex. Civ. App.—Amarillo 1980, writ dism'd); Beggs v. Texas Elec. Serv. Co., 396 S.W.2d 461, 463 (Tex. Civ. App.—Fort Worth 1965, writ ref'd n.r.e.).

"trickery, artifice, or device."[309] It is not enough simply to show that a contractual provision or its effect was misexplained,[310] or even misrepresented.[311] Nor is it sufficient to simply aver knowledge and intent on the part of the alleged wrongdoer.[312] "A party is charged with the obligation of reading what he [or she] signs."[313]

In *Town North National Bank v. Broaddus*, the Texas Supreme Court considered the admissibility of extrinsic evidence in a dispute over the liability of two co-makers (Broaddus and Taylor) of a promissory note upon default by a third co-maker (Curtis).[314] Town North sued all three co-makers and moved for summary judgment.[315] Broaddus and Taylor opposed Town North's motion for summary judgment by filing sworn affidavits stating that one of Town North's officers, "as agent for the Bank, explained to them that Curtis would have sole responsibility for payment of the note, the proceeds of which were to be used to purchase two cows [presumably for Curtis's use], and that the Bank would not look to either [Broaddus or Taylor] for repayment."[316] The trial court granted Town North's motion for summary judgment.[317] The court of appeals reversed and remanded on the ground that Broaddus's and Taylor's affidavits raised a fact question as to fraud in their inducement to sign the note.[318]

The supreme court reversed the court of appeals and affirmed the trial court's summary judgment, notwithstanding the affidavits by Broaddus

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[309]Town North Nat'l Bank v. Broaddus, 569 S.W.2d 489, 494 (Tex. 1978); *accord* Thompson v. Chrysler First Bus. Credit Corp., 840 S.W.2d 25, 33-34 (Tex. App.—Dallas 1992, no writ); Simpson v. MBank Dallas, N.A., 724 S.W.2d 102, 108 (Tex. App.—Dallas 1987, writ ref'd n.r.e.); Clark v. Dedina, 658 S.W.2d 293, 296 (Tex. App.—Houston [1st Dist.] 1983, writ dism'd); *Nowland*, 650 S.W.2d at 885; *see also* Motorola, Inc. v. Chapman, 761 F. Supp. 458, 462 (S.D. Tex. 1991).

[310]*See Motorola*, 761 F. Supp. at 462-63.

[311]*See Simpson*, 724 S.W.2d at 108.

[312]*See Clark*, 658 S.W.2d at 296.

[313]*Id.* at 297; Lawler v. FDIC, 538 S.W.2d 245, 247-48 (Tex. Civ. App.—Beaumont 1976, writ ref'd n.r.e.); *see also* Fisher Controls Int'l, Inc. v. Gibbons, 911 S.W.2d 135, 142 (Tex. App.—Houston [1st Dist.] 1995, writ requested) ("When experienced executives represented by counsel voluntarily sign a contract whose terms they know, they should not be allowed to claim fraud in any earlier oral statement inconsistent with a specific contract provision.") (citing Boggan v. Data Sys. Network Corp., 969 F.2d 149, 153-54 (5th Cir. 1992), and Airborne Freight Corp. v. C.R. Lee Enters., 847 S.W.2d 289, 297 (Tex. App.—El Paso 1992, writ denied)).

[314]569 S.W.2d 489, 490 (Tex. 1978).

[315]*See id.*

[316]*Id.* at 490-91.

[317]*See id.* at 491.

[318]*See id.*

and Taylor.[319] The court explained:

> "[A] party to a written agreement . . . is charged as a matter of law with knowledge of its provisions and as a matter of law cannot claim fraud when he is bound to the provisions unless he can demonstrate that he was tricked into its execution." . . . [T]he mere representation by a payee to the maker that the maker will not be liable on the note does not constitute fraud in the inducement so as to be an exception to the parol evidence rule.
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> In reaching its decision that parol evidence [the affidavits] was admissible in this case, the court of civil appeals placed primary reliance on *Berry v. Abilene Savings Association* and *Viracola v. Dallas International Bank.* It is true that the rule to be taken from those two decisions is that when there has been a representation by the payee to the maker of a note that the maker will not be liable thereon, extrinsic evidence of fraud in the inducement is to be permitted. A careful reading of *Berry* and *Viracola*, however, reveals that some sort of trick, artifice, or device was employed by the payee in addition to his representation to the maker that he would not be liable. . . . [T]his element of trickery or deception [is] common to the other Texas decisions involving promissory notes in which fraud in the inducement was recognized as an exception to the parol evidence rule.
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> . . . .
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> . . . Applying that standard to the facts before us, we find no such showing by [Broaddus and Taylor]. The affidavits offered by Broaddus and Taylor in opposition to the Bank's motion for summary judgment indicate only that the Bank made representations to Broaddus and Taylor that they would not be liable on the note, which, even if correct, would be insufficient [to create a factual issue of fraudulent inducement].[320]

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[319]*See id.* at 494.

[320]*Id.* at 492-94 (citations omitted) (footnote omitted).

*Berry v. Abilene Savings Ass'n*, cited by the *Broaddus* court, involved allegations that McAden, the president of Western Savings & Loan, and Newman, Berry's employer, induced Berry to make and sign a $5,000 promissory note by false and fraudulent representations.[321] After Berry failed to repay the note at or after maturity, Abilene Savings, Western's successor-in-interest to the note, sued Berry and moved for summary judgment.[322] Berry opposed summary judgment with an affidavit alleging that: (1) McAden and Newman were neighbors; (2) Western could not lend the money to Newman directly; (3) a scheme was worked out so that Berry could borrow the money and then turn it over to Newman; (4) McAden told Berry several times that he would not be liable for repayment; (5) McAden told Berry that he would have never lent the money to Berry, given his financial situation; (6) McAden and Newman both pressured Berry to sign the note; and (7) Berry signed the note, received the money, and promptly handed it over to Newman.[323] Based on these alleged facts, the court of civil appeals found that Berry had raised a fact issue concerning fraudulent inducement.[324]

*Viracola v. Dallas International Bank*, also cited by the *Broaddus* court, concerned the liability of Viracola, the president of American Panel, on a note taken out by American Panel to provide operating funds during negotiations for the sale of the business.[325] In opposition to the bank's motion for summary judgment, Viracola offered an affidavit averring, inter alia, that the note was originally signed only by Viracola in his representative capacity, and that

> [s]oon thereafter, [the] Bank requested Viracola to co-sign the note individually and to pledge his American Panel Corporation stock with [the] Bank "only to assure the Bank that the note would be paid in full first from the proceeds of the sale before any distribution of funds was made to other creditors and stockholders." Viracola was also assured by [the] [b]ank that "if the sale was not final-

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[321] 513 S.W.2d 872, 872 (Tex. Civ. App.—Eastland 1974, writ ref'd n.r.e.).

[322] *See id.*

[323] *See id.* at 873-74.

[324] *See id.* at 875; *see also Broaddus*, 569 S.W.2d at 493-94 (reciting the facts of *Berry*, distinguishing them from the facts at bar, and intimating that the court approved the court of civil appeals's holding in *Berry*).

[325] 508 S.W.2d 472, 473 (Tex. Civ. App.—Waco 1974, writ ref'd n.r.e.).

> ized" the stock would be returned to him and his individual liability on the note would end.[326]

Notwithstanding these assurances, the bank looked to Viracola individually for repayment of the note when the sale fell through.[327] As in *Berry*, the trial court granted summary judgment in the bank's favor and the court of civil appeals reversed and remanded, holding that Viracola had raised a genuine issue of material fact regarding whether "the Bank" had fraudulently induced him to co-sign the note and pledge his stock.[328]

Despite the Texas Supreme Court's efforts to distinguish *Broaddus* from *Berry* and *Viracola*, the distinction appears to be no more than a matter of degree. All three cases involved alleged oral representations by the lender that the defendant would not have to repay the note. *Berry* and *Viracola* may be distinguishable from *Broaddus* due to a third party's alleged involvement in the "scheme." But the "third party" in *Viracola* was American Panel, on whose behalf Viracola had acted.[329] *Berry* may differ from *Broaddus* and *Viracola* because the court may have viewed the defendant's actions as duress, which could truly distinguish it from either *Broaddus* or *Viracola*. Unfortunately, the *Broaddus* court did not explain why the situation before it was distinguishable from *Berry* and *Viracola*; the court simply said that it was so.[330]

### 3. Mutual Mistake

The parol evidence rule does not bar extrinsic proof of mutual mistake.[331] Mutual mistake occurs when both (or all) "parties to an agreement have contracted under a misconception about or ignorance of a material fact . . . ."[332] To qualify as an exception to the parol evidence rule, the mistake must be *mutual*.[333] One party cannot complain that it was ignorant of, or mistaken about, the contents of an agreement, nor can a party com-

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[326]*Id.* at 473.

[327]*See id.* at 474.

[328]*See id.* at 475.

[329]*Id.* at 473.

[330]*See Broaddus*, 569 S.W.2d at 494.

[331]*See* Santos v. Mid-Continent Refrigerator Co., 471 S.W.2d 568, 569 (Tex. 1971) (per curiam); Sweeney v. Taco Bell, Inc., 824 S.W.2d 289, 292 (Tex. App.—Fort Worth 1992, writ denied); Shenandoah Assocs. v. J & K Props., Inc., 741 S.W.2d 470, 488-89 (Tex. App.—Dallas 1987, writ denied); Alkas v. United Savs. Ass'n, 672 S.W.2d 852, 858 (Tex. App.—Corpus Christi 1984, writ ref'd n.r.e.).

[332]*Sweeney*, 824 S.W.2d at 291.

[333]*See* RESTATEMENT (SECOND) OF CONTRACTS §§ 152, 155 (1981).

plain that it failed to read the agreement before accepting it when the agreement clearly states that it was agreed to and understood by the party.[334] Mutual mistake must be pleaded in order to allow a party to present parol evidence supporting its claim to reform or avoid the contract.[335]

An interesting case of mutual mistake is presented by *Josten's, Inc. v. Gilcrease*.[336] The court of appeals considered whether a facially unambiguous termination agreement permitting appellee Buffington to retain Josten's merchandise in his possession included certain Dallas Cowboys Super Bowl rings.[337]

> The parties concede that a binding contract was made. They differ, however, as to whether the terms of the contract include the Super Bowl Rings. Josten's alleged the Super Bowl Rings were excluded from the scope of the contract because Buffington represented before the contract was made, and Josten's believed his representation, that the rings were lost or stolen; and, Josten's alleged, it learned thereafter that Buffington knew his representation was false when he made it. Buffington concedes the representation but contends it was true when made.[338]

In response to Josten's argument that the agreement did not include the Super Bowl rings because of Buffington's allegedly false pre-agreement representation,

> Buffington responds that the parties' pre-contract understanding is immaterial because the contract is *unambiguous* in awarding Buffington all articles he had in his possession or that he acquired during his association with the company. The parol-evidence rule therefore precludes Josten's from varying the contract description by extrinsic evidence of the pre-contract representation and understanding . . . even though *both* parties thought at the time

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[334]*See* American Guar. & Liab. Ins. Co. v. Shel-Ray Underwriters, Inc., 844 F. Supp. 325, 332 (S.D. Tex. 1993) (citing Heritage Manor of Blaylock Props., Inc. v. Petersson, 677 S.W.2d 689, 691 (Tex. App.—Dallas 1984, writ ref'd n.r.e.)).

[335]*See* Thompson v. Chrysler First Bus. Credit Corp., 840 S.W.2d 25, 33-34 (Tex. App.—Dallas 1992, no writ); *Shenandoah Assocs.*, 741 S.W.2d at 488.

[336]798 S.W.2d 835 (Tex. App.—Austin 1990, writ denied).

[337]*See id.* at 836.

[338]*Id.* at 837.

> of contracting that the Super Bowl Rings were lost or stolen.[339]

The court of appeals, considering the propriety of the district court's summary judgment in favor of Buffington, remarked:

> We assume the contract was unambiguous relative to the articles Buffington "acquired during his association with Josten's." This does not mean, however, that the trial court was bound by the parol-evidence rule to deny legal effect to the undisputed fact that both contracting parties (Josten's and Buffington) thought the rings were lost or stolen when they made the contract . . . .[340]

The court of appeals reversed the summary judgment.[341] Citing to, inter alia, *Stewart v. Selder*[342] and *City of Pinehurst v. Spooner Addition Water Co.*[343] for the proposition that a court should construe even a facially unambiguous contract in light of the circumstances surrounding its execution, the *Josten's* court concluded that the parties' "mutual belief at the time of contracting that the Super Bowl Rings were lost or stolen . . . was an operative fact essential to arrive at the meaning they intended in the contract language they chose to describe the articles that should belong thereafter to Buffington."[344] Therefore, Josten's was entitled to present evidence of the mutual mistake, notwithstanding the fact that the agreement was facially unambiguous.[345]

4. Collateral Agreements

A contemporaneous collateral agreement, " 'though it refer to the same subject matter, and may affect the rights of the parties under the written contract,' may be proven [only] if not *inconsistent* with the integrated contract."[346] To be collateral, the parties must agree for separate consideration, or the agreement "must be such as the parties might naturally

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[339]*Id.* at 838.

[340]*Id.*

[341]*See id.* at 839.

[342]473 S.W.2d 3 (Tex. 1971).

[343]432 S.W.2d 515 (Tex. 1968).

[344]*Josten's*, 798 S.W.2d at 839.

[345]*See id.*

[346]Beijing Metals & Minerals Import/Export Corp. v. American Bus. Ctr., Inc., 993 F.2d 1178, 1184 (5th Cir. 1993) (quoting Conner v. May, 444 S.W.2d 948, 952 (Tex. Civ. App.—Austin 1969, writ ref'd n.r.e.)).

make separately and would not ordinarily be expected to embody in the writing; and it must not be so clearly connected with the principal transaction as to be part and parcel thereof."[347]

In *Beijing Metals & Minerals Import/Export Corp. v. American Business Center, Inc.*, appellant ABC asserted two separate oral agreements that it claimed altered its written payment agreement with appellee MMB.[348] "First, ABC assert[ed] that MMB conceded that ABC [was] entitled to an offset of roughly $400,000 for defective and nonconforming goods."[349] The Fifth Circuit found that this alleged oral agreement directly contradicted the payment provision of the written agreement, which recited the total amount that ABC owed to MMB as a result of the dispute giving rise to the written agreement.[350] Therefore, the Fifth Circuit held that evidence regarding the first alleged oral agreement was inadmissible.[351] "Second, ABC maintain[ed] that its obligation under the payment schedule was contingent upon MMB's [oral] agreement to resume shipment" to ABC on credit terms.[352] The Fifth Circuit admitted that this second oral agreement was "not inconsistent with the payment terms stated in the written agreement, because [the latter was] silent as to future sales."[353] Nonetheless, the Fifth Circuit ruled that evidence regarding this second oral agreement was inadmissible because (1) "its contingent nature is inconsistent with the unconditional language of the written agreement," and (2) "we cannot conclude that a contingency of this nature would naturally be made as a separate agreement."[354] In reporting its ruling as to the second alleged oral agreement, the court recounted the following from a similar case:

> It is implausible that Toys would have used explicit, unconditional release language in Markham's letter, while orally agreeing to make the release contingent on some vague guarantee of future business. Nor can we believe that the alleged oral agreement is one that would be made separately . . . . This court recognizes that even the most

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[347]Weinacht v. Phillips Coal Co., 673 S.W.2d 677, 680 (Tex. App.—Dallas 1984, no writ); *accord Beijing Metals*, 993 F.2d at 1184.

[348]*Beijing Metals*, 993 F.2d at 1184.

[349]*Id.*

[350]*See id.*

[351]*See id.*

[352]*Id.*

[353]*Id.*

[354]*Id.*

> sophisticated businessmen often deal with each other informally and verbally, but in circumstances such as these, even an unsophisticated businessman . . . would either have protested the unconditional release language or insisted on getting the alleged oral agreement in writing.[355]

Similarly, in *N.K. Parrish, Inc. v. Southwest Beef Industries Corp.*, the Fifth Circuit rejected the appellants' argument that alleged oral limitation-of-liability agreements between the appellants and the appellees were "collateral agreements, or agreements which induced the written contracts, and, under Texas law, [were] considered exceptions to the parol evidence rule."[356] The court held that "[n]o such limitation of an investor's liability could be collateral. It would directly conflict with the unambiguous terms of both the agency agreement and the prospectus, and the trial judge erred in considering such evidence."[357]

### 5. Subsequent Acts or Agreements

The parol evidence rule excludes only extrinsic evidence of prior or contemporaneous agreements.[358] What about dealings after the contract is executed?

#### *a. Subsequent Agreement*

The parol evidence rule *does not* apply to oral or written agreements made between some or all of the same parties after the parties execute the written agreement.[359] In *Smith v. Smith*, the wife executed an Agreement Incident to Divorce (AID) on May 25, 1984, and delivered it to the husband for his execution.[360] On May 31, 1984, the wife executed an Addendum.[361] On June 1, 1984, both the AID and the Addendum were finalized by the parties and made enforceable pursuant to Texas Rule of Civil Pro-

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[355] *Id.* at 1184 (quoting Jack H. Brown & Co. v. Toys "R" Us, Inc., 906 F.2d 169, 176 (5th Cir. 1990)).

[356] 638 F.2d 1366, 1369 (5th Cir. 1981).

[357] *Id.*

[358] *See* RESTATEMENT (SECOND) OF CONTRACTS § 212 (1981).

[359] *See* Quitta v. Fossati, 808 S.W.2d 636, 642 (Tex. App.—Corpus Christi 1991, writ denied); Robbins v. Warren, 782 S.W.2d 509, 512 (Tex. App.—Houston [1st Dist.] 1989, no writ); Oxford Dev. Co. v. Eppes, 422 S.W.2d 583, 585 (Tex. Civ. App.—Corpus Christi 1967, no writ).

[360] 794 S.W.2d 823, 825 (Tex. App.—Dallas 1990, no writ).

[361] *See id.*

cedure 11.[362] The wife subsequently argued, inter alia, that the Addendum was inadmissible to vary the terms of the AID because of "the parol evidence rule, the merger doctrine, and an integration clause contained in the AID."[363] The court of appeals rejected the wife's argument, concluding that the Addendum to the AID was exactly what it purported to be: a subsequent written agreement modifying the AID, the prior written agreement.[364]

> A written agreement is not superseded or invalidated by a subsequent integration relating to the same subject matter if the [subsequent] agreement is such that [it] might naturally be made as a separate agreement. Parties to a contract may adjust the details of a transaction without abrogating the entire agreement.[365]

### *b. Subsequent Oral Modification*

Provided that the original written agreement does not expressly require that any subsequent modifications be in writing, parol evidence regarding subsequent oral modifications of a prior written agreement may be admissible.[366] However, if the written agreement does require that subsequent modifications be in writing, Texas courts will, with two exceptions discussed below, bar admission of extrinsic evidence to establish a subsequent oral agreement.[367]

A no-oral-modification clause may be waived by a party either by ac-

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[362]*See id.* at 828.

[363]*Id.* at 827. The integration clause in "[t]he AID provided that 'this instrument expresses the entire agreement between the parties concerning the subjects it purports to cover.' " *Id.* n.3.

[364]*See id.* at 828.

[365]*Id.*

[366]*See* Quitta v. Fossati, 808 S.W.2d 636, 642 (Tex. App.—Corpus Christi 1991, writ denied); Robbins v. Warren, 782 S.W.2d 509, 512 (Tex. App.—Houston [1st Dist.] 1989, no writ); Oxford Dev. Co. v. Eppes, 422 S.W.2d 583, 585 (Tex. Civ. App.—Corpus Christi 1967, no writ).

[367]*See* Uhlir v. Golden Triangle Dev. Corp., 763 S.W.2d 512, 516-17 (Tex. App.—Fort Worth 1988, writ denied); Texas Constr. Assocs. v. Balli, 558 S.W.2d 513, 521 (Tex. Civ. App.—Corpus Christi 1977, no writ); D.H. Overmyer Co. v. Harbison, 453 S.W.2d 368, 370 (Tex. Civ. App.—El Paso 1970, no writ); Chambless v. J.J. Fritch, Gen. Contractor, Inc., 336 S.W.2d 200, 203-04 (Tex. Civ. App.—Dallas 1960, writ ref'd n.r.e.); *see also* TEX. BUS. & COM. CODE ANN. § 2.209(b) (Vernon 1994) ("A signed agreement which excludes modification or rescission except by a signed writing cannot be otherwise modified or rescinded . . . ."); South Hampton Co. v. Stinnes Corp., 733 F.2d 1108, 1117-18 (5th Cir. 1984) (applying Texas law).

cepting nonwritten changes from the other party or by making nonwritten changes.[368] Moreover, notwithstanding a no-oral-modification clause, Texas law permits proof of a subsequent oral agreement as long as the statute of frauds does not require that the underlying contract be in writing.[369]

*c. Rescission*

A prior written contract may be rescinded by subsequent oral agreement.[370] In such a case, extrinsic evidence offered to prove the rescission may be admitted even in the face of an unambiguous, fully integrated written contract.[371]

*d. Novation*

Evidence showing an agreement to substitute a new obligation for an existing one, with the intent to extinguish the prior obligation, is admissible to show that the parties have agreed to extinguish the terms of the prior written agreement or that the prior written agreement was not integrated.[372]

6. Illegal Provisions or Agreements

Parol evidence is admissible to show that an otherwise integrated, unambiguous contract is or was entered into in a manner that is contrary to law, public policy, or public morals.[373]

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[368]*See, e.g.*, Union Bldg. Corp. v. J & J Bldg. & Maintenance Contractors, Inc., 578 S.W.2d 519, 520-21 (Tex. Civ. App.—Houston [14th Dist.] 1979, writ ref'd n.r.e.).

[369]*See* Dave Summers Realtors, Inc. v. Astro Leasing, Inc., 603 S.W.2d 301, 302 (Tex. Civ. App.—Beaumont 1980, no writ); *see also South Hampton*, 733 F.2d at 1117 & n.13.

[370]*See* RESTATEMENT (SECOND) OF CONTRACTS § 148 (1981).

[371]*See* Speer v. Dalrymple, 222 S.W. 174, 176 (Tex. Comm'n App. 1920, holding approved) (holding that the trial court erred by excluding extrinsic evidence of nondelivery, fraud, and rescission because the evidence offered did not seek to *alter* the written contract; rather, it went to whether the written contract was binding at all); *see also* Farr v. Moreland, 197 S.W.2d 386, 388 (Tex. Civ. App.—Texarkana 1946, no writ) (discussing the degree of proof of parol rescission of a prior written contract for sale of land). *But see* Reyes v. Smith, 288 S.W.2d 822, 825 (Tex. Civ. App.—Austin 1956, writ ref'd n.r.e.) (holding that a written contract conforming to the statute of frauds could not be modified or rescinded by subsequent oral agreement and, therefore, parol evidence regarding the alleged oral rescission was inadmissible).

[372]For example: "A and B enter into an oral contract, and prepare and sign a writing to incorporate its terms. Though the writing contains substantially all the orally agreed terms, they are not fully satisfied with it, and they agree to have it redrafted. There is no integrated agreement." RESTATEMENT (SECOND) OF CONTRACTS § 209 cmt. b, illus. 1.

[373]*See* Muhm v. Davis, 580 S.W.2d 98, 101 (Tex. Civ. App.—Houston [1st Dist.] 1979, writ ref'd n.r.e.); *see also* McFarland v. Shaw, 45 S.W.2d 193, 195 (Tex. Comm'n App. 1932,

### 7. Evidence Pertinent to Consideration

#### *a. Lack of or Failure of Consideration*

Parol evidence is admissible to show want or failure of consideration.[374] As the Restatement (Second) of Contracts explains:

> Where a written agreement requires consideration and none is stated in the writing, a finding that the writing is a completely integrated agreement would mean that it is not binding for want of consideration. Since only a binding integrated agreement brings the parol evidence rule into operation, evidence is admissible to show that there was consideration and what it was.[375]

#### *b. True Consideration*

Parol evidence is also admissible to establish the actual consideration given for a written agreement where the actual consideration is different from that recited in the agreement,[376] or where the agreement fails to recite the consideration at all.[377]

### 8. Condition Precedent

It is well settled that parol evidence of a condition precedent to a con-

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holding approved) (quoting 3 RULING CASE LAW 869-70 (William M. McKinney & Burdett A. Rich eds., 1914), which states that "[i]t may not be contended for example, that, as between the parties to an instrument parol evidence is incompetent to show . . . illegality . . . ."); Bradbury v. State *ex rel.* Clutter, 503 S.W.2d 619, 622 (Tex. Civ. App.—Tyler 1973, no writ) (holding that the parol evidence rule did not bar appellees from showing that "official documents declaring the City of Preston to be an incorporated town were void or voidable and of no legal effect").

[374]*See* DeLuca v. Munzel, 673 S.W.2d 373, 376 (Tex. App.—Houston [1st Dist.] 1984, writ ref'd n.r.e.); Gaines Motor Sales Co. v. Hastings Mfg. Co., 104 S.W.2d 548, 551 (Tex. Civ. App.—Fort Worth 1937, writ dism'd).

[375]RESTATEMENT (SECOND) OF CONTRACTS § 218 cmt. d; *see also id.* § 218(2) ("[Extrinsic] [e]vidence is admissible to prove whether or not there is consideration for a promise, even though the parties have reduced their agreement to a writing which appears to be a completely integrated agreement.").

[376]*See DeLuca*, 673 S.W.2d at 376; *Gaines Motor Sales*, 104 S.W.2d at 551.

[377]*See* RESTATEMENT (SECOND) OF CONTRACTS § 218 cmt. e ("Where consideration is required, the requirement is not satisfied by a false recital of consideration . . . . An incorrect statement of a consideration does not prevent proof either that there was no consideration or that there was a consideration different from that stated.").

tract or contractual provision is admissible.[378] The effect of such a condition "is not to vary the terms of a binding instrument, but merely . . . to postpone the effective date of the instrument until the happening of a contingency."[379] Parol testimony may show "that an ordinary written instrument was executed under an agreement that it was not to become effective except upon certain conditions or contingencies."[380]

Note that, despite the special treatment afforded conditions precedent, "extrinsic evidence is admissible to establish an oral condition precedent *only* if it is consistent with the terms of the written contract."[381] That is, of course, assuming that the written contract has terms with which the alleged oral agreement could be inconsistent. By the same token, according to the Restatement (Second) of Contracts, "where the parties to a written agreement agree orally that performance of the agreement is subject to the occurrence of a stated condition, the agreement is *not integrated with respect to the oral condition.*"[382] The commentary to the Restatement (Second) of Contracts elaborates:

> [A]n oral requirement of a condition is never completely consistent with a signed written agreement which is complete on its face; in such cases evidence of the oral requirement bears directly on the issues [of] whether the writing was adopted as an integrated agreement and if so whether the agreement was completely integrated or partially integrated . . . . If the parties orally agreed that per-

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[378]*See* Rincones v. Windberg, 705 S.W.2d 846, 847 (Tex. App.—Austin 1986, no writ). A condition precedent is distinguished from a "condition subsequent" for purposes of the parol evidence rule. A condition subsequent is "a condition referring to a future event, upon the happening of which the obligation becomes no longer binding upon the other party, if he chooses to avail himself of the condition." BLACK'S LAW DICTIONARY 293-94 (6th ed. 1990); *see also Rincones*, 705 S.W.2d at 848 (quoting with approval the same definition as it appeared in an earlier edition of BLACK'S LAW DICTIONARY). In other words, evidence of a condition subsequent, unlike evidence of a condition precedent, is barred by the parol evidence rule. *See id.* at 848-49 and cases cited therein.

[379]Baker v. Baker, 143 Tex. 191, 183 S.W.2d 724, 728 (1944); *accord Rincones*, 705 S.W.2d at 847.

[380]*Baker*, 183 S.W.2d at 728; *see also* Holt v. Gordon, 107 Tex. 137, 174 S.W. 1097, 1097 (1915).

[381]Pan Am. Bank v. Nowland, 650 S.W.2d 879, 885 (Tex. App.—San Antonio 1983, writ ref'd n.r.e.) (emphasis added) (citing Denman v. Hall, 144 Tex. 633, 193 S.W.2d 515, 516 (1946), and *Baker*, 183 S.W.2d at 728), *disapproved of on other grounds by* Crimmins v. Lowry, 691 S.W.2d 582 (Tex. 1985).

[382]RESTATEMENT (SECOND) OF CONTRACTS § 217 (emphasis added).

> formance of the written agreement was subject to a condition, either the writing is not an integrated agreement or the agreement is only partially integrated until the condition occurs. Even a "merger" clause in the writing, explicitly negating oral terms, does not control the question [of] whether there is an integrated agreement or the scope of the writing.[383]

Conditional language, such as "if," is indicative that a condition precedent was intended by the parties.[384] For example, in *Belmont Constructors, Inc. v. Lyondell Petrochemical Co.*, the contract contained a "mandatory arbitration" provision that read as follows: "If the parties cannot agree within 10 days on a different method of resolving the matter, the matter shall be submitted by the parties to and be decided by binding arbitration."[385] The court of appeals "conclude[d] such language created a condition precedent to mandatory arbitration. The contract provided for mandatory arbitration only in the event the parties could not first agree on an alternate method of resolving their dispute."[386]

In *First National Bank v. Walker*, the court of civil appeals addressed the admissibility of parol testimony under the following conditions:

> During the trial appellee Walker testified that although he was not involved with the negotiations leading to the $30,000 loan from the bank to Instant Ice, Inc., he was familiar with such loan and that on August 7, 1974, he received a telephone call from First National's officer, Vaughn Pearson, who requested that he execute a guaranty of the loan. . . . Walker went to [Pearson's] office and . . . Pearson's secretary handed Walker his printed form of guaranty which was completely blank, that is no blanks were filled in with typewriting. . . . Walker discussed the matter of the blank form with Pearson. Walker

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[383] *Id.* § 217 cmt. b. The Second Restatement advises further that "[a] major rationale expressed by the courts for the rule of this Section is that it has to do with an oral condition that must occur before the written contract comes into existence. Thus, if the oral condition is not met *there is no subsequent and superseding agreement* and no reason to apply the parol evidence rule." *Id.* § 217 reporter's note to cmt. b (emphasis added).

[384] *See* Criswell v. European Crossroads Shopping Ctr., Ltd., 792 S.W.2d 945, 948 (Tex. 1990); Hohenberg Bros. Co. v. George E. Gibbons & Co., 537 S.W.2d 1, 3 (Tex. 1976).

[385] 896 S.W.2d 352, 357 (Tex. App.—Houston [1st Dist.] 1995, no writ) (emphasis omitted).

[386] *Id.*

> indicated that he would sign the blank guaranty form *upon the condition* that the bank secure from Ted Kreatschman a similar agreement and that the extent of Walker's guaranty would be limited to the amount of his ownership interest in Instant Ice, Inc. which was approximately fifteen percent. Walker testified that Pearson agreed to his *conditions of delivery of the [guaranty]*. Walker testified that he executed a blank form of guaranty and left it with Pearson to be completed only upon the agreed condition of delivery. . . .
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> Pearson denied that any parol agreements were made with respect to the guaranty . . . .[387]

Noting the lack of a merger provision, the court of civil appeals held that the trial court did not err in permitting Walker to offer parol evidence to establish the oral condition precedent to his guaranty.[388] The court explained:

> Parol testimony is admissible to show the execution of a written instrument under an agreement that it is not to become effective except upon certain conditions. It is well settled that a written contract does not become a binding obligation until delivery, and, if the delivery is conditional, the written contract does not become a binding obligation until [the] condition upon which delivery depends has been fulfilled.
>
> . . . [O]ne who executes an obligation conditional upon the express representation, of which the obligee has notice, that a third party shall likewise execute an agreement and share the liability thereon, will be released from liability if the third party fails to so execute the instrument.[389]

### 9. Lost or Destroyed Contract

When a written, signed contract is lost or destroyed such that the party seeking to prove or enforce the agreement is unable to produce the written

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[387]544 S.W.2d 778, 782-83 (Tex. Civ. App.—Dallas 1976, no writ).

[388]*See id.* at 784; *see also supra* note 275 and accompanying text.

[389]*Id.* (citations omitted).

agreement in court, the existence and terms of the written contract may be proved by clear and convincing parol evidence.[390]

10. Scrivener's Error

Extrinsic evidence may be admissible to show the existence of a clerical error in a written agreement.[391] Some courts will extend the scope of this exception to include more than mere clerical errors. For example, in *McCauley v. Alexander*, the court of civil appeals affirmed the trial court's judgment based, at least in part, on extrinsic evidence that showed

> without dispute and beyond any doubt that Mrs. Permenter intended to leave all of her estate to the Eden Home, and that the omission in question resulted from the *inadvertent failure* of the lawyer who prepared the will *to include the words* "all of my property and estate" at the end of the second paragraph.[392]

Other courts, however, are reluctant to permit parol evidence to correct what appear to be nothing more than clerical errors. For example, in *Joseph v. Mahoney Corp.*, plaintiff and defendant executed a lease on April 5, 1956, that included a provision whereby "Lessee shall pay all taxes in excess of taxes assessed against said property over and above City, County and State taxes *for the year 1951*."[393] Despite the fact that the lease term was clearly in error, the court of civil appeals affirmed the trial court's judgment against the Lessee, holding that, because "[t]he parties to the lease agreement knew the contents of the written lease, . . . the 'scrivener's mistake' exception" to the parol evidence rule did not apply.[394]

11. Course of Dealing or Course of Performance

A course of dealing is "a sequence of previous conduct between the

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[390]*See* EP Operating Co. v. MJC Energy Co., 883 S.W.2d 263, 267 n.1 (Tex. App.—Corpus Christi 1994, writ denied); Chakur v. Zena, 233 S.W.2d 200, 202 (Tex. Civ. App.—San Antonio 1950, no writ).

[391]*See, e.g.*, Ford v. Ford, 492 S.W.2d 376, 377-78 (Tex. Civ. App.—Texarkana 1973, writ ref'd n.r.e.) (affirming the trial court's reformation of a trust instrument based on the preparer's testimony that he intended to write the instrument so that the trust was irrevocable for ten years).

[392]543 S.W.2d 699, 700-01 (Tex. Civ. App.—Waco 1976, writ ref'd n.r.e.) (emphasis added).

[393]367 S.W.2d 213, 214 (Tex. Civ. App.—Austin 1963, writ ref'd n.r.e.) (emphasis added).

[394]*Id.* at 215.

parties to an agreement which is fairly to be regarded as establishing a common basis of understanding for interpreting their expressions and other conduct."[395] The Restatement formulation closely tracks the Uniform Commercial Code,[396] as well as most of the more recent reported cases invoking usage of trade to construe contracts subject to the UCC. Nonetheless, course of dealing and course of performance are legitimate grounds for resorting, in cases not governed by the UCC, to otherwise excludable extrinsic evidence.[397]

In *Crest Construction, Inc. v. Murray*, appellant (Crest) argued that the trial court erred by refusing to admit several documents dealing with contract provisions and with subcontract terms between Crest and Murray, all of which were dated and signed by Crest, but were not signed by Murray—although there was no evidence that Murray had refused to sign any of the documents.[398]

The court of appeals explained further:

> Because of the state of the record and because there were no fully signed sub-contracts on the three jobs, a paramount, disputed issue arose between the parties as to when Crest was obligated legally to make advanced, weekly payroll payments to Murray on the three jobs germane to this litigation.
>
> The basic position of Murray was that there was an *oral agreement which made it mandatory and legally obligatory upon Crest to make weekly payroll payments on the three jobs.* Crest on the other hand asserted that it was to pay Murray only on a monthly basis in accordance with the usage, procedure, and custom that Crest and Murray had utilized for many years . . . .[399]

The court of appeals found that "under the course of dealing between the parties approximating about nine or ten years," the excluded documents were relevant and "ha[d] a strong tendency to prove the existence of a fact

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[395]RESTATEMENT (SECOND) OF CONTRACTS § 223(1) (1981).

[396]*See infra* Part III.F.1.a; *see also* RESTATEMENT (SECOND) OF CONTRACTS § 223 cmt. a.

[397]Recall that, inter alia, course of dealing and course of performance are "surrounding circumstances" against which backdrop contractual terms are to be construed. *See supra* Part II.C.1.

[398]888 S.W.2d 931, 946 (Tex. App.—Beaumont 1994), *rev'd on other grounds*, 900 S.W.2d 342 (Tex. 1995).

[399]*Id.*

of ultimate consequence" regarding Crest's obligations to Murray.[400] Therefore, the court of appeals sustained Crest's point of error complaining about the trial court's exclusion of the documents and remanded the case for further proceedings.[401]

### 12. Custom and Usage

Evidence that might otherwise be excluded by operation of the parol evidence rule may be admissible to show industry custom or trade usage, which are presumed to be a "backdrop" against which all commercial contracts are drafted.[402] Nonetheless, "where a contract is clear, complete and unambiguous . . . new terms [cannot] be added to the contract by incorporating a usage or custom which would add to the contractual obligations of one of the parties."[403]

In *International Piping Systems, Ltd. v. M.M. White & Associates*, the court of appeals addressed the admissibility of expert testimony regarding industry practice, determining whether agency agreements were standard in the industry in question.[404] In that case, White and Brown discussed White's acting as an agent for Brown's employer, IPS.[405] On November 14, 1983, White and Brown met and discussed a "proposed agreement"

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[400]*Id.*

[401]*See id.* at 946-47.

[402]Chase Manhattan Bank v. First Marion Bank, 437 F.2d 1040, 1046 (5th Cir. 1971) (observing that evidence relating to course of dealing and usage of trade "merely delineates a commercial backdrop for intelligent interpretation of the agreement"); *see* Royal Indem. Co. v. Marshall, 378 S.W.2d 364, 370 (Tex. Civ. App.—Austin 1964) (approving the trial court's admission of expert testimony regarding the meaning of certain terms and industry practices among automobile dealers), *rev'd on other grounds*, 388 S.W.2d 176 (Tex. 1965); *see also In re* Fuel Oil Supply & Terminaling, Inc., 72 B.R. 752, 759 (S.D. Tex. 1987) (noting that "extrinsic evidence, like the course of dealings or the practice in the industry, is admissible to establish the intent expressed in the writing . . ."), *rev'd on other grounds*, 837 F.2d 224 (5th Cir. 1988); Oil Ins. Ass'n v. Royal Indem. Co., 519 S.W.2d 148, 150 (Tex. Civ. App.—Houston [14th Dist.] 1975, writ ref'd n.r.e.) (citing *Marshall* for the general proposition that "[i]t is well settled in Texas law that expert testimony of industry custom is admissible to explain the meaning of technical terms used by parties in an industry," but refusing to extend that well-settled law to cover a contract to which one party was *not* a part of the industry in question). *See generally* RESTATEMENT (SECOND) OF CONTRACTS § 209 cmt. a (1981); *id.* § 202(3)(b), (4) & (5) & cmts. f & g (describing the roles of technical terms, course of performance, course of dealing, and trade usage in contract interpretation and construction).

[403]S.K.Y. Inv. Corp. v. H.E. Butt Grocery Co., 440 S.W.2d 885, 891-92 (Tex. Civ. App.—Corpus Christi 1969, no writ).

[404]831 S.W.2d 444, 448 (Tex. App.—Houston [14th Dist.] 1992, writ denied).

[405]*See id.*

regarding White's agency.[406] On November 17, 1983, White received a letter from Brown authorizing White to act as IPS's sales representative.[407] The November 17th letter was silent as to the duration of White's agency.[408] At trial, White testified that his agreement with IPS was for one year, beginning November 17, 1983.[409] White also proffered expert testimony that one-year agency agreements "were standard in the industry" and that all of IPS's agreements with other agents had one-year terms.[410] The jury found that a one-year agreement existed.[411] The court of appeals held that, given the testimony of White and White's expert, the evidence was legally sufficient to support the jury's finding.[412]

The party suggesting that a contract be construed consistently with custom and usage must provide evidence that the custom or usage was generally known or had been in use for a sufficient time to become generally known, and that the contracting parties knew or should have known of the proffered custom or usage, and therefore the court can presume that the parties contracted with reference to it.[413] For example, in *Monesson v. Champion International Corp.*, a written proposal to supply cabinets, which was subsequently accepted and became the contract pursuant to which cabinets were supplied to the appellant, contained the phrase "[p]rices subject to change without notice."[414] The court of civil appeals

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[406]*Id.*

[407]*See id.*

[408]*See id.*

[409]*See id.*

[410]*Id.*

[411]*See id.*

[412]*See id.* Other Texas courts have permitted or approved expert testimony regarding standard practices with respect to written agreements. *See, e.g.*, Schwartz v. Prairie Producing Co., 833 S.W.2d 629, 632 (Tex. App.—Houston [1st Dist.] 1992, writ dism'd) (reversing and remanding for further proceedings when the trial court permitted expert testimony regarding gas processing agreements in general, but excluded expert testimony regarding industry custom concerning the sale of hydrogen sulfide gas, and then directed a verdict against the proffering party); Liquid Energy Corp. v. Trans-Pan Gathering, Inc., 758 S.W.2d 645, 655 (Tex. App.—Amarillo) (overruling a "no evidence" point in light of expert testimony regarding whether a pricing provision in a gas purchasing agreement was reasonable and common in the industry), *vacated on other grounds*, 762 S.W.2d 758 (Tex. App.—Amarillo 1988, no writ). The Fifth Circuit has followed suit. *See, e.g.*, Bernard v. Gulf Oil Corp., 890 F.2d 735, 741 (5th Cir. 1989) (affirming a judgment in favor of an employer in light of, inter alia, expert testimony that the employer's personnel policies conformed with industry practices at the time).

[413]*See* Texas Gas Exploration Corp. v. Broughton Offshore Ltd. II, 790 S.W.2d 781, 785 (Tex. App.—Houston [14th Dist.] 1990, no writ).

[414]546 S.W.2d 631, 637 (Tex. Civ. App.—Tyler 1976, writ ref'd n.r.e.).

found the contract to be ambiguous because there were at least two reasonable interpretations of the phrase "[p]rices subject to change without notice."[415] The court ruled, therefore, that extrinsic evidence of industry custom and usage regarding pricing terms was admissible.[416]

In *Chase Manhattan Bank v. First Marion Bank*, the Fifth Circuit considered the admissibility of extrinsic evidence of course of dealing and trade usage to determine the parties' respective obligations under a subordination agreement.[417] The parties executed the agreement to secure a further extension of credit by Chase to the borrowers of a series of loans made by a group of lenders, including both Chase and First Marion.[418] As part of the agreement, First Marion and others were obligated to compensate Chase in the event that they sold any of their shares of the stock that was the original security on the loan package.[419] The issue before the Fifth Circuit was whether the district judge erred in refusing to consider extrinsic evidence of trade usage in the commercial lending industry and the prior course of dealing among the various parties to the subordination agreement.[420]

Finding that section 2-202 of the UCC did not apply because the agreement at issue did not involve the sale of goods, the Fifth Circuit relied on common law to determine whether the district court had erred.[421] Reciting the definitions of "course of dealing" and "usage of trade" in sections 1-205(1) and 1-205(2) of the UCC, respectively, the court opined: "Certainly the [common-law] parol evidence rule does not preclude evidence of course of dealing or usage of trade, for such evidence merely delineates a commercial backdrop for intelligent interpretation of the agreement."[422] The Fifth Circuit held:

> [E]vidence of course of dealing and usage of trade is admissible to permit analysis of the written agreement in the proper commercial setting. Such evidence *might* disclose ambiguities within the provisions of the agreement and ostensible inconsistencies in their relationship to one another. Certainly, in the context of this case, Chase's prof-

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[415] *Id.*

[416] *See id.*

[417] 437 F.2d 1040, 1041-42 (5th Cir. 1971).

[418] *See id.*

[419] *See id.* at 1042-44.

[420] *See id.* at 1045.

[421] *See id.*

[422] *Id.* at 1046.

fered testimony and evidence as to course of dealing and usage of trade remain subject to cross-examination, as well as First Marion's contrary testimony and evidence regarding the same matters. Ultimately, having considered all relevant course of dealing and usage evidence, the District Judge must determine whether the written agreement contains ambiguities or lacks potentially material terms.

If the [trial] court—after consideration of all relevant course of dealing and usage of trade evidence—determines as a matter of law that the written agreement is unambiguous and integrated, evidence of the intentions and subsequent actions of the parties is irrelevant to the decision of this case. Viewed against the proper background, clear words and provisions leave no room for factual judgments. However, if the District Judge rules that the agreement in question is ambiguous, incomplete, or uncertain in any respect, parol evidence of the intent and purposes of the parties in making the contract becomes admissible for construction. . . .[423]

Evidence to explain ambiguity, establish a custom, or show the meaning of technical terms, and the like, is not regarded as an exception to the [parol evidence] rule, because it does not contradict or vary the written instrument, but simply places the court in the position of the parties when they made the contract, and enables it to appreciate the force of the words they used in reducing it to writing. It is received where doubt arises upon the face of the instrument as to its meaning, not to enable the court to hear what the parties said, but to enable it to understand what they wrote, as they understood it at the time. Such evidence is explanatory, and must be [consistent] with the terms of the contract.[424]

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[423] *Id.* at 1047-48 (citations omitted). After all, "[t]he object of rules of construction generally, and of parol evidence particularly, is to ascertain the intention of the parties." *Id.* at 1048.

[424] *Id.* (quoting Thomas v. Scutt, 27 N.E. 961, 962-64 (N.Y. 1891)).

## 13. Meaning of Technical Terms

Evidence that might otherwise be excluded by operation of the parol evidence rule may be admissible to explain or interpret technical terms used in a written agreement.[425] "Technical terms and words of art [should be] given their technical meaning when used in a transaction within their technical field."[426]

In *Sivert v. Continental Oil Co.*, the court of civil appeals considered the admissibility of extrinsic evidence regarding the meaning of the terms "secondary recovery" and "waterflood," which the parties used in a written unitization agreement.[427] Noting that "Texas courts have consistently permitted this type of testimony,"[428] the court of civil appeals found that the trial court did not err in permitting two petroleum engineers to testify as to the meaning of the terms.[429] The court explained: "The terms 'secondary recovery' and 'waterflood' are not terms of common usage, and are technical terms peculiarly applicable to the oil industry. . . . This evidence was not parol evidence tending to vary the terms of the written agreement, but was *explanatory* of such technical terms used in the unitization agreement."[430]

In *Byrd v. Smith*, the court of civil appeals rejected an argument that extrinsic evidence of the meaning of the term "carried interest" used in a written agreement was barred by the parol evidence rule.[431] The court of civil appeals explained:

> "[C]arried interest" . . . is a technical term adopted from the oil industry and was used in a contract concerning a speculative real estate venture. . . . As used in the oil industry, the holder of a carried interest of a working inter-

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[425]*See* Byrd v. Smyth, 590 S.W.2d 772, 774-75 (Tex. Civ. App.—El Paso 1979, no writ); Barrett v. Ferrell, 550 S.W.2d 138, 141-42 (Tex. Civ. App.—Tyler 1977, writ ref'd n.r.e.); Burdette v. Cook Indus., 544 S.W.2d 495, 497 (Tex. Civ. App.—Corpus Christi 1976, writ dism'd w.o.j.); Sivert v. Continental Oil Co., 497 S.W.2d 482, 489 (Tex. Civ. App.—San Antonio 1973, writ ref'd n.r.e.); Gruss v. Cummins, 329 S.W.2d 496, 501 (Tex. Civ. App.—El Paso 1959, writ ref'd n.r.e.); Frost v. Martin, 203 S.W. 72, 74 (Tex. Civ. App.—Fort Worth 1918, no writ). *See generally* 4 WALTER H.E. JAEGER, WILLISTON ON CONTRACTS § 613 (3d ed. 1961) and cases cited therein.

[426]RESTATEMENT (SECOND) OF CONTRACTS § 202(3)(b) (1981).

[427]*Sivert*, 497 S.W.2d at 489.

[428]*Id.*

[429]*See id.*

[430]*Id.* (emphasis added).

[431]590 S.W.2d 772, 775 (Tex. Civ. App.—El Paso 1979, no writ).

> est has no personal obligation for operating costs while the co-owners who advance such costs are entitled to reimburse themselves first from future production. As the term was used here, it meant that the co-owners who advanced expenses were entitled to reimburse themselves first from the profits of the venture before equal distribution to all shareholders was made. This meaning was explained to the Appellant, and the testimony was that he was then in complete agreement. The trial [c]ourt adopted this explanation in its interpretation of the assignment and of the Joint Venture Agreement. We are in accord with that conclusion.[432]

### 14. Meaning Peculiar to the Contracting Parties

Extrinsic evidence may also be admissible to explain terms, technical or otherwise, used in a written agreement, whose meaning is peculiar to the contracting parties.[433]

### 15. Scope of Contract

Evidence that might otherwise be excluded by operation of the parol evidence rule may be admissible to show the scope of the work or transaction contemplated by the contract.[434]

### 16. False, Misleading, or Deceptive Practices

The parol evidence rule has been held not to bar the admissibility of extrinsic proof of false, misleading, or deceptive practices under the Texas Deceptive Trade Practices Act.[435]

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[432] *Id.* at 774-75 (citation omitted).

[433] *See generally* 4 JAEGER, *supra* note 425, § 613 and cases cited therein.

[434] *See* Moreau v. Otis Elevator Co., 531 F.2d 311, 313 (5th Cir. 1976); Chemical Constr. Corp. v. Continental Eng'g, Ltd., 407 F.2d 989, 992-93 n.3 (5th Cir. 1969) (adopting the trial court's decision which, inter alia, permitted appellant to offer extrinsic evidence of the scope of the work that appellant understood the agreement to cover).

[435] *See* Weitzel v. Barnes, 691 S.W.2d 598, 600 (Tex. 1985); *see also* Honeywell, Inc. v. Imperial Condominium Ass'n, 716 S.W.2d 75, 78-79 (Tex. App.—Dallas 1986, no writ) (permitting consumers to introduce extrinsic evidence of precontractual misrepresentations, as well as factual misrepresentations in the contract itself); Tom Benson Chevrolet, Inc. v. Alvarado, 636 S.W.2d 815, 820 (Tex. App.—San Antonio 1982, writ ref'd n.r.e.) (holding that a writing not part of the sales contract was admissible to show that the seller misrepresented the price of an automobile); United Postage Corp. v. Kammeyer, 581 S.W.2d 716, 720-21 (Tex.

### D. The Parol Evidence Rule in Action: A Simplified Checklist

> *To even the most courageous Pickwickian, the parol evidence rule must seem a treacherous bog in the field of contract law. Interspersed in this quagmire are quick-sand-like state court decisions, which appear equitable in specific situations but remain perilous for legal precedent. Federal courts, attempting to clarify, have sometimes but confused and compounded muddled interpretation of the axiom.*
>
> *Thus we tread cautiously in this morass . . . .*
>
> —Judge David W. Dyer[436]

While the parol evidence rule may be easy to recite, it is much more difficult to pin down in practice. As discussed previously, and as is apparent from the foregoing statements of the parol evidence rule, before a trial court reaches the question of whether evidence offered regarding a prior agreement or prior discussions will be admitted before the trier of fact, the court must make the following threshold determinations:[437]

(1) Is there a valid (*i.e.*, not void or voidable, due to illegality, fraud, or mistake) written agreement covering the subject matter of the proffered extrinsic evidence?

(2) If so, does the written agreement constitute the final agreement of the parties regarding the subject matter of the proffered extrinsic evidence?

(3) If so, does the written agreement constitute the complete and exclusive agreement of the parties regarding the subject matter of the proffered extrinsic evidence?

(4) If so, are the final and complete terms of the written agreement unambiguous?[438]

(5) If so, does the proffered extrinsic evidence contradict, vary, or supplement any terms of the written agreement that the court has previ-

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Civ. App.—Dallas 1979, no writ) (holding that plaintiff's testimony that he relied upon oral representations made by the defendant, rather than the written representations in his contract with the seller, created a fact issue sufficient to prevent summary judgment for the seller).

[436]Chase Manhattan Bank v. First Marion Bank, 437 F.2d 1040, 1045 (5th Cir. 1971).

[437]*See generally* Arthur L. Corbin, *The Parol Evidence Rule*, 53 YALE L.J. 603, 610 (1944); HUNTER, *supra* note 1, ¶ 7.03, at 7-7 to 7-9.

[438]This step of the inquiry is optional, depending upon whether ambiguity has been pleaded by one or more of the parties. *See generally supra* Part III.A.3.

ously determined to be unambiguous, final, and complete?

If the answer to *any* of the foregoing questions is "No"—or, arguably, "Maybe"[439]—then the parol evidence rule *does not* prevent the trier of fact from considering the proffered extrinsic evidence. If the answer to all of the foregoing questions is "Yes," then the trial court must answer the following additional question:

(6) Does the proffered extrinsic evidence, which is otherwise subject to the parol evidence rule, fit one or more of the numerous exceptions to the rule?[440]

If so, then, again, the parol evidence rule *does not* prevent the trier of fact from considering the proffered extrinsic evidence. If not, *and only if not*, then the parol evidence rule (common-law or statutory) applies to bar the trier of fact from considering the proffered extrinsic evidence. Moreover, in order to answer any or all of the foregoing questions, the trial court is free to consider any and all extrinsic evidence that might aid the court in making its decision.[441]

The foregoing questions should be raised and resolved as early in the case as possible, as they will govern the extent and types of evidence that may be submitted to the trier of fact, as well as the extent to which the

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[439]"Maybe" is not really a viable answer to question one—there either is or is not a written agreement regarding the subject matter at issue. Whether a "Maybe" answer to questions two, three, or four, in and of itself, will permit the introduction of extrinsic evidence depends in large part on the underlying presumptions regarding integration and ambiguity. Applying the Texas common-law presumption in favor of full integration and the burden imposed by Texas law on a party asserting ambiguity, *see supra* Parts III.B.3.a and III.A.1 & .3, respectively, any answer other than a clear "No" will be presumed to be a "Yes." On the other hand, applying the presumptions in the second Restatement or the UCC, any answer to questions two, three, or four other than a clear "Yes" will be presumed to be a "No." *See supra* Part III.B.3.b and *infra* Part III.F.1.

[440]*See supra* Part III.C.

[441]*See* Corbin, *supra* note 437, at 609-10; RESTATEMENT (SECOND) OF CONTRACTS § 209 cmt. c (1981) ("Whether a writing has been adopted as an *integrated* agreement is a question of fact to be determined [by the trial judge] in accordance with all relevant evidence." (emphasis added)); *id.* § 210 cmt. b ("That a writing was or was not adopted as a *completely integrated* agreement may be proved by any relevant evidence." (emphasis added)); *id.* § 212 cmt. b ("Any determination of meaning or *ambiguity* should only be made in the light of the relevant evidence . . . ." (emphasis added)); *id.* § 213 cmt. b ("To apply this [parol evidence] rule, the court must make preliminary determinations that there is an integrated agreement and that it is *inconsistent* with the term in question. Those determinations are made in accordance with all relevant evidence . . . ." (emphasis added)). *See generally* HUNTER, *supra* note 1, ¶ 7.03[1][a], at 7-10.

written agreement will be open to interpretation.[442]

### *E. Consideration of Extrinsic Evidence by the Trial Court and the Factfinder Under Texas Common Law: A Summary*[443]

In summary, extrinsic evidence proffered to assist in the construction or interpretation of a written agreement may be considered as follows:

#### 1. The Trial Court's Threshold Determination of Integration

In determining whether a contract term is integrated, the trial court may freely consider extrinsic evidence of surrounding circumstances, including custom and usage, course of dealing, and the like.[444]

#### 2. The Trial Court's Threshold Determination of Ambiguity

In determining whether a contract term (integrated or not) is ambiguous, the trial court, likewise, may freely consider extrinsic evidence of surrounding circumstances.[445]

#### 3. Construing and Interpreting Integrated Terms

If the trial court finds that a contract term is integrated, it must still decide whether the term is ambiguous (as above).

##### *a. Integrated, Ambiguous Terms*

If the court finds that an integrated term or provision is ambiguous, the factfinder should be permitted to consider evidence of *alternative, but not contradictory,* interpretations of the ambiguous term.[446]

##### *b. Integrated, Unambiguous Terms*

If the court finds that an integrated term or provision is unambiguous, the trial court should construe the term, as a matter of law, considering

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[442]*See generally* HUNTER, *supra* note 1, ¶ 7.03[1][a], at 7-10 & n.62.

[443]The structure of this summary is drawn from Adams, *supra* note 244, at 254-55.

[444]*See* RESTATEMENT (SECOND) OF CONTRACTS § 209 reporter's note to cmt. c; *id.* § 213 cmt. b. *See generally supra* Part II.C.1.

[445]*See supra* Parts III.A.3.a and III.B.3; *see also supra* Parts III.A.1 and III.A.2.

[446]*See* Lenape Resources Corp. v. Tennessee Gas Pipeline Co., 925 S.W.2d 565, 574 (Tex. 1996); Sun Oil Co. v. Madeley, 626 S.W.2d 726, 732 (Tex. 1981); R & P Enters. v. LaGuarta, Gavrel & Kirk, Inc., 596 S.W.2d 517, 519 (Tex. 1980); Sidelnik v. American States Ins. Co., 914 S.W.2d 689, 691 (Tex. App.—Austin 1996, writ denied) (all holding that the trier of fact is free to consider extrinsic evidence to interpret an ambiguous contract or contractual provision).

extrinsic evidence of surrounding circumstances.[447] The factfinder plays no role in the construction or interpretation of integrated, unambiguous terms.[448]

4. Construing and Interpreting Unintegrated Terms

If the trial court finds that a contract term is not integrated, the parol evidence rule will not bar either the trial court or the factfinder from considering extrinsic evidence of terms that contradict, alter, add to, subtract from, or otherwise modify the written, unintegrated term.[449]

*a. Unintegrated, Ambiguous Terms*

If the court finds that an unintegrated term is ambiguous, the factfinder must decide the terms of the agreement.[450] In so doing, the factfinder is free to consider extrinsic evidence of terms that contradict, alter, add to, subtract from, or otherwise modify the written, unintegrated term.

*b. Unintegrated, Unambiguous Terms*

If the court finds that an unintegrated term is unambiguous, the trier of fact is free to consider extrinsic evidence to "fill in" the missing portion(s) of the agreement.[451] However, the trier of fact may not consider extrinsic evidence that alters or contradicts any portion of the written agreement which is integrated.[452] In such a case, the trial court should instruct the jury, considering extrinsic evidence of surrounding circumstances, on the meaning of the unambiguous term.[453]

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[447]*See, e.g.*, Hussong v. Schwan's Sales Enters., 896 S.W.2d 320, 324 (Tex. App.—Houston [1st Dist.] 1995, no writ); GT & MC, Inc. v. Texas City Ref., Inc., 822 S.W.2d 252, 255-56 (Tex. App.—Houston [1st Dist.] 1991, writ denied).

[448]*See* Hycarbex, Inc. v. Anglo-Suisse, Inc., 927 S.W.2d 103, 108-10 (Tex. App.—Houston [14th Dist.] 1996, no writ); *Sidelnik*, 914 S.W.2d at 692 (citing *R & P Enters.*, 596 S.W.2d at 518, and Birdwell v. Birdwell, 819 S.W.2d 223, 229 (Tex. App.—Fort Worth 1991, writ denied)).

[449]*See* Matthews v. Drew Chem. Corp., 475 F.2d 146, 148-50 (5th Cir. 1973); Walley v. Bay Petroleum Corp., 312 F.2d 540, 543-44 (5th Cir. 1963) (both applying analogous Florida law).

[450]*See supra* note 213 and accompanying text; *see also supra* Part III.E.3.a.

[451]*See, e.g.*, Morrow v. Chicago Trading Corp., 435 S.W.2d 301, 303-04 (Tex. Civ. App.—Dallas 1968, writ ref'd n.r.e.) (collecting cases).

[452]*See id.*; *see also Matthews*, 475 F.2d at 150 (applying analogous Florida law).

[453]*See* Adams, *supra* note 244, at 254.

## F. The Admissibility Under the Uniform Commercial Code of Extrinsic Evidence Otherwise Subject to the Parol Evidence Rule

The Uniform Commercial Code, as adopted in Texas,[454] provides a codification of the parol evidence rule as it pertains to contracts for the sale or lease of goods,[455] as well as for negotiable instruments.[456] These codified versions of the parol evidence rule are presumed to "trump" the "plain meaning" and other approaches to construing and interpreting contracts—*even fully integrated contracts*—between commercial actors.[457]

### 1. Uniform Commercial Code Sections 2.202 and 2A.202[458]

Even in the case of an integrated, unambiguous contract or contractual provision for the sale or lease of goods,[459] contractual terms may be explained or supplemented by evidence of course of dealing, usage of trade, course of performance, or evidence of consistent additional terms.

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[454]*See* TEX. BUS. & COM. CODE ANN. §§ 1.101-11.108 (Vernon 1994 & Supp. 1996).

[455]*See id.* §§ 2.202 & 2A.202; *see also* Bob Robertson, Inc. v. Webster, 679 S.W.2d 683, 688 (Tex. App.—Houston [1st Dist.] 1984, no writ) (holding that section 2.202 applies to the sale of goods); *accord* King v. Fordice, 776 S.W.2d 608, 611 (Tex. App.—Dallas 1989, writ denied).

[456]*See* TEX. BUS. & COM. CODE ANN. § 3.117 (Vernon Supp. 1996).

[457]The Texas Uniform Commercial Code

> rejects both the "lay-dictionary" and the "conveyancer's" reading of a commercial agreement. Instead the meaning of the agreement of the parties is to be determined by the language used by them and by their action, *read and interpreted in light of commercial practices* and other surrounding circumstances. The measure and background for interpretation are set by the commercial context *which may explain and supplement even the language of a [fully integrated] writing.*

TEX. BUS. & COM. CODE ANN. § 1.205 cmt. 1 (Vernon 1994) (emphasis added). While a contract for the sale of goods may be subject to the more lenient section 2.202 of the UCC, the stricter common-law parol evidence rule has been applied to, inter alia, agreements regarding payment schedules for overdue invoices for goods purchased, *see, e.g.*, Beijing Metals & Minerals Import/Export Corp. v. American Bus. Ctrs., Inc., 993 F.2d 1178, 1183 & n.10 (5th Cir. 1993), and agreements regarding the payment of damages incurred due to the breach of a contract for the sale of goods, *see, e.g.*, Jack H. Brown & Co. v. Toys "R" Us, Inc., 906 F.2d 169, 170-73 (5th Cir. 1990).

[458]Section 2A.202, regarding the parol evidence rule applicable to contracts for the lease of goods, is identical to 2.202, except for the parenthetical cross-reference. *See* TEX. BUS. & COM. CODE ANN. § 2A.202 (Vernon 1994).

[459]The Code contains other parol evidence provisions governing matters other than the sale or lease of goods. *See supra* Part III.B.3.b. However, for present purposes, this discussion is confined to Articles 2 and 2A.

> Terms with respect to which the confirmatory memoranda of the parties agree or which are otherwise set for 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*
>
> (1) by course of dealing or usage of trade (Section 1.205) or by course of performance (Section 2.208); and
>
> (2) by evidence of consistent additional terms *unless* the court finds the writing to have been intended also as a complete and exclusive statement of the terms of the agreement.[460]

Section 2.202 dispenses with the presumption that a written contract is fully integrated,[461] as well as "[t]he requirement that a condition precedent to the admissibility of the type of evidence specified in paragraph (a) is an original determination by the court that the language used is ambiguous."[462]

According to the Fifth Circuit, section 2.202

> adds a third level to the traditional two-level [ambiguity] inquiry. Instead of asking, "Were the contract terms ambiguous" and then, "If they were ambiguous what do they mean in light of extrinsic evidence," the Code poses *three* inquiries:
>
> 1. Were the express contract terms ambiguous?
>
> 2. If not, are they ambiguous after considering evidence of course of dealing, usage of trade, and course of performance?

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[460]TEX. BUS. & COM. CODE ANN. § 2.202 (Vernon 1994) (emphases added). *See generally* Franz Chem. Corp. v. Philadelphia Quartz Co., 594 F.2d 146, 149 (5th Cir. 1979) (outlining the various parol evidence provisions in section 2.202 and their effects on the issues before the court).

[461]TEX. BUS. & COM. CODE ANN. § 2.202 cmt. 1(a); *accord* King v. Fordice, 776 S.W.2d 608, 611 (Tex. App.—Dallas 1989, writ denied).

[462]TEX. BUS. & COM. CODE ANN. § 2.202 cmt. 1(c); *accord* Paragon Resources, Inc. v. National Fuel Gas Distrib. Corp., 695 F.2d 991, 995 (5th Cir. 1983).

> 3. If the express contract terms by themselves are ambiguous, or if the terms are ambiguous when course of dealing, usage of trade, and course of performance are considered (that is, if the answer to either of the first two questions is yes), what is the meaning of the contract in light of *all* extrinsic evidence?[463]

The first inquiry is a question of law; the third inquiry is a question of fact.[464] The "thorny problem," in the words of the Fifth Circuit, is determining whether the second inquiry is one of law, fact, or both.[465] Neither the Texas courts nor the Fifth Circuit has as yet resolved this thorny question.

Section 2.202 also clarifies, for purposes of disputes over contracts subject to Article 2, that language used in a written contract should be afforded "the meaning which arises out of the commercial context in which it was used," rather than the meaning that might be attributed to it "by rules of construction existing in the [common] law."[466] According to the official commentary to section 2.202, written contracts for the sale of goods

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[463]*Paragon Resources*, 695 F.2d at 996. As discussed above, the court should undertake its ambiguity inquiry only *after* determining that (1) there is a valid written agreement covering the subject matter of the proffered extrinsic evidence, (2) the written agreement constitutes the parties' final agreement regarding the subject matter of the proffered extrinsic evidence, and (3) the written agreement constitutes the complete agreement of the parties regarding the subject matter of the proffered evidence. *See supra* Part III.D. And, if the court finds the agreement lacking on one or more of the "elements" required to exclude extrinsic evidence under the parol evidence rule, it should admit the proffered extrinsic evidence and permit the trier of fact to consider it fully. *See, e.g.*, Hideca Petroleum Corp. v. Tampimex Oil Int'l, Ltd., 740 S.W.2d 838, 845 (Tex. App.—Houston [1st Dist.] 1987, no writ) (affirming the trial court's decision to consider extrinsic evidence to determine the parties' true intent where the written agreement "was not intended by the parties to be a complete and exclusive statement of the terms of the contract." (applying TEX. BUS. & COM. CODE ANN. § 2.202)).

[464]*See Paragon Resources*, 695 F.2d at 996.

[465]*Id.* Eleven years later, the Fifth Circuit again took the opportunity not to decide whether the effect of trade usage, course of dealing, and course of performance was to be determined by the court as a matter of law or by the trier of fact. *See* Bloom v. Hearst Entertainment, Inc., 33 F.3d 518, 522-23 (5th Cir. 1994) (quoting the passage above from *Paragon Resources*, observing that the *Paragon Resources* court did not resolve the question of who was to answer the second inquiry, and then failing to resolve the issue itself).

[466]TEX. BUS. & COM. CODE ANN. § 2.202 cmt. 1(b).

> are to be read on the assumption that the course of prior dealings between the parties and the usages of trade were taken for granted when the document was phrased. *Unless carefully negated they have become an element of the meaning of the words used.* Similarly, the course of actual performance by the parties is considered the best indication of what they intended the writing to mean.[467]

As the Fifth Circuit explained more than twenty-five years ago:

> Evidence of course of dealing and usage of trade [is] necessarily and properly admissible to explain, qualify, or supplement the provisions of [the] written agreement. In providing for the admission of such evidence, the [UCC] manifests the law's recognition of the fact that perception is conditioned by environment: unless a judge considers a contract in the proper commercial setting, his view is apt to be distorted or myopic, increasing the probability of error.[468]

### *a. Course of Dealing*

"A course of dealing is a *sequence* of previous conduct between the parties to a particular transaction which is fairly to be regarded as establishing a common basis of understanding for interpreting their expressions and other conduct."[469] "A course of dealing between parties . . . give[s] particular meaning to and supplement[s] or qualif[ies] terms of an agreement."[470] The parties' course of dealing "may enter the agreement *either* by explicit provisions or the agreement *or* by tacit recognition" arising out of prior conduct.[471]

"[A] single transaction cannot constitute a course of dealing" as that term is defined in section 1.205.[472] The parties' course of dealing "is restricted, literally, to a sequence of conduct between the parties previous to

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[467]*Id.* § 2.202 cmt. 2 (emphasis added).

[468]Chase Manhattan Bank v. First Marion Bank, 437 F.2d 1040, 1046 (5th Cir. 1971).

[469]TEX. BUS. & COM. CODE ANN. § 1.205(a) (emphasis added).

[470]*Id.* § 1.205(c).

[471]*Id.* cmt. 3 (emphasis added).

[472]International Therapeutics, Inc. v. McGraw-Edison Co., 721 F.2d 488, 491 (5th Cir. 1983); *see also* Kern Oil & Ref. Co. v. Tenneco Oil Co., 792 F.2d 1380, 1385 (9th Cir. 1986) (applying Texas law).

the agreement."[473]

### b. *Usage of Trade*

Section 1.205 of the Texas Uniform Commercial Code provides, inter alia:

> (b) A usage of trade is any practice or method of dealing having such regularity of observance in a place, vocation or trade as to justify an expectation that it will be observed with respect to the transaction in question. The existence and scope of such a usage are to be proved as facts. . . .
>
> (c) . . . [A]ny usage of trade *in the vocation or trade* in which [the parties] are engaged or of which they are or should be aware give[s] particular meaning to and supplement[s] or qualif[ies] terms of an agreement.
>
> . . . .
>
> (e) An applicable usage of trade *in the place where any performance is to occur shall* be used in interpreting the agreement as to that part of the performance.[474]

The language of any commercial contract "is to be interpreted as meaning what it may be fairly expected to mean to parties involved in the particular commercial transaction in a given locality or in a given vocation or trade."[475] Usages of trade "furnish the background and give particular meaning to the language used, and are the framework of common understanding controlling any general rules of law which hold only when there is no such understanding."[476] To be recognized as such, usages of trade are not required to be " 'ancient or immemorial,' 'universal,' or the like";[477] rather, section 1.205(b) encompasses "usages currently observed by the great majority of decent dealers, even though dissidents ready to cut corners do not agree."[478]

The existence and scope of trade usage by which the terms of a sales

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[473]TEX. BUS. & COM. CODE ANN. § 1.205 cmt. 2.

[474]*Id.* § 1.205(b), (c) & (e) (emphases added).

[475]*Id.* § 1.205 cmt. 4.

[476]*Id.*

[477]*Id.* cmt. 5.

[478]*Id.*

contract may be explained are fact questions.[479] Trade usage may supplement or explain, but may not contradict the express terms of a contract.[480] However, if the usage of trade supplements the written agreement to the extent that it "effectively created a new contract," then the proffered evidence of trade usage has been held to violate the parol evidence rule.[481]

In *Raney v. Uvalde Producers Wool & Mohair Co.*, Raney and Uvalde entered into a written contract whereby Raney would sell to Uvalde 25,000 fleeces, composed of "1973 Spring Adult and Spring Kid Mohair," at a price of $1.47 per pound and $1.75 per pound, respectively.[482] Raney delivered 41,000 pounds of Mohair, which Uvalde, citing the commonly accepted meaning of "fleeces" in the mohair industry, claimed was some 46,500 pounds less than called for under the contract. As a result, Uvalde was required to purchase 46,500 pounds of mohair on the open market in order to satisfy its commitments to the buyer it had lined up for Raney's mohair.[483] Uvalde sued Raney for the difference between the open market price of $2.07 per pound and the contract prices for the 46,500 pounds Uvalde claimed that Raney was deficient.[484] The trial court, following a jury trial, entered judgment in Uvalde's favor based, inter alia, on a finding that "the word 'fleeces' had a well recognized meaning based upon the usage of trade in the mohair industry, that the weight of a Spring fleece of kid mohair was three pounds on the average and that the weight of a Spring fleece of adult mohair was four pounds on the average."[485] On appeal, Raney argued that "fleece" meant "all the mohair from one goat and therefore he was contracting for 25,000 head of goats."[486] Raney further argued that Uvalde's attempted conversion of 25,000 fleeces into pounds resulted in "a failure of the meeting of the minds of the contracting par-

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[479]*See* Pennzoil Co. v. Federal Energy Regulatory Comm'n, 789 F.2d 1128, 1143 (5th Cir. 1986); Printing Ctr., Inc. v. Supermind Pub. Co., 669 S.W.2d 779, 784 (Tex. App.—Houston [14th Dist.] 1984, no writ); MortgageAmerica Corp. v. American Nat'l Bank, 651 S.W.2d 851, 859 (Tex. App.—Austin 1983, writ ref'd n.r.e.).

[480]*See* Liberty Enters. v. Moore Transp. Co., 679 S.W.2d 779, 785 (Tex. App.—Fort Worth 1984), *aff'd in part and rev'd in part on other grounds*, 690 S.W.2d 570 (Tex. 1985); *Printing Ctr.*, 669 S.W.2d at 784.

[481]Corso v. Carr, 634 S.W.2d 804, 809 (Tex. App.—Fort Worth 1982, writ ref'd n.r.e.); *accord Liberty Enters.*, 679 S.W.2d at 785.

[482]571 S.W.2d 199, 199 (Tex. Civ. App.—San Antonio 1978, writ ref'd n.r.e.).

[483]*See id.* at 199-200.

[484]*See id.* at 200.

[485]*Id.*

[486]*Id.*

ties—and, therefore, there was no contract."[487]

Noting that "parol evidence is admissible to explain usage of trade," the court of civil appeals found that there was ample evidence in the record to show that in the business of mohair production the word "fleeces" has the well-understood meaning attributed to it by both Uvalde and the trial court.[488]

> [Raney] would be expected to contract for the sale of his mohair with full knowledge of the factors and usage of trade that are peculiar to the business of mohair production and marketing. He had been in the mohair business since 1966 and there was testimony to the effect that he was the largest producer of mohair in the area .... *This contract is to be read on the assumption that the usage of trade was taken for granted when the contract was phrased*, and unless it has been carefully negated in the contract, it [*i.e.*, the usage of trade] has become an element of the meaning of the word "fleece."[489]

### c. *Course of Performance*

> Where the contract for sale involves repeated occasions for performance by either party with knowledge of the nature of the performance and opportunity for objection to it by the other, any course of performance accepted or acquiesced in without objection *shall* be relevant to determine the meaning of the agreement.[490]

"[C]ourse of performance is *always* relevant to determine the meaning of the agreement."[491] A single act or omission does not constitute a course of performance.[492] As with course of dealing and trade usage, extrinsic evidence of course of performance may supplement or explain, but *may*

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[487] *Id.*

[488] *Id.* (citing Burdette v. Cook Indus., 544 S.W.2d 495 (Tex. Civ. App.—Corpus Christi 1976, writ dism'd w.o.j.)).

[489] *Id.* at 200-01 (citation omitted) (emphasis added).

[490] TEX. BUS. & COM. CODE ANN. § 2.208(a) (Vernon 1994) (emphasis added). Section 2A.207 sets forth the analogous provision regarding lease contracts. *Id.* § 2A.207(a).

[491] *Id.* § 2.208 cmt. 2 (emphasis added).

[492] *See id.* cmt. 4.

*not contradict*, the express terms of a contract.[493]

In *Krupp Organization v. Belin Communities, Inc.*, the court of civil appeals considered the effect of the parties' course of performance of an agreement between a printer of promotional brochures (Krupp) and a resort community (Elkins Lake).[494] The written agreement called for the preparation of 250,000 brochures at a cost to Elkins Lake of $235 per 1,000, plus postage.[495] Shortly after the execution of the written agreement, the parties appear to have modified the order so that Krupp would provide 50,000, rather than 250,000 brochures.[496] The question before the court was whether the 50,000 quantity constituted a "first printing" or the entire agreement.[497] The parties proffered several writings to the trial court, the cumulative effect of which was to complicate, rather than clarify, the question of quantity due as agreed by the parties.[498]

The court of civil appeals, reviewing the trial court record, concluded that the trial judge was entitled to conclude from the documentary evidence that the agreement for 250,000 units "was not intended by the parties as a final expression of their agreement as to the number of mailings and to admit parol evidence to clarify the parties' dealings."[499] In light of the trial testimony and other evidence extrinsic to the proffered agreement, the court of civil appeals concluded that the trial court's findings were amply supported by evidence of the course of the parties' performance.[500]

> The testimony . . . as to the number of units agreed upon is conflicting and the documentary evidence is not clear as to whether the parties had agreed to reduce the order to 50,000 units or had merely agreed to start performance of the contract by a first printing of 50,000 units. . . . Section 2.208(a) of the Code concerning course of performance . . . recognizes that the parties know best what they mean and that their actions under their agreement are the best indication of its meaning.

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[493]*See* Liberty Enters. v. Moore Transp. Co., 679 S.W.2d 779, 785 (Tex. App.—Fort Worth 1984) (citing Texas Ill. Co. v. Gant, 251 S.W. 575, 577 (Tex. Civ. App.—Amarillo 1923, no writ)), *aff'd in part and rev'd in part on other grounds*, 690 S.W.2d 570 (Tex. 1985).

[494]582 S.W.2d 514, 516-19 (Tex. Civ. App.—Houston [1st Dist.] 1979, writ ref'd n.r.e.).

[495]*See id.* at 518.

[496]*See id.*

[497]*See id.* at 519.

[498]*See id.*

[499]*Id.*

[500]*See id.*

> There was introduced into evidence a Krupp invoice for 47,240 brochures, the number actually printed and mailed. This invoice outlined the mailing schedule and was backed up by individual invoices for each of them. Heard [Elkins Lake's representative] testified that [Krupp] agreed to a sample mailing but cautioned Heard that a smaller printing run would cost more than the quoted price of $235 per thousand. According to Heard, the additional cost was $65 or $75 per thousand, and Feinstock [Krupp's representative] was to invoice Elkins Lake for the difference in price between mailing out 50,000 and 250,000 brochures. The invoices admitted into evidence reflect this additional cost of $66.52 per thousand. The third mailing consisted of 2000 at $66.52 additional charge per thousand and 7196 at $71.52 additional cost per thousand. The remaining invoices each reflected an additional charge of $71.52 per thousand. These additional charges amounted to $3,318.60 plus postage, etc., for a total of $6,210.17. This course of performance was capable of being taken to substantiate Elkins Lake's contention that the only final agreement was for a sample mailing of 50,000 brochures.[501]

Having determined that the parol evidence was admissible, the court of civil appeals found sufficient evidence to support the trial court's findings.[502]

The dispute in *Kern Oil & Refining Co. v. Tenneco Oil Co.* revolved around the following contract terms:

> Crude oil from the above leases will be balanced against crude oil sold to Tenneco by [Kern Oil] up to 3,000 barrels per day. All stripper crude oil from the above leases and the Rosecrans Field . . . will be sold at the appropriate lower tier price. Each month, enough oil from the Yowlumne Field will be sold at the lower tier price to make the total stripper and Yowlumne crude oil sold at the lower tier price equal to 3,000 barrels per day. *The remaining barrels produced from the Yowlumne Field will*

[501] *Id.* (citation omitted).

[502] *See id.*

> *be sold at the upper tier price, and the non-stripper leases will be sold at the appropriate lower or upper tier prices.*[503]

The Ninth Circuit, applying Texas law, attempted to resolve the meaning of the contractual terms in light of evidence proffered regarding the parties' course of performance under the contract:

> Contrary to Tenneco's assertions, the record reveals that the meaning of the term "upper tier price" was virtually undisputed. The "upper tier price" was the price charged for crude oil that was subject to the upper tier ceiling price. The upper tier price was less than or equal to the upper tier ceiling price, depending on market conditions. Crude oil that was not subject to the upper tier ceiling price was sold at the "lower tier price" or the "uncontrolled price," depending on the type of oil. "New" crude oil that was not subject to the upper tier ceiling price was sold at the "uncontrolled price." . . .
>
> The district court made the following finding of fact:
>
> The term "upper-tier price," as used in the May 19, 1977 agreement, is unambiguous. Upper-tier ceiling prices are specific ceiling prices established by DOE regulations and computed by a formula set forth in those regulations. Posted upper-tier prices are prices at or below upper-tier ceiling prices, published in price bulletins issued by major oil companies. The term "upper-tier price" does not mean uncontrolled market prices posted for crude oil released by the government from price controls.[504]

The Ninth Circuit affirmed the district court's finding.[505]

Tenneco argued, inter alia, that the record supported a course of performance under the subject agreement contrary to the district court's findings.[506] The court of appeals disposed of Tenneco's arguments as follows:

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[503]792 F.2d 1380, 1381 (9th Cir. 1986) (alteration in original) (applying Texas law).

[504]*Id.* at 1383-84 (citations omitted).

[505]*See id.* at 1390.

[506]*See id.*

> To avoid the prohibition contained in section 2-208(2), Tenneco must show that the extrinsic evidence "explains" or "supplements" the express terms of the contract. The extrinsic evidence cited by Tenneco does not show that "upper tier price" has a meaning different from the meaning found by the district court. As a result, the extrinsic evidence does not "explain" that term. The remaining inquiry is whether the extrinsic evidence "supplements" the contract. To be admissible under that theory, the extrinsic evidence must tend to show that the parties intended for Tenneco to charge the highest available market price without the need to negotiate with Kern Oil in the event of deregulation. A careful review of the record reveals that Tenneco's extrinsic evidence did not meet that requirement.
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> . . . .
>
> Tenneco also asserts that the record shows four occasions on which Tenneco sold crude oil to Kern Oil at prices higher than those authorized by the contract. Tenneco claims that this evidence establishes a course of performance. In fact, the record reveals that each price variation was negotiated. Accordingly, the four occasions cited by Tenneco do not establish a course of performance contrary to the district court's findings.
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> Finally, Tenneco argues that Kern Oil's payment of the invoices in 1980 establishes a course of performance. To the extent that Kern Oil acted under a mistake of fact, however, its payment of the invoices cannot constitute a course of performance.[507]

## 2. Construing and Interpreting Agreements Governed by the UCC

> The express terms of the agreement and any . . . course of performance, as well as any course of dealing and usage of trade, shall be construed whenever reasonable as

[507] *Id.* at 1385 (citation omitted) (footnote omitted).

> consistent with each other; but when such construction is unreasonable, *express terms shall control course of performance and course of performance shall control both course of dealing and usage of trade* . . . .[508]

Furthermore,

> [t]he express terms of an agreement and an applicable course of dealing or usage of trade shall be construed whenever reasonable as consistent with each other; but when such construction is unreasonable express terms control both course of dealing and usage of trade and course of dealing controls *usage of trade*.[509]

In *Corenswet, Inc. v. Amana Refrigeration, Inc.*, the Fifth Circuit considered a clear conflict between the express contract provisions, which gave Amana the right to terminate Corenswet's distributorship, and Amana's past course of performance under the same contract with Corenswet and other distributors.[510] The court stated:

> The Code commands that express contract terms and "an applicable course of dealing or usage of trade shall be construed wherever reasonable as consistent with each other." In this case, however, no reasonable construction can reconcile the contract's express terms with the interpretation Corenswet seeks to glean from the conduct of the parties. The conflict could not be more complete: Amana's past conduct, with regard to both Corenswet and . . . its other distributors, may have created a reasonable expectation that Amana would not terminate a distributorship arbitrarily, yet the contract expressly gives Amana the right to do so. We can find no justification, except in cases of conduct of the sort giving rise to promissory estoppel, for holding that a contractually reserved power, however distasteful, may be lost through nonuse. *The express contract term cannot be construed as Coren-*

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[508]TEX. BUS. & COM. CODE ANN. § 2.208(b) (Vernon 1994) (emphasis added). Section 2A.207(b) sets forth the analogous provision regarding lease contracts. *Id.* § 2A.207(b).

[509]*Id.* § 1.205(d) (emphasis added); *see also* RESTATEMENT (SECOND) OF CONTRACTS § 203(b) (1981) (setting forth the same priority scheme established in TEX. BUS. & COM. CODE ANN. §§ 1.205(d) & 2.208(b) for all contracts, not only those governed by the UCC).

[510]594 F.2d 129 (5th Cir. 1979) (applying Iowa's version of the UCC).

> *swet would const[rue] it, and it therefore controls over any allegedly conflicting usage or course of dealing.*[511]

### 3. Consistent Additional Terms

Under the comment to section 2.202(2) of the Texas Uniform Commercial Code,

> consistent additional terms, not reduced to writing, may be proved unless the court finds that the writing was intended by both parties as a complete and exclusive statement of all terms. If the additional terms are such that, if agreed upon, they would certainly have been included in the document in the view of the court, then evidence of their alleged making must be kept from the trier of fact.[512]

Where a written agreement is determined not to be the final and complete expression of the parties' agreement, courts have permitted extrinsic evidence of additional consistent terms. For example, in *Conner v. May*, May and Conner entered into a written agreement for the sale and delivery of cattle three months hence.[513] The trial court permitted extrinsic evidence of an oral agreement regarding how the cattle were to be fed between the date of the agreement and the date of delivery based upon the testimony of May and Bush, a disinterested third party who was present when May and Conner executed their agreement.[514] The court of civil appeals recited: "May and Bush . . . testified that when the writing was signed, both May and Conner recognized that the paper did not encompass

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[511] *Id.* at 136 (citations omitted) (emphasis added).

[512] TEX. BUS. & COM. CODE ANN. § 2.202(2) cmt. 3. Section 216 of the Second Restatement takes a similar position as the UCC, but in some ways goes further toward allowing evidence of consistent additional terms:

> (1) Evidence of a consistent additional term is admissible to supplement an integrated agreement unless the court finds that the agreement was completely integrated.
>
> (2) An agreement *is not* completely integrated if the writing omits a consistent additional agreed term which is
>
> (a) agreed to for separate consideration, or
>
> (b) such a term as in the circumstances might naturally be omitted from the writing.

RESTATEMENT (SECOND) OF CONTRACTS § 216 (emphasis added).

[513] 444 S.W.2d at 948, 949 (Tex. Civ. App.—Austin 1969, writ ref'd n.r.e.).

[514] *See id.* at 950.

the feeding agreement, which they orally reaffirmed at the time. Conner himself testifie[d] the writing 'just covered the meat of the contract' . . . ."[515]

The court of civil appeals affirmed the trial court's finding that the parties did not intend the written agreement to be a fully integrated contract.[516] In particular, the court found that the custom and usage of those trading in livestock was to have a separate agreement regarding the feeding of cattle and that often such agreements were oral.[517] Because the parties did not intend for the written contract to reflect their entire agreement or to incorporate every term thereof, the testimony concerning the alleged oral agreement regarding the feeding of the cattle was permissible as it did not contradict any of the stated terms.[518]

## IV. CONCLUSION

As the foregoing discussion demonstrates, the rules of construction and interpretation will often play a dispositive role in Texas contract litigation. Because the effect of these rules can be felt even in cases where no issue of ambiguity or integration exists, attorneys must always account for the impact of these rules, whether the task is drafting an agreement that will be subject to Texas law, or planning litigation strategy in a contract dispute.

The careful lawyer will also recognize, whether drafting an agreement or litigating the meaning of one, that the parol evidence rule has become a rule more in name than in effect. The many judicially-created exceptions to the rule, and the several exceptions added by the express provisions of the Uniform Commercial Code, dramatically increase the probability that, when the scope of the parties' agreement is in dispute, extrinsic proof may be considered by the finder of fact in resolving that dispute. When ambiguity or non-integration is found to exist, the probability that the trier of fact will hear such proof becomes a certainty.

The consequence of all this need not be to render the effect of the written word unpredictable. Care and precision in the drafting of written agreements will always lend greater certainty to their interpretation. But precision in the drafting of agreements means more than simply the proper choice of words. Attorneys must also be mindful of the rules of interpre-

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[515] *Id.* at 953.

[516] *See id.* at 954.

[517] *See id.* at 953.

[518] *See id.* at 954.

tation and integration described above, the potential for ambiguity, the effect of technical terms, relevant industry custom, and other surrounding circumstances. Many different dictionaries may be consulted when construing and interpreting the terms of a written agreement, and the careful attorney will take each of them into account when drafting agreements or litigating their effect.

The careful lawyer will also remember, perhaps above all else, that prolixity will never substitute for clarity. If there were any doubt of this, the following exchange will be sobering:

> *Mephistopheles: In sum—have words to lean upon,*
> *And through that trusty gateway, lexicon,*
> *You pass into the shrine of certainty.*
>
> *Student: Yet with each word there must a concept be.*
>
> *Mephistopheles: Oh, quite—no need, though, to be racking*
> *One's brain, for just where concept's lacking*
> *A word in time supplies the remedy.*
>
> —Johann Wolfgang von Goethe[519]

[519]JOHANN WOLFGANG VON GOETHE, FAUST pt. I, 47 (Cyrus Hamlin ed., W.W. Norton & Co. 1976).