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# CONTRACT INTERPRETATION IN CALIFORNIA: PLAIN MEANING, PAROL EVIDENCE AND USE OF THE “JUST RESULT” PRINCIPLE

Harry G. Prince\*

*In reaching a just and fair result in this case, does it matter that, personally, one might not like the plaintiffs? The city is doing a wonderful thing—it uses, or it proposes to use the land for a park. Should that play a role here, or is the sole issue before the court what is the fair result reached under principles of law?*<sup>1</sup>

*As [opposing counsel] so quaintly pointed out in his reply brief, this case is about title, it's not about virtue. We're glad they agree.*<sup>2</sup>

## I. INTRODUCTION

A steady stream of cases involving contract interpretation issues emanates from the California courts. In addition to a large number of insurance contract cases,<sup>3</sup> the interpretation disputes address many other interesting agreements, including a contract for development of Hard Rock Cafes in the United States years before the restaurants began to enjoy tremendous success,<sup>4</sup> a deed involving contested

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1. Scott Graham, *Bounty Hunters, Robber Barons and the High Court*, THE RECORDER, Feb. 23, 1996, at 1 (quoting California Supreme Court Justice Joyce Kennard in oral arguments of *City of Manhattan Beach v. Superior Court*, at 13 Cal. 4th 232, 267, 914 P.2d 160, 183, 52 Cal. Rptr. 2d 82, 105 (1996) (Kennard, J., dissenting)).

2. *Id.* (quoting Joseph Dzida, attorney for plaintiff heirs, challenging sale of land from railway to the city in oral arguments of *City of Manhattan Beach*, at 13 Cal. 4th 232, 914 P.2d 160, 52 Cal. Rptr. 2d 82).

3. The insurance cases invariably involve similar questions of contract interpretation, although in varied contexts, and discuss whether a policy covers a particular incident. The insurance cases also involve somewhat specialized rules. See *infra* notes 74-86 and accompanying text.

4. See *Okun v. Morton*, 203 Cal. App. 3d 805, 809, 250 Cal. Rptr. 220, 222 (1988), discussed *infra* Part III.A.

ownership of railway right-of-way land located in the Los Angeles suburb of Manhattan Beach and worth as much as \$100 million some one hundred years after the deed's execution,<sup>5</sup> and an employment agreement to pay singer Peggy Lee for speaking and singing performances for the very popular Disney animated film *Lady and The Tramp* almost thirty years before the development of video cassettes as a popular method of distribution.<sup>6</sup>

These cases illustrate the inherent difficulties that courts face in identifying the parties' intent through the rules of contract interpretation, and the likelihood that courts often seek to impose a "just result" in such cases. A cursory examination of *City of Manhattan Beach v. Superior Court*,<sup>7</sup> a recent California Supreme Court case, reveals the difficulties of interpreting contracts and the court's imposition of a "just result" when parties have not expressed any discoverable intent as to a particular, probably unforeseen, situation.

In 1887 the Redondo Land Company ("Land Company") purchased a parcel of land located primarily in the present-day Los Angeles suburb of Manhattan Beach.<sup>8</sup> The next year the company conveyed an interest in a portion of the property to the Redondo Beach Railway ("Railway") for "construction, maintenance and operation of a Steam Railroad . . . ."<sup>9</sup> The wording of the conveyance did not

5. See *City of Manhattan Beach v. Superior Court*, 13 Cal. 4th 232, 914 P.2d 160, 52 Cal. Rptr. 2d 82 (1996), cert. denied, 117 S. Ct. 511 (1996), discussed *infra* Part III.B.

6. See *Lee v. Walt Disney Co.*, No. B058897 (Cal. Ct. App. Sept. 30, 1992) (unpublished opinion), cert. denied, 1992 Cal. LEXIS 6172 (Dec. 16, 1992), discussed *infra* Part III.C.

7. 13 Cal. 4th 232, 914 P.2d 160, 52 Cal. Rptr. 2d 82 (1996).

8. See *id.* at 234, 914 P.2d at 162, 52 Cal. Rptr. 2d at 84. The original action also challenged a similar transfer of land from Santa Fe to the adjacent city of Hermosa Beach, but the trial court determined that the land transfer from the Land Company in Hermosa Beach precluded any claim by the company's heirs. See Kim Kowsky, *Judge Switches Again on Who Owns Railroad Right of Way*, L.A. TIMES, Sept. 2, 1993, at B3.

9. *City of Manhattan Beach*, 13 Cal. 4th at 236, 914 P.2d at 163, 52 Cal. Rptr. 2d at 85. The deed read in part:

That said parties of the First part [Land Company and Charles Silent] for and in consideration of the sum of One Dollar to them in hand paid by said party of the Second part [Railway], the receipt of which is hereby acknowledged do by these presents remise, release and quit-claim unto said party of the second part the right-of-way for the construction, maintenance and operation of a Steam Railroad, upon over and along the following tract and parcel of land, situated, lying and being in the County of Los Angeles, State of California . . . .

*Id.* at 250-51, 914 P.2d at 172, 52 Cal. Rptr. 2d at 94 (Mosk, J., concurring and dissenting). The language of the conveyance is set out more fully *infra* note 402.

precisely state whether the Land Company intended to grant a fee simple interest or to confer an easement.<sup>10</sup> The motivation of the grantors, however, was clear. Manhattan Beach was not easily accessible at the time and the developers realized that the operation of the railway would make the land more marketable.<sup>11</sup> Thus, for the price of one dollar, the Land Company intended to give at least such interest in the land as the operation of the railroad would require.<sup>12</sup> The deed contained a number of express conditions effectively concerning short-term operation of the railroad, with a provision that the failure to comply with the conditions would cause reversion of the interest in the land back to the grantors.<sup>13</sup> It did not, however, include explicit provisions addressing the long-term disposition of the property.

True to the Land Company's wishes, the Redondo Beach Railway and its successors operated the railway and facilitated the development of Manhattan Beach and nearby areas. In 1982, however, the last railway successor, the Atchison, Topeka and Santa Fe Railway Company ("Santa Fe"), discontinued operation of rail services<sup>14</sup> and sold the property to the City of Manhattan Beach in 1986 for \$4.2 million and other consideration.<sup>15</sup> The city converted the property

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10. *See id.* at 235, 914 P.2d at 162, 52 Cal. Rptr. 2d at 84.

11. *See id.* at 248, 914 P.2d at 171, 52 Cal. Rptr. 2d at 93; *see also* James Rainey, *Descendants File Suit Seeking Title to Railroad Right of Way in 2 Cities*, L.A. TIMES, Mar. 20, 1988, at 6 (indicating that developers who founded the Land Company knew that holdings would increase in value if a railroad came to the area).

12. *See City of Manhattan Beach*, 13 Cal. 4th at 236, 914 P.2d at 163, 52 Cal. Rptr. 2d at 85.

13. *See id.* The express conditions required maintaining convenient crossings for access to adjacent property, culverts for water drainage, and a warehouse at a specified location. The deed explicitly provided that noncompliance with any of these conditions would cause "said right of way to revert" to grantors and their successors in interest. *Id.* at 251, 914 P.2d at 173, 52 Cal. Rptr. 2d at 95 (Mosk, J., concurring and dissenting).

14. *See id.* at 237, 914 P.2d at 163, 52 Cal. Rptr. 2d at 85; *see also* Hugo Martin, *Hermosa Beach Agrees to Buy Santa Fe Right of Way Property for \$7.5 Million*, L.A. TIMES, Oct. 7, 1988, at 8 (explaining that the railway became obsolete as the coastal area became more residential and commercial centers and heavy industry moved to other areas).

15. The city gave Santa Fe \$4.2 million in cash and title to other land worth \$800,000. *See* Dean Murphy, *Cost of Coveted Railway Land Raises Doubts in Manhattan*, L.A. TIMES, Feb. 23, 1986, at 1. The City also agreed to rezone a 2.1-acre portion of the railroad right-of-way retained by Santa Fe for commercial use, worth an estimated developmental value of \$5 million, bringing the city's total purchase price to \$10 million. *See id.* Because of questions concerning Santa Fe's title to the property, Santa Fe agreed to indemnify the city for five years

into a park with a jogging path.<sup>16</sup> Using the property as public open space seemed like a fine resolution until two "hobbyist heir hunters" located heirs of the Land Company and initiated a lawsuit in 1987 challenging the ability of Santa Fe to convey the property.<sup>17</sup> The heirs' theory was that the grant to the Railway in 1888 was not a fee simple but only an easement or right-of-way which terminated with the cessation of railway services.<sup>18</sup> Thus, the heirs argued the property belonged to them and they should be compensated for the condemnation of the property at a value claimed to be as much as \$100 million.<sup>19</sup>

*City of Manhattan Beach* ostensibly turned on both an accurate interpretation of the deed, which in California would be interpreted in the same manner as other contracts, and the proper use of extrinsic evidence in that process.<sup>20</sup> The trial court agreed with the heirs of the Land Company that the proper interpretation of the deed revealed the conveyance of only a conditional easement to the railway.<sup>21</sup> Thus, the trial court found Santa Fe and the city liable for inverse condemnation and indicated that the amount of damages would be determined in subsequent proceedings.<sup>22</sup> In an interlocutory appeal of the

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against any legal action over title to the property. *See id.* at 1 (also including information about the land sale).

16. *See* Kim Kowsky, *Judge Reverses Ruling, Gives City Full Title to 21-Acre Park*, L.A. TIMES, Aug. 26, 1993, at B3. The park is situated between two major northbound and southbound thoroughfares and is one of the few open spaces within Manhattan Beach city.

17. *See City of Manhattan Beach*, 13 Cal. 4th at 236 n.1, 914 P.2d at 162 n.1, 52 Cal. Rptr. 2d at 84 n.1. The heir hunters, John P. Farquhar and Ricardo B. Johnson, apparently succeeded in locating over 80 alleged heirs. *See id.* Heirs were found from as far away as Rhode Island and Maine. *See* Kowsky, *supra* note 8, at B3. The heir hunters financed the litigation in exchange for one-half of any recovery. *See* Kowsky, *supra* note 16, at B3.

18. *See* Kowsky, *supra* note 16, at B3.

19. *See id.* Another report indicated that the property value had risen to between \$8 million and \$70 million. *See* Graham, *supra* note 1, at 1.

20. *See* CAL. CIV. PROC. CODE § 1856(h) (West 1983). The parol evidence rule reads: "As used in this section, the term agreement includes deeds and wills, as well as contracts between parties." *Id.* *See also In re Marriage of Iberti*, 55 Cal. App. 4th 1434, 1439, 64 Cal. Rptr. 2d 766, 769 (1997) (holding that marital settlement agreements are generally construed under rules governing contracts); *Machado v. Southern Pac. Transp. Co.*, 233 Cal. App. 3d 347, 352, 284 Cal. Rptr. 560, 563 (1991) (grant of real property is to be interpreted in the same manner as any other contract).

21. *See City of Manhattan Beach*, 13 Cal. 4th at 238, 914 P.2d at 164, 52 Cal. Rptr. 2d at 86.

22. *See id.* The trial court trifurcated the proceedings, first addressing the interpretation issue and leaving for subsequent proceedings the question of heirship and damages. The trial court decided the interpretation issue and also de-

title issue only, the intermediate court of appeal upheld the trial court's interpretation of the deed.<sup>23</sup> The California Supreme Court, however, found itself bitterly divided over the issue, with only a bare majority of four justices reversing the trial and intermediate appellate courts, based upon a finding that the deed granted a fee simple to the Railway and its successors that allowed the valid sale to the city some one hundred years later.<sup>24</sup> Three dissenting justices asserted that the deed was properly interpreted to convey only an easement and that the transfer to the city was inconsistent with the 1888 conveyance.<sup>25</sup> The sharp but close division within the court accurately reflects the immense difficulty often surrounding contract interpretation and construction.

California law rather consistently states that the primary objective in interpreting a contract is to "ascertain and carry out the intention of the parties."<sup>26</sup> The majority of the supreme court in *City of Manhattan Beach* concluded that the deed itself was unresolvably ambiguous and therefore resorted to extrinsic evidence—primarily subsequent conduct of the grantors—to conclude that the parties intended to confer the property in fee simple to the railway.<sup>27</sup> The dissenting justices, on the other hand, concluded that the deed did not

cided that Santa Fe and the city were jointly liable. *See id.* The trial court also determined the question of heirship but did not reach the issue of damages before the supreme court agreed to hear the appeal and reversed the decision on liability. *See Kowsky, supra* note 16, at B3.

23. *See City of Manhattan Beach*, 35 Cal. App. 4th 359, 365, 31 Cal. Rptr. 2d 206, 208 (1994). The city had previously appealed the interpretation issue and the California Supreme Court had issued an order that the trial judge needed to explain or reverse his decision. After the trial judge reaffirmed his decision on the interpretation issue, the city brought the appeal decided in the case at hand. *See id.*

24. *See City of Manhattan Beach*, 13 Cal. 4th at 249-50, 914 P.2d at 172, 52 Cal. Rptr. 2d at 94.

25. *See id.* at 250-68, 914 P.2d at 172-84, 52 Cal. Rptr. 2d at 94-106 (Mosk, J., concurring and dissenting; Kennard, J., dissenting).

26. *See id.* at 238, 914 P.2d at 164, 52 Cal. Rptr. 2d at 86; *see also Machado*, 233 Cal. App. 3d at 352, 284 Cal. Rptr. at 563 (stating that the court must put itself in the position of the parties to ascertain intent at the time of contracting). Note, however, that Justice Mosk might disagree that the parties' intent is most important. He emphasizes the public notice aspect, especially with deeds, suggesting that courts might be obligated to give application to the objective meaning of the language even in the face of substantial evidence that the parties shared a different subjective meaning. *See City of Manhattan Beach*, 13 Cal. 4th at 252-53, 914 P.2d at 173-74, 52 Cal. Rptr. 2d at 95-96 (Mosk, J., concurring and dissenting).

27. *See City of Manhattan Beach*, 13 Cal. 4th at 235, 914 P.2d at 162, 52 Cal. Rptr. 2d at 84.

present any ambiguity that could not be resolved by looking solely within the four corners of the document.<sup>28</sup> Thus, the dissenters concluded that extrinsic evidence should not have been used.<sup>29</sup> Moreover, the dissenters viewed the extrinsic evidence as supporting, if anything, the finding of only an easement.<sup>30</sup>

More significant than its treatment of the general contract interpretation rules, *City of Manhattan Beach* reflects a fundamental division among the justices of the California Supreme Court—indeed among judges at all levels of the court system—about the ability to decipher the parties' intent by looking solely at the writing. As a related matter, the case presents one of a number of scenarios wherein the search for the parties' intent, either within the four corners of the document or even among the extrinsic evidence, is likely to be a futile pursuit. The court's failure to recognize the improbability of knowing the parties' actual intent avoids confrontation with the important question of what a court should do in that circumstance, particularly when the contract has been performed to such an extent that it is impossible to unwind the transaction and return the parties to status quo ante.<sup>31</sup> One possible answer, which finds support in the *Restatement (Second) of Contracts* and the California rules for contract interpretation, is that the court should consider what is known about the contracting parties' purpose and objectives in its attempt to identify what term the parties would have agreed upon.<sup>32</sup> The *Restatement (Second)* also suggests a second possibility for resolving such an "indecipherable intent" case: that the court may be guided by a "sense of justice."<sup>33</sup> This Article asserts that a search for a just

28. *See id.* at 262, 267, 914 P.2d at 180, 183, 52 Cal. Rptr. 2d at 102, 105 (Mosk, J., concurring and dissenting; Kennard, J., dissenting).

29. *See id.* (Mosk, J., concurring and dissenting; Kennard, J., dissenting).

30. *See id.* (Mosk, J., concurring and dissenting; Kennard, J., dissenting).

31. *See* RESTATEMENT (SECOND) OF CONTRACTS § 204 cmt. b (1981). For a number of reasons, parties may fail to make an express provision:

The parties to an agreement may entirely fail to foresee the situation which later arises and gives rise to a dispute; they then have no expectations with respect to that situation, and a search for their meaning with respect to it is fruitless. Or they may have expectations but fail to manifest them, either because the expectation rests on an assumption which is unconscious or only partly conscious, or because the situation seems to be unimportant or unlikely, or because discussion of it might be unpleasant or might produce delay or impasse.

*Id.*

32. *See id.* § 204 cmt. d (suggesting that courts may ascertain what term the parties would have used if the issue had been addressed in the writing); *infra* text accompanying note 370.

33. *See id.* (stating that where no agreement exists in fact, the court should

result would take into account all equities of the case, including such factors as the status of the parties, the risk of out-of-pocket loss or windfall gain, whether either party has engaged in culpable or meritorious behavior, and any public interests at stake.<sup>34</sup> Indeed, the “just result” principle may best explain why a majority of the supreme court decided against imposing millions of dollars of liability upon the City of Manhattan Beach for the benefit of “heir hunters” and heirs dispersed across the country who would not have pursued the litigation on their own initiative.<sup>35</sup>

Some commentators have accepted, if not altogether embraced, the idea that at times courts simply search for a just result in pursuing questions of contract interpretation. As stated in a leading contracts textbook:

It is obvious . . . that there is no unanimity as to the content of the parol evidence rule or the process called interpretation, and that the rules are complex, technical and difficult to apply. 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 the rule that they think will give rise to a just result in the particular case. We have also seen that often under a guise of interpretation a court will actually enforce its notions of “public policy” which is “nothing more than an attempt to do justice.”<sup>36</sup>

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supply a term consistent with standards of fairness).

34. See *infra* Part III.

35. See Kowsky, *supra* note 16, at B3 (quoting Manhattan Beach City Manager Bill Smith stating that the city had operated under the fear of bankruptcy if it had to pay damages of \$100 million; also quoting the heirs stating that they were happy to let Farquhar and Johnson bear the expense of pressing their claim).

36. JOHN D. CALAMARI & JOSEPH M. PERILLO, *THE LAW OF CONTRACTS* § 3-16 (3d ed. 1987) (citations omitted); see also E. ALLAN FARNSWORTH, *CONTRACTS* § 7.16 (2d ed. 1990) (If the parties failed to foresee a situation, “it is often naive to assume that a court can determine how the parties would have dealt with it . . . .” Moreover, there is the possibility that the parties might have agreed to an uneven term because of an imbalance in bargaining power; thus, courts should impose a term derived from “basic principles of justice.”); Michael B. Metzger, *The Parol Evidence Rule: Promissory Estoppel’s Next Conquest?*, 36 *VAND. L. REV.* 1383, 1401-02 (1983) (suggesting that courts depart from official statements of the parol evidence rule to achieve fair results).



Sections 204<sup>37</sup> and 207<sup>38</sup> of the *Restatement (Second)* offer at least limited support for the just result principle.

Other California cases reveal a number of areas in which the rules governing contract interpretation and construction are fraught with apparent inconsistencies. *City of Manhattan Beach*, in addition to raising the possibility of a gap in the contract terms, highlights a perplexing conflict within California law: the tension between the maxim that contract interpretation should be based on the plain meaning of its terms as determined by looking solely within the four corners of the document, and the principle that courts should resort to extrinsic evidence to better understand the bargaining context and intent of the parties. Other areas of concern include the proper application of the parol evidence rule's exclusion from the contract terms that are left out of a final writing and the proper relation of implied terms to the express terms of the agreement.

This Article first undertakes a succinct review of the principles of contract interpretation and construction within California. Part II then narrows its focus, discussing the three specific problem areas indicated above: the plain meaning rule,<sup>39</sup> the parol evidence rule,<sup>40</sup> and the use of implied terms, such as trade usage and customs, in conjunction with final writings.<sup>41</sup> Finally, Part III examines a number of cases where courts use the normal maxims of interpretation as a cover for actually applying the just result principle in construing the contract. The judicial search for a just result takes place in such recent cases as *Okun v. Morton*,<sup>42</sup> *City of Manhattan Beach*,<sup>43</sup> and *Lee v.*

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37. RESTATEMENT (SECOND) OF CONTRACTS § 204 (1981) (regarding courts supplying an omitted essential term): When the parties to a bargain sufficiently defined to be a contract have not agreed with respect to a term which is essential to a determination of their rights and duties, a term which is reasonable in the circumstances is supplied by the court. *See supra* notes 31-33 and accompanying text.

38. RESTATEMENT (SECOND) OF CONTRACTS § 207 (1981): 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. *See id.* The sole comment to section 207 provides in part: "The rule [favoring the public] . . . rests more on considerations of public policy than on the probable intention of the parties." *Id.* at cmt. a.

39. *See infra* Part II.B.

40. *See infra* Part II.C.

41. *See infra* Part II.D.

42. 203 Cal. App. 3d 805, 250 Cal. Rptr. 220 (1988); *see infra* Part III.A.

43. No. B058897 (Cal. Ct. App. Sept. 30, 1992) (unpublished opinion), *cert. denied*, 1992 Cal. LEXIS 6172 (Dec. 16, 1992); *see infra* Part III.B.

*Walt Disney Co.*<sup>44</sup> This latter discussion will also identify the proper limits for application of the just result principle.<sup>45</sup>

## II. GENERAL PRINCIPLES OF INTERPRETATION

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Courts faced with an alleged breach of contract first must identify all of the contract terms, express and implied, which constitute the parties' total obligations. The express terms may be entirely oral, entirely written in one or more documents, or may be partly oral and

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44. 13 Cal. 4th 232, 914 P.2d 160, 52 Cal. Rptr. 2d 82 (1996); *see infra* Part III.C.

45. This discussion might well be categorized as a question of the courts' application of a "default rule" when the parties have failed to expressly provide for a particular situation within the contract. Default rule analysis has become a frequent writing topic among academics. *See, e.g.*, Randy E. Barnett, *The Sound of Silence: Default Rules and Contractual Consent*, 78 VA. L. REV. 821 (1992); Dennis Patterson, *The Pseudo-Debate over Default Rules in Contract Law*, 3 S. CAL. INTERDISC. L.J. 235 (1993). Nonetheless, the default rule analysts have engendered some criticism. *See, e.g.*, N. David Slawson, *The Futile Search for Principles for Default Rules*, 3 S. CAL. INTERDISC. L.J. 29 (1993) (suggesting that the analysis adds nothing, other than a new phrase for the arena, to the issue of courts providing terms when a contract is silent).

Professor Lisa Bernstein characterized the perspectives of the writers in the default rule analysis discussion as falling into four areas: hypothetical bargain, economic theory, consent theory, and relational theory. *See* Lisa Bernstein, *Social Norms and Default Rules Analysis*, 3 S. CAL. INTERDISC. L.J. 59 (1993). The hypothetical bargain approach focuses on what the parties might have agreed to if they had addressed the issue; the economists generally argue that default rules should be set so as to maximize efficiency; the consent theory emphasizes parties' manifestations of consent as a basis for deriving default rules; and the relational theory focuses on the need to preserve relationships by balancing the interests of the parties. *See id.* Although default rule analysis and terminology do not shape the scope of this Article, such principles might well lead to similar results as those produced by the more traditional analysis contained in this Article.

46. *Disclaimer* (KNBR 680 AM radio broadcast, May, 1995) (standard disclaimer as read by San Francisco Giants Baseball Club radio announcer, Hank Greenwald, during every San Francisco Giants game broadcast) (on file with *Loyola of Los Angeles Law Review*).

47. Paraphrase of editorial comments by Hank Greenwald made during May 1995, poking fun at the baseball club's standard disclaimer.

partly written.<sup>48</sup> Courts may also determine that some terms are implicit from facts or law, including terms derived from usage of trade and the like,<sup>49</sup> in addition to those terms expressly made part of the agreement.<sup>50</sup> Courts often face difficult questions when the parties have placed many of the express terms in a final writing and at least one party asserts that additional express terms exist either in what the parties said orally or in earlier writings. Whether to allow extrinsic evidence to "supplement" or add terms beyond the final writing most clearly invokes the dreaded "parol evidence rule."<sup>51</sup>

A related issue is the degree to which the courts will recognize terms, implicit in the facts or implied as a matter of law, to supplement any written or oral express terms.<sup>52</sup> The *Restatement (Second)* approach does not draw a line between express and implied-in-fact terms, the latter merely being those agreed to by conduct rather than by words or fairly inferred from the words used.<sup>53</sup> Implied-in-law

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48. See RESTATEMENT (SECOND) OF CONTRACTS § 4 (1981).

49. See U.C.C. §§ 1-205, 2-208 (1995) (defining usage of trade, course of dealing and course of performance). Parties may assume that practices are incorporated into an agreement if trade practices within an industry or a relevant market are widely adopted and known. Course of dealing concerns prior transactions of a similar type between the same two parties that may be deemed to demonstrate a common understanding between the parties as to later transactions. Course of performance concerns circumstances in which a contract presents multiple opportunities of performance by one or more parties. The performance rendered and accepted may be deemed as evidence of the parties' understanding of the contract from the beginning or may reflect a waiver or modification of original terms. See *id.*

50. A distinction exists between contract construction and contract interpretation. The term "construction" refers more precisely to the legal effect that courts will give to a contract under relevant rules of law; "interpretation" refers more accurately to the process of assigning meaning to the contract terms once identified. The legal effect or construction, however, may not be determined exclusively by the parties' intent. Ultimately, the courts, the *Restatement (Second)*, and the writers do not emphasize this theoretical difference. See CALAMARI & PERILLO, *supra* note 36, § 3-9; FARNSWORTH, *supra* note 36, § 7.7.

51. See FARNSWORTH, *supra* note 36, § 7.2 ("One writer, with some hyperbole, has said that '[f]ew things [in our law] are darker than this or fuller of subtle difficulties.'" (quoting James B. Thayer, *The "Parol Evidence" Rule*, 6 HARV. L. REV. 325 (1893))); Justin Sweet, *Contract Making and Parol Evidence: Diagnosis and Treatment of a Sick Rule*, 53 CORNELL L. REV. 1036, 1036-37, (1968) (Parol evidence rule is a maze of conflicting tests, subrules, and exceptions adversely affecting both the counseling of clients and the litigation process.).

52. See *infra* Part II.C.

53. Section 4, comment a of the *Restatement (Second)* states that express and implied contracts do not differ in legal effect but merely in whether assent is manifested by words or conduct. See RESTATEMENT (SECOND) OF CONTRACTS § 4 cmt. a (1981).

An implied term may also be fairly drawn from the express terms under

terms, on the other hand, can be more problematic. More specifically, the difficulties with such terms arise when one of the parties asserts an implied-in-law term that arguably conflicts with either an express term within the writing or a purported collateral term that was left out of the final writing. In theory, the implied-in-law term should clearly yield to a contrary express term of the contract because courts generally use implied-in-law terms to fill in gaps in the agreement.<sup>54</sup> One can argue, however, that courts should avoid finding conflict between express terms included in a final writing and implied-in-law terms, especially when such terms are derived from usage of trade or course of dealing.<sup>55</sup> What to do with an implied term that conflicts with a purported collateral term omitted from a final writing depends on the validity of the collateral term. Theoretically, if the court finds the collateral term to have constituted part of the agreement of the parties, the term should prevail over a conflicting term that would have been implied. Moreover, the fact that a term would have been implied by law may tremendously affect a court's assessment of whether the parties did, in fact, agree to the purported collateral term.<sup>56</sup>

After identifying all of the contract terms, the courts addressing alleged breaches of contract must interpret the terms. Simply stated, the process of interpretation determines what meaning to assign to the terms that make up the contract. The process of interpretation is integral to ascertaining what performances or obligations the parties owe. Only after interpretation can the courts determine whether a party has failed to perform in a way that would constitute a breach

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the given circumstances. For example, if a customer requests a local firewood company to deliver firewood on Saturday and expressly promises to pay \$100, the facts imply that the customer will make payment upon delivery unless special circumstances, such as a course of dealing, suggest some other arrangement. See *id.* § 234.

54. *But see* *Nanakuli Paving and Rock Co. v. Shell Oil Co.*, 664 F.2d 772, 783 n.16, 794-96 (9th Cir. 1981) (suggesting that express terms in the sale of goods context might yield to implied terms derived from usage of trade or course of dealing).

55. See *infra* text accompanying notes 333-52 for discussion of *Hayter Trucking v. Shell Western E&P, Inc.*, 18 Cal. App. 4th 1, 22 Cal. Rptr. 2d 229 (1993).

56. For a good example, see *infra* Part III.C.1, discussing *Masterson v. Sine*, 68 Cal.2d 222, 436 P.2d 561, 65 Cal. Rptr. 545 (1968). Briefly stated, the law would have implied a term that an option to repurchase property was freely assignable. One party alleged that a collateral term was omitted from the writing that would have made the option nonassignable. The fact that the free assignability term would have been implied by law supports the argument that the parties should have placed a contrary term in the final writing rather than omitting it.

and therefore cause liability in the absence of a recognizable excuse.<sup>57</sup>

Frequently, courts, including those in California, will state their preference for interpreting the contract by looking solely to the final writing, if one exists.<sup>58</sup> This method, the plain meaning approach, would bar extrinsic evidence in this second step of assigning meaning to contract terms, just as the parol evidence rule may bar extrinsic evidence in the first step of deciding what terms make up the contract.<sup>59</sup> Just as often as courts embrace the plain meaning rule, however, the same courts—or perhaps a dissenting judge within the same opinion—may endorse and apply a contextual approach to contract interpretation that freely uses extrinsic evidence.<sup>60</sup> These equivocal messages thus may cause confusion concerning the law that governs contract interpretation generally, and in California in particular.

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57. The failure to render performance when due may be excused, of course, under a legally recognized doctrine such as mistake or impracticability. See FARNSWORTH, *supra* note 36, § 9.1. Parties may also be legitimately excused from apparent contractual obligations because of some fault in the formation process, such as lack of capacity, misrepresentation, or duress. See *id.* § 4.1.

58. See, e.g., *S. Kornreich & Sons, Inc. v. Genesis Ins. Co.*, 56 Cal. App. 4th 407, 417, 65 Cal. Rptr. 2d 418, 423 (1997) (holding that insurance policy should be given its plain and ordinary meaning); *Miscione v. Barton Dev. Co.*, 52 Cal. App. 4th 1320, 1326, 61 Cal. Rptr. 2d 280, 284 (1997) (stating that “the rules of interpretation of written contracts are for the purpose of ascertaining the meaning of the words used therein . . .”) (citations omitted); *Machado v. Southern Pac. Transp. Co.*, 233 Cal. App. 3d 347, 352-53, 284 Cal. Rptr. 560, 563 (1991) (stating that court should first attempt to derive parties’ intent from the plain meaning of words before resorting to rules of construction). But see Margaret N. Kniffin, *A New Trend in Contract Interpretation: The Search for Reality as Opposed to Virtual Reality*, 74 OR. L. REV. 643 (1995) (suggesting that the plain meaning rule is falling increasingly into disfavor).

59. See Arthur L. Corbin, *The Interpretation of Words and the Parol Evidence Rule*, 50 CORNELL L.Q. 161, 161-62 (1965) (noting the tendency of courts to often state, if not follow, the rule that a court must find written words ambiguous before it can admit extrinsic evidence to aid in contract interpretation if the written words themselves are plain and clear).

60. See, e.g., *Waller v. Truck Ins. Exch.*, 11 Cal. 4th 1, 900 P.2d 619, 44 Cal. Rptr. 2d 370 (1995) (applying contextual approach; dissent argues that plain meaning rule is more appropriate standard); *In re Marriage of Iberti*, 55 Cal. App. 4th 1434, 1439-40, 64 Cal. Rptr. 2d 766, 769 (1997) (reiterating that extrinsic evidence is only admissible to prove a meaning to which the contract is reasonably susceptible); *Department of Indus. Relations v. UI Video Stores, Inc.*, 55 Cal. App. 4th 1084, 1094-95, 64 Cal. Rptr. 2d 457, 463 (1997) (applying contextual approach to interpretation of settlement agreement between Blockbuster Video and governmental agency over unpaid wages and benefits); *Curry v. Moody*, 40 Cal. App. 4th 1547, 1552, 48 Cal. Rptr. 2d 627, 630 (1995) (stating that court is not limited to contract language in determining meaning of contract); see also, e.g., Corbin, *supra* note 59, at 161-63 (noting the common practice of courts to cite to the plain meaning rule and then deviate from its application).

### A. *California Rules for Contract Interpretation*

Both the California Civil Code and court opinions reflect the fundamental goal of contract interpretation for California courts: to identify and give effect to the expressed mutual intention of the parties.<sup>61</sup> In deriving the mutual intent of the parties, the California Supreme Court continues to state, relying on the California Civil Code, that contractual language that is clear and explicit must govern the interpretation of the contract.<sup>62</sup> Giving such priority to the facial meaning of the written contract appears to embody the plain meaning rule, which will be discussed below as a source of confusion within California law on contract interpretation.<sup>63</sup>

Other principles reinforce the priority given to the writing. First, courts must try to avoid ambiguity by construing the written language in the context of the instrument and the pertinent circumstances, and courts should not deem a writing ambiguous as an abstract or hypothetical matter.<sup>64</sup> Moreover, the California courts often have phrased the interpretation rules in a manner that suggests that a court should examine extrinsic evidence only if there is patent ambiguity in the express terms.<sup>65</sup> The plain meaning rule has persisted in the courts despite key California Supreme Court decisions and California Code of Civil Procedure section 1856, modified in 1978 to reflect those key judicial developments, which clearly discredit the rule.<sup>66</sup>

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61. See CAL. CIV. CODE § 1636 (West 1985); *Bank of the West v. Superior Court*, 2 Cal. 4th 1254, 1264-65, 833 P.2d 545, 552, 10 Cal. Rptr. 2d 538, 545 (1992); *Golden West Baseball Co. v. City of Anaheim*, 25 Cal. App. 4th 11, 21, 31 Cal. Rptr. 2d 378, 385 (1994).

62. See CAL. CIV. CODE § 1638; *City of El Cajon v. El Cajon Police Officers' Ass'n*, 49 Cal. App. 4th 64, 71, 56 Cal. Rptr. 2d 723, 727 (1996); *Bank of the West*, 2 Cal. 4th at 1264-65, 833 P.2d at 552, 10 Cal. Rptr. 2d at 545.

63. See discussion *infra* Part II.B.

64. See *Bank of the West*, 2 Cal. 4th at 1265, 833 P.2d at 552, 10 Cal. Rptr. 2d at 545 (citing CAL. CIV. CODE § 1641).

65. See, e.g., *Powers v. Dickson, Carlson & Campillo*, 54 Cal. App. 4th 1102, 1111, 63 Cal. Rptr. 2d 261, 266 (1997) (“Under the parol evidence rule, extrinsic evidence is not admissible to contradict express terms in a written contract or to explain what the agreement was . . . . The agreement is the writing itself.”) (citing *Sunniland Fruit, Inc. v. Verni*, 233 Cal. App. 3d 892, 898, 284 Cal. Rptr. 824, 827 (1991); *AIU Ins. Co. v. Superior Court*, 51 Cal. 3d 807, 821-22, 799 P.2d 1253, 1264, 274 Cal. Rptr. 820, 831 (1990) (Parties’ mutual intent “is to be inferred, if possible, solely from the written provisions of the contract.”) (citing CAL. CIV. CODE § 1639); *Golden West Baseball*, 25 Cal. App. 4th 11, 31 Cal. Rptr. 2d 378 (holding that precise meaning of a contract depends upon the parties’ expressed intent, using an objective standard).

66. Section 1856 of the California Code of Civil Procedure, as amended in 1978, states in part:

An analytical review of relevant California cases involving contract interpretation reveals that although the plain meaning rule is often recited as though a mantra, it actually holds little value. The California courts repeatedly apply a contextual analysis in determining how to interpret contracts.<sup>67</sup> Unfortunately, however, a minority of the courts do in fact apply a plain meaning approach and thereby create the risk that the obligations imposed will not be those that the parties contemplated when making the contract.<sup>68</sup> Similarly, the courts inconsistently determine when the use of extrinsic evidence may properly supplement a written contract or how implied terms may interact with the written terms of a contract.<sup>69</sup>

The California courts have also expressed the view that once a writing is completely integrated, it represents the contract of the parties.<sup>70</sup> Extrinsic evidence is therefore irrelevant in establishing the terms of the agreement.<sup>71</sup> This phrasing, similar to the frequent

(b) The terms set forth in a writing described in subdivision (a) may be explained or supplemented by evidence of consistent additional terms unless the writing is intended also as a complete and exclusive statement of the terms of the agreement.

(c) The terms set forth in a writing described in subdivision (a) may be explained or supplemented by course of dealing or usage of trade or by course of performance.

....

(g) This section does not exclude other evidence of the circumstances under which the agreement was made or to which it relates, as defined in Section 1860, or to explain an extrinsic ambiguity or otherwise interpret the terms of the agreement, or to establish illegality or fraud.

CAL. CIV. CODE § 1856.

The official comments to section 1856 make clear that the purpose of the section was to codify the key California Supreme Court rulings on the use of extrinsic evidence, such as *Pacific Gas & Elec. v. G.W. Thomas Drayage & Rigging Co.*, 69 Cal. 2d 33, 442 P.2d 641, 69 Cal. Rptr. 561 (1968), discussed *infra* Part II.B, and *Masterson v. Sine*, 68 Cal. 2d 222, 436 P.2d 561, 65 Cal. Rptr. 545 (1968), discussed *infra* notes 231-64 and accompanying text. See also *FPI Dev., Inc. v. Nakashima*, 231 Cal. App. 3d 367, 386-90, 282 Cal. Rptr. 508, 519-22 (1991) (discussing the codification of the parol evidence rule in section 1856).

67. See discussion *infra* Parts II.A-B.

68. See, e.g., *Haggard v. Kimberly Quality Care, Inc.*, 39 Cal. App. 4th 508, 517-18, 46 Cal. Rptr. 2d 16, 21-22, (6th Dist. 1995) (certified for partial publication); *Banco Do Brasil, S.A. v. Latian, Inc.*, 234 Cal. App. 3d 973, 1001, 285 Cal. Rptr. 870, 886 (2d Dist. 1991); *Gerdlund v. Electronic Dispensers Int'l*, 190 Cal. App. 3d 263, 272, 235 Cal. Rptr. 279, 283-84 (1987).

69. See Susan J. Martin-Davidson, *Yes, Judge Kozinski, There Is a Parol Evidence Rule in California—The Lessons of a Pyrrhic Victory*, 25 Sw. U. L. REV. 1, 4-5 (1995) (noting the use of parol evidence in trial courts and frequent reversals in the appellate courts in California).

70. See *Cione v. Foresters Serv. Inc.*, 58 Cal. App. 4th 625, 637-38, 68 Cal. Rptr. 2d 167, 174 (4th Dist. 1977).

71. See *Hayter Trucking, Inc. v. Shell Western E&P, Inc.*, 18 Cal. App. 4th 1,

formulation of the plain meaning rule, suggests an overly restrictive approach to the possibility that the parties may have left terms out of the final writing. Additionally, it is inconsistent with the most authoritative California Supreme Court case on the parol evidence rule, *Masterson v. Sine*,<sup>72</sup> and the statutory embodiment of that rule in section 1856 of the California Code of Civil Procedure.<sup>73</sup>

Many of the recent leading cases have involved questions of interpretation based on insurance contracts.<sup>74</sup> California courts have stated repeatedly that “[w]hile insurance contracts have special features, they are still contracts to which the ordinary rules of contractual interpretation apply.”<sup>75</sup> Ultimately, a number of interpretive rules that are particularly relevant to the insurance contract context may in fact come into play. One such classic rule states that courts should construe any ambiguity against the insurer and in favor of coverage.<sup>76</sup> In a recent case, however, the California Supreme Court emphasized that resort to that special rule of construction cannot be made until there is a determination that an ambiguity exists under the general rules of contract interpretation.<sup>77</sup>

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14, 22 Cal. Rptr. 2d 229, 237 (1993); *Alling v. Universal Mfg.*, 5 Cal. App. 4th 1412, 1433-36, 7 Cal. Rptr. 2d 718, 731-32 (1992); *Banco Do Brasil, S.A. v. Latian, Inc.*, 234 Cal. App. 3d 973, 1000-01, 285 Cal. Rptr. 870, 886 (1991).

72. 68 Cal. 2d 222, 436 P.2d 561, 65 Cal. Rptr. 545 (1968).

73. See discussion *infra* Part II.C.

74. See, e.g., *Waller v. Truck Ins. Exch.*, 11 Cal. 4th 1, 900 P.2d 619, 44 Cal. Rptr. 2d 370 (1995) (affirming that commercial general liability insurer is not required to defend a third-party action seeking incidental damages for emotional distress); *La Jolla Beach & Tennis Club, Inc. v. Industrial Indem. Co.*, 9 Cal. 4th 27, 884 P.2d 1048, 36 Cal. Rptr. 2d 100 (1994) (holding unanimously that claim for wrongful termination and infliction of emotional distress did not potentially fall within scope of workers' compensation policy); *Bank of the West*, 2 Cal. 4th 1254, 833 P.2d 545, 10 Cal. Rptr. 2d 538 (holding that insurance policy did not cover claims arising from advertising injury due to unfair business practices); *AIU Ins.*, 51 Cal. 3d 807, 799 P.2d 1253, 274 Cal. Rptr. 820 (ruling that insurer was obligated to provide coverage for cleanup and other response costs incurred due to compliance with federal and state environmental laws under policy provision covering “all sums which [the insured] shall become legally obligated to pay as damages . . .”).

75. See *La Jolla Beach & Tennis*, 9 Cal. 4th at 37, 884 P.2d at 1053, 36 Cal. Rptr. 2d at 105 (quoting *Bank of the West*, 2 Cal. 4th at 1264, 833 P.2d at 551-52, 10 Cal. Rptr. 2d at 544-45).

76. See *id.*; see also *Bank of the West*, 2 Cal. 4th at 1265, 833 P.2d at 552, 10 Cal. Rptr. 2d at 545.

77. See *Bank of the West*, 2 Cal. 4th at 1264-65, 833 P.2d at 552, 10 Cal. Rptr. 2d at 545. After the trial court applied a plain meaning analysis in ruling that the term “unfair competition” did not cover the alleged advertising activity, the intermediate appellate court reversed based on a finding that the term was ambiguous and should be construed against the insurance company. The supreme



The rule favoring coverage derives from the perception that the insurer usually drafts the contract language and that the insured has little or no opportunity to bargain for change.<sup>78</sup> This doctrine of *contra proferentum* in construing contracts against the drafter has particular effect when used against insurance companies<sup>79</sup> and other special parties, such as lawyers, who are perceived to have an advantage over more unsophisticated parties.<sup>80</sup> If the insured, however, actually drafted or participated in drafting the policy language, the presumption of construing ambiguities in favor of coverage may be altered.<sup>81</sup>

The courts have also emphasized that the rule of construction against the drafter does not mean that the policy will be distorted to provide coverage that has been explicitly excluded by the language of the policy.<sup>82</sup> Although this principle is essentially reasonable, the

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court, however, held that the term was not ambiguous when viewed in the proper context. *See id.* at 1272, 833 P.2d at 557, 10 Cal. Rptr. 2d at 550; *see also* Wilmington Liquid Bulk Terminals, Inc. v. Somerset Marine Inc., 53 Cal. App. 4th 186, 195, 61 Cal. Rptr. 2d 727, 732 (1997) (stating that the court will construe ambiguities in favor of coverage but will not strain to find ambiguity); *AIU Ins.*, 51 Cal. 3d at 822, 799 P.2d at 1264, 274 Cal. Rptr. at 831 (applying, first, the meaning a layperson would ascribe if not ambiguous; second, the meaning the promisor should have understood the promisee to attach; and third, in the insurance context, resolving ambiguities in favor of coverage).

78. *See AIU Ins.*, 51 Cal. 3d at 822, 799 P.2d at 1265, 274 Cal. Rptr. at 832 (citing *Garcia v. Truck Ins. Exch.*, 36 Cal. 3d 426, 438, 682 P.2d 1100, 1105-06, 204 Cal. Rptr. 435, 440-41 (1984) and *Bareno v. Employers Life Ins. Co.*, 7 Cal. 3d 875, 878, 500 P.2d 889, 890, 103 Cal. Rptr. 865, 866 (1972)).

79. *See, e.g., La Jolla Beach & Tennis*, 9 Cal. 4th at 37, 884 P.2d at 1053, 36 Cal. Rptr. 2d at 105; *General Star Indem. Co. v. Superior Court*, 47 Cal. App. 4th 1586, 1593, 55 Cal. Rptr. 2d 322, 325 (1996); *Desai v. Farmers Ins. Exch.*, 47 Cal. App. 4th 1110, 1117, 55 Cal. Rptr. 2d 276, 279 (1996).

80. *See, e.g., Mayhew v. Benninghoff*, 53 Cal. App. 4th 1365, 1370, 62 Cal. Rptr. 2d 27, 30 (1997) (finding that "the doctrine of *contra proferentum* . . . applies with even greater force when the person who prepared the writing is a lawyer"). *Cf. Century 21 Butler Realty, Inc. v. Vasquez*, 41 Cal. App. 4th 888, 891, 49 Cal. Rptr. 2d 1, 2 (1995) (holding that where broker has prepared a listing agreement, uncertainty about commission will be construed in favor of seller); *Powers*, 54 Cal. App. 4th at 1112-16, 63 Cal. Rptr. 2d at 267 (enforcing arbitration provision in retainer agreements between client and attorney based on finding that the arbitration provisions unambiguously covered malpractice claims that might be brought against attorney).

81. *See AIU Ins.*, 51 Cal. 3d at 822, 799 P.2d at 1264, 274, Cal Rptr. at 831 (1990).

82. *See La Jolla Beach & Tennis*, 9 Cal. 4th at 41-42, 884 P.2d at 1056, 36 Cal. Rptr. 2d at 108 (finding that workers' compensation insurance policy was not ambiguous in its exclusion of claim for damages based on wrongful termination when the contract was construed as a whole and in light of the circumstances); *Gunderson v. Fire Ins. Exch.*, 37 Cal. App. 4th 1106, 1118, 44 Cal. Rptr. 2d 272, 280 (1995) (finding plain meaning of "property damage" in homeowner insur-

California courts' placement of undue emphasis upon the plain meaning aspects of insurance policy interpretation unfortunately may tend to exclude consideration of extrinsic evidence.<sup>83</sup> Circumstances certainly arise where applying a plain meaning approach may likely lead to an absurd result.<sup>84</sup>

Even if California law on contract interpretation begins with the written terms, the applicable rules note a number of circumstances in which resort to evidence outside the writing would be appropriate. For example, the supreme court has stated that "[i]f the terms of a promise are in any respect ambiguous or uncertain, it must be interpreted in the sense in which the promisor believed, at the time of making it, that the promisee understood it."<sup>85</sup> At the same time,

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ance policy required physical damage or destruction of tangible property and not merely interference with use of property by claim of adverse possession); *Lunardi v. Great-West Life Assurance Co.*, 37 Cal. App. 4th 807, 819-21, 44 Cal. Rptr. 2d 56, 62 (1995) (finding no ambiguity in insurance application language which provided that no effect would be given to policy where applicant learned of material change in health after application but prior to delivery of policy).

83. See *Bluehawk v. Continental Ins. Co.*, 50 Cal. App. 4th 1126, 1132, 58 Cal. Rptr. 2d 147, 151 (1996) (stating that extrinsic interpretative aids may be used only if policy is ambiguous); *Gunderson*, 37 Cal. App. 4th at 1118, 44 Cal. Rptr. 2d at 280 ("The language of the insurance policy must be interpreted in light of its plain and ordinary meaning, unless the Policy clearly indicates to the contrary."); *National Auto. & Cas. Ins. Co. v. Stewart*, 223 Cal. App. 3d 452, 461, 272 Cal. Rptr. 625, 630 (1990) (holding that the plain language of insurance policy limitations must be respected).

84. See, e.g., *Knopp*, 50 Cal. App. 4th 1415, 58 Cal. Rptr. 2d 331. In *Knopp* the auto insurance policy excluded coverage for "use of a vehicle while used to carry persons or property for a charge." *Id.* at 1419, 58 Cal. Rptr. 2d at 333. The insured was involved in an accident while driving a commercial limousine after having dropped off his passengers and returning to his employer's place of business unaccompanied. See *id.* The insured asserted that because he was not carrying a person for a charge at the time of the accident, the exclusion was not applicable. See *id.* at 1419-20, 58 Cal. Rptr. 2d at 333. The appellate court affirmed the trial court's judgment in favor of the insurer, emphasizing that coverage was limited to the objectively reasonable expectations of the insured. See *id.* at 1422, 58 Cal. Rptr. 2d at 335. Notably, however, a true plain meaning approach to the policy might have led to coverage in a circumstance where all reason would suggest that none should have been had. See also *Continental Heller Corp. v. St. Paul Fire & Marine Ins. Co.*, 47 Cal. App. 4th 291, 54 Cal. Rptr. 2d 621 (1996) (holding that policy covering contractor for injury or damage that "results from" subcontractor's "work" should not have been interpreted by trial court as having "plain meaning" to exclude coverage for worker injured while gathering tools at the job site in preparation to performing assigned tasks), *cert. denied* 47 Cal. App. 4th 291, 54 Cal. Rptr. 2d 621 (1996), and *ordered depublished* 47 Cal. App. 4th 291, 54 Cal. Rptr. 2d 621 (1996).

85. *Bank of the West*, 2 Cal. 4th at 1264-65, 833 P.2d at 552, 10 Cal. Rptr. 2d at 545 (quoting CAL. CIV. CODE § 1649 (West 1985)); see also *AIU Ins.*, 51 Cal. 3d at 822, 799 P.2d at 1264, 274 Cal. Rptr. at 831 (stating that ambiguities should be

California courts have adopted the generally prevailing view in American courts that contracts should be interpreted on the basis of objective evidence, therefore rendering the parties' purely subjective intent irrelevant.<sup>86</sup>

The California courts also have adopted the general rule "that in construing the terms of a contract the construction given it by the acts and conduct of the parties with knowledge of its terms, and before any controversy has arisen as to its meaning, is admissible on the issue of the parties' intent."<sup>87</sup> While the conduct of one party to the contract is not conclusive evidence as to the meaning of the contract, it is relevant to the question of whether the contract is reasonably susceptible to the meaning advanced by one of the parties.<sup>88</sup> Conversely, courts that do utilize extrinsic evidence may find the drafting history helpful in understanding the meaning of express terms in the writing.<sup>89</sup>

Using another interpretive rule, the courts will fill in gaps in contracts with default terms in accordance with widely accepted norms. For example, if an otherwise enforceable contract fails to specify a time for performing an act, a court will insert a "reasonable time" provision, with reasonableness depending on the circumstances of each case.<sup>90</sup> California courts repeatedly state that the law implies a

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resolved to mean what the promisor thought the promisee meant when the contract was formed).

86. See *Winet v. Price*, 4 Cal. App. 4th 1159, 1166, 6 Cal. Rptr. 2d 554, 558 (1992) (supporting the position that the outward expression of the agreement, rather than any unexpressed intention, is what the court will enforce); *Edwards v. Comstock Ins. Co.*, 205 Cal. App. 3d 1164, 1169, 252 Cal. Rptr. 807, 810 (1988) (When intent can be derived from words and acts, unexpressed state of mind is immaterial.); *Sheehan v. Atlantic Int'l Ins. Co.*, 812 F.2d 465, 470 (9th Cir. 1986) (Under California law, unexpressed reservations cannot contradict express terms of contract.).

87. *Southern Cal. Edison Co. v. Superior Court*, 37 Cal. App. 4th 839, 851, 44 Cal. Rptr. 2d 227, 234 (1995) (citing *Universal Sales Corp. v. California Press Mfg. Co.*, 20 Cal. 2d 751, 761, 128 P.2d 665, 671 (1942)).

88. See *id.* at 851, 44 Cal. Rptr. 2d at 234; *Golden West Baseball Co. v. City of Anaheim*, 25 Cal. App. 4th 11, 39, 31 Cal. Rptr. 2d 378, 397 (1994) (considering parties' conduct both before and after making of contract).

89. See *Foothill Properties v. Lyon/Copley Corona Assocs.*, 46 Cal. App. 4th 1542, 1549-52, 54 Cal. Rptr. 2d 488, 492-94 (1996) (The fact that party rejected earlier drafts that included firm dates for completion of mapping of a development, and instead accepted a final writing requiring only that developer "diligently pursue" mapping, undercut proposed interpretation that mapping had to be completed by end of option contract.).

90. See, e.g., *Consolidated World Invs., Inc., v. Lido Preferred Ltd.*, 9 Cal. App. 4th 373, 379-80, 11 Cal. Rptr. 2d 524, 527-28 (1992) (positing that where contract was properly read to require that escrow close within sixty days but

covenant of good faith and fair dealing in every contract but also emphasize that the nature and extent of the duty depend on the contractual context.<sup>91</sup>

### *B. Interpretation and the Plain Meaning Rule*

In his widely cited *Pacific Gas & Electric v. G.W. Thomas Drayage & Rigging Co.*<sup>92</sup> opinion, Roger Traynor, a legendary justice of the California Supreme Court who served from 1940 to 1970,<sup>93</sup> observed that “[i]f words had absolute and constant referents, it might be possible to discover contractual intention in the words themselves and in the manner in which they were arranged. Words, however, do not have absolute and constant referents.”<sup>94</sup> According to Justice Traynor, then, contract terms will inevitably require some degree of contextual interpretation. Indeed, in *Pacific Gas* the California Supreme Court held that contract language can never be deemed sufficiently clear such that the terms should be given their “plain meaning” without at least a brief examination of extrinsic evidence that might further explain the parties’ intent.<sup>95</sup>

One cannot discuss the plain meaning rule in California without a discussion of *Pacific Gas* or its most famous criticism by Judge Alex Kozinski in *Trident Center v. Connecticut General Life Insurance*

failed to specify when escrow should open, a reasonable time for opening is one that allows for closing within sixty days); *cf. El Cajon v. El Cajon Police Officers’ Assoc.*, 49 Cal. App. 4th 64, 73, 56 Cal. Rptr. 2d 723, 728 (1996) (deeming labor contracts of indeterminate duration terminable at will).

91. *See, e.g., Foley v. Interactive Data Corp.*, 47 Cal. 3d 654, 684, 765 P.2d 373, 390, 254 Cal. Rptr. 211, 227-28 (1988) (holding that employment contract imposed duty of good faith but precise meaning depends on contractual purposes); *Torelli v. J.P. Enters., Inc.*, 52 Cal. App. 4th 1250, 1255-56, 61 Cal. Rptr. 2d 76, 79-80 (1997) (holding that duty of good faith prevented seller from circumventing duty to pay commission to real estate broker who located a buyer) *Foothill Properties*, 46 Cal. App. 4th at 1550, 54 Cal. Rptr. 2d at 492 (interpreting contract provision that developer would “diligently pursue” final mapping of new development to mean that developer was reasonable in delaying final mapping in light of dramatic downturn in real estate market).

92. 69 Cal. 2d 33, 442 P.2d 641, 69 Cal. Rptr. 561 (1968).

93. *See James R. McCall, Roger Traynor: Teacher, Jurist, and Friend*, 35 HASTINGS L.J. 741, 743-46 (1984). Traynor served as chief justice from 1964 to 1970. *See id.* at 745-46. For additional information on Judge Traynor, see Henry J. Friendly, *Ablest Judge of His Generation*, 71 CAL. L. REV. 1039, 1039 (1983).

94. *Pacific Gas*, 69 Cal. 2d at 38, 442 P.2d at 644, 69 Cal. Rptr. at 564; *cf. Kniffin, supra* note 58, at 644-49 (explaining untenable nature of plain meaning rule).

95. *See Pacific Gas*, 69 Cal. 2d at 40-41, 442 P.2d at 645-46, 69 Cal. Rptr. at 566.

Co.<sup>96</sup> Other cases in this area, such as the more recent California Supreme Court decision in *Waller v. Truck Insurance Exchange, Inc.*,<sup>97</sup> continue to point to the futility of the plain meaning rule while also reflecting the courts' tendency to try to use it.

1. *Pacific Gas & Electric v. G.W. Thomas Drayage & Rigging Co.*

*Pacific Gas* involved a contract calling for the G.W. Thomas Drayage & Rigging Company ("Thomas") to perform repair work on a steam turbine owned by Pacific Gas & Electric ("PG&E").<sup>98</sup> While making the repairs, a cover fell onto the turbine and caused more than \$25,000 worth of damage.<sup>99</sup> PG&E sought to hold Thomas liable for the repairs based upon language in the contract, a standard form agreement drafted by PG&E,<sup>100</sup> with a key term providing that Thomas would "indemnify" PG&E "against all loss, damage, expense and liability resulting from . . . injury to property, arising out of or in any way connected with the performance of this contract."<sup>101</sup>

PG&E brought suit and recovered a judgment at trial on the theory that the indemnity provision held Thomas responsible for all injury to property regardless of ownership.<sup>102</sup> At trial, Thomas attempted to rebut PG&E's position by offering extrinsic evidence that the indemnity clause was intended to cover harm to property belonging to third parties only.<sup>103</sup> The trial court, however, excluded the extrinsic evidence and held that the "plain language" of the agreement required Thomas to indemnify PG&E for all damage to property, regardless of ownership, including harm to the steam turbine belonging to PG&E.<sup>104</sup>

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96. 847 F.2d 564 (9th Cir. 1988).

97. 11 Cal. 4th 1, 900 P.2d 619, 44 Cal. Rptr. 2d 370 (1995).

98. See *Pacific Gas*, 69 Cal. 2d at 36, 442 P.2d at 643, 69 Cal. Rptr. at 563.

99. See *id.*

100. See *Pacific Gas & Elec. v. G.W. Thomas Drayage & Rigging Co.*, 62 Cal. Rptr. 203, 203 (1967).

101. *Id.* at 204. The full indemnity clause read:

Contractor [Thomas] shall indemnify Company [PG&E], its officers, agents, and employees, against all loss, damage, expense and liability resulting from injury to or death of person or injury to property, arising out of or in any way connected with the performance of this contract. Contractor shall, on Company's request, defend any suit asserting a claim covered by this indemnity. Contractor shall pay any costs that may be incurred by Company in enforcing this indemnity. *Id.* at 204.

102. See *Pacific Gas*, 69 Cal. 2d at 36, 442 P.2d. 643, 69 Cal. Rptr. at 563.

103. See *id.*

104. See *id.*

Despite ruling that the plain meaning required Thomas to compensate PG&E for the damage, the trial court observed that the language used was “the classic language for a third party indemnity provision” and that “one could very easily conclude that . . . its whole intendment is to indemnify third parties.”<sup>105</sup> Thus, rather paradoxically, while the trial court acknowledged that the contract language might have been understood to reflect a third party indemnity provision, it still refused to admit any extrinsic evidence for purposes of aiding the interpretation of the contract. The court gave the contract’s words a flat, absolute interpretation of covering harm to all property without consideration to ownership and ignored the possibility that in a particular context these words may have been used imperfectly to express a different intent.

Ironically, the trial court found the contract to have a plain meaning that was the antithesis of what the court of appeal found.<sup>106</sup> That is, the appellate court held that the language of the contract expressly limited Thomas to indemnification of PG&E’s liability for harm to third parties.<sup>107</sup> The court of appeal reinforced its decision by reference to a definition of “indemnity” found in the California Civil Code<sup>108</sup> and to the maxim that an ambiguous contract should be construed against the drafter, in this case PG&E.<sup>109</sup> Ultimately, the court of appeal held that the contract had an obvious meaning, even without resorting to extrinsic evidence,<sup>110</sup> and rendered final judgment in favor of Thomas.

The California Supreme Court rejected the conflicting plain

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105. *See id.*

106. *See Pacific Gas & Elec. v. G.W. Thomas Drayage & Rigging Co.*, 62 Cal. Rptr. 203, 204-05 (1967).

107. *See id.* at 204. After first noting that “[t]he term ‘indemnity’ has a distinct meaning in the law of contracts” involving a responsibility to save another from obligation incurred to a third person, the appellate court stated: “It is clear that the subject indemnity provision was drafted for the sole purpose of protecting the ‘Company’ [PG&E] from all third party claims made against it and that [PG&E] did not look to this provision to insure its own property.” *Id.*

108. *See id.* The appellate court stated, “Indemnity is a contract by which one engages to save another from a *legal consequence* of the conduct of one of the parties, or of some other person.” *Id.* (citing CAL. CIV. CODE § 2772 (West 1993)). The court then reasoned that since no legal consequence was imposed on PG&E by virtue of harm to its *own* property, the indemnity clause would not be relevant to the damage in the case. *See id.*

109. *See id.* at 204-05.

110. Because the trial court had excluded extrinsic evidence, the appellate court also rendered its decision without resort to such materials. *See id.*

meaning rulings of both the trial and the appellate courts.<sup>111</sup> Indeed, the rather remarkable fact that the trial and intermediate appellate courts could find conflicting “plain meanings” within the same contract language underscores the approach’s futility.<sup>112</sup> In a rather stinging rebuke of the plain meaning approach, Justice Traynor wrote for the majority<sup>113</sup> of the court:

When the court interprets a contract on this basis, it determines the meaning of the instrument in accordance with the “. . . extrinsic evidence of the judge’s own linguistic education and experience.” The exclusion of testimony that might contradict the linguistic background of the judge reflects a judicial belief in the possibility of perfect verbal expression. This belief is a remnant of a primitive faith in the inherent potency and inherent meaning of words.<sup>114</sup>

Justice Traynor further stated that patent or facial ambiguity is not the proper test for the admissibility of extrinsic evidence to aid the interpretation of a written contract. Rather, said Justice Traynor, the proper test is “whether the offered evidence is relevant to prove a meaning to which the language of the instrument is reasonably susceptible.”<sup>115</sup> Moreover, Justice Traynor saw two particular flaws in the “plain meaning” approach: the de-emphasis of the parties’ intent as found in extrinsic evidence and the presupposition that words may ordinarily have precise and stable meanings.<sup>116</sup>

Justice Traynor observed, with apparent disdain, that a plain meaning approach excluding the use of extrinsic evidence would determine the obligations of the parties based on a supposed neutral reading of “certain magic words” without concern as to what the parties may have actually intended.<sup>117</sup> Justice Traynor noted that the

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111. See *Pacific Gas*, 69 Cal. 2d at 40-41, 442 P.2d at 646, 69 Cal. Rptr. at 566. In the opinion, the supreme court spoke directly to only the trial court ruling; it did, however, vacate the appellate court decision. The supreme court’s reasoning was equally damaging to both the trial and appellate courts’ bases for decision. See *id.*

112. See also *supra* note 77 (discussing *Bank of the West v. Superior Court*, 2 Cal. 4th 1254, 833 P.2d 545, 10 Cal. Rptr. 2d 538 (1992), in which the trial and appellate courts found conflicting “plain” meanings in the contract language).

113. The court ruled 6 to 1 that the trial court had erred. Five justices concurred in the Traynor opinion, with Justice McComb dissenting without written opinion.

114. *Pacific Gas*, 69 Cal. 2d at 36-37, 442 P.2d at 643-44, 69 Cal. Rptr. at 563-64 (citations omitted).

115. *Id.* at 37, 442 P.2d at 644, 69 Cal. Rptr. at 564.

116. See *id.* at 37-38.

117. *Id.* at 38, 442 P.2d at 644, 69 Cal. Rptr. at 564. To exemplify this extreme

California law on interpretation emphasizes “the intention of the parties as expressed in the contract” but reasoned that the meaning of particular words varies with the context and parties involved.<sup>118</sup> Therefore, the application of the plain meaning rule might well result in giving a contract a meaning that the parties never intended. Justice Traynor cited the area of trade usage as an example of using extrinsic evidence to “interpret” rather than “supplement” the written terms.<sup>119</sup> He also acknowledged, however, that the practice of words being used to convey a special meaning may occur in other contexts as well.<sup>120</sup>

Justice Traynor thus ruled that “rational interpretation” required a court to engage in at least a preliminary consideration of all credible extrinsic evidence offered to prove the intention of the parties,<sup>121</sup> including testimony about the context of the making of the writing, with the court aiming to put itself into the position of the parties at the time the contract was made.<sup>122</sup> Only after engaging in a preliminary review and concluding that a proffered interpretation is reasonable should the court actually admit the extrinsic evidence to support it.<sup>123</sup> Ostensibly, the finder of fact must then determine which

plain meaning or objective approach, Traynor quoted an earlier opinion by Justice Holmes: “A contract has, strictly speaking, nothing to do with the personal, or individual, intent of the parties. A contract is an obligation attached by the mere force of law to certain acts of the parties, usually words, which ordinarily accompany and represent a known intent.” *Hotchkiss v. National City Bank of New York*, 200 F. 287, 293 (S.D.N.Y. 1911).

118. *Id.* Justice Traynor argued that words can only have meaning in light of the “verbal context and surrounding circumstances” and the linguistic background of the parties. *See id.* at 38, 442 P.2d at 644, 69 Cal. Rptr. at 564 (quoting Arthur L. Corbin, *The Interpretation of Words and the Parol Evidence Rule*, 50 CORNELL L.Q. 161, 187 (1965)).

119. *See id.* at 39, 442 P.2d at 645, 69 Cal. Rptr. at 565.

120. *See id.* at 39, 442 P.2d at 645, 69 Cal. Rptr. at 565. Justice Traynor cited a number of examples of words taking on special meaning by virtue of trade usage: the term “United Kingdom” in a motion picture distribution contract including Ireland; the word “ton” meaning a long ton or 2240 pounds; the word “stubble” including not only stumps but everything “left on the ground after the harvest time;” the term “north” indicating a boundary line running along the “magnetic and not the true meridian;” and a form contract for purchase and sale which was actually an agency contract. *See id.* at 39 n.6, 442 P.2d at 645 n.6, 69 Cal. Rptr. at 565 n.6. (citations omitted).

121. *Id.* at 39-40, 442 P.2d at 645, 69 Cal. Rptr. at 565 (citing CAL. CIV. CODE § 1647 (West 1985); CAL. CIV. PROC. CODE § 1860 (West 1983)).

122. *See id.* at 40, 442 P.2d at 645, 69 Cal. Rptr. at 565, (citing *Universal Sales Corp. v. California Press Mfg. Co.*, 20 Cal. 2d 751, 761, 128 P.2d 665, 672 (1942); *Lemm v. Stillwater Land & Cattle Co.*, 217 Cal. 474, 480-81, 19 P.2d 785, 788 (1933)).

123. *See id.* at 39-40, 442 P.2d at 645-46, 69 Cal. Rptr. at 565-66.



of the possible, reasonable interpretations is better supported by the facts. This approach is consistent with the approach in section 214 of the *Restatement (Second)*.<sup>124</sup>

The court in *Pacific Gas* concluded by noting the facial ambiguity caused by including a type of indemnity clause sometimes used to reference harm to property of third parties, and the fact that the term "indemnify" can apply either to third parties or to contracting parties, as evidenced by its definitions in various dictionaries.<sup>125</sup> The court also determined that other provisions in the contract did not resolve the ambiguity otherwise present.<sup>126</sup> The case was remanded for retrial.

Importantly, Justice Traynor acknowledged the key difference between extrinsic evidence used to "add to, detract from, or vary the terms of a written contract" and extrinsic evidence used to interpret the terms that are concededly part of the written agreement.<sup>127</sup> Thus, the opinion drew the distinction between the interpretation issues that it addressed and the supplementation issues addressed in *Masterson* as discussed below.<sup>128</sup>

Although some might accuse Justice Traynor of overindulgence with his reference to mystical beliefs in the power of words,<sup>129</sup> *Pacific*

124. See RESTATEMENT (SECOND) OF CONTRACTS § 214 cmt. b. (1981) ("[W]ords, written or oral, cannot apply themselves to the subject matter . . . . Even though words seem on their face to have only a single possible meaning, other meanings often appear when the circumstances [of their application] are disclosed.").

125. See *Pacific Gas*, 69 Cal. 2d at 41-42 n.9, 442 P.2d at 646-47 n.9, 69 Cal. Rptr. at 566-67 n.9.

126. PG&E argued unsuccessfully that the use of the word "all" to qualify the loss prevented application only to third parties and that the provisions that defendant perform the work "at his own risk and expense" and procure liability insurance to cover damages to plaintiff's property also amount to absolute assumptions of liability. See *id.*

127. *Id.* at 39, 442 P.2d at 645, 69 Cal. Rptr. at 565.

128. See *infra* Part II.C.1.

129. Justice Traynor included reference to mystical beliefs in the magic of words in two footnotes, quoting in one note:

"The elaborate system of taboo and verbal prohibitions in primitive groups; the ancient Egyptian myth of Khern, the apotheosis of the word, and of Thoth, the Scribe of Truth, the Giver of Words and Script, the Master of Incantations; the avoidance of the name of God in Brahmanism, Judaism and Islam; totemistic and protective names in mediaeval Turkish and Finno-Ugrian languages; the misplaced verbal scruples of the 'Precieuses'; the Swedish peasant custom of curing sick cattle smitten by witchcraft, by making them swallow a page torn out of the psalter and put in dough . . . ."

And in another footnote: "'Rerum enim vocabula immutabilia sunt, homines mutabilia,' (Words are unchangeable, men changeable) . . . ."

*Gas* ultimately stands both as a penetrating disestablishment of the plain meaning rule and as a framework for the consideration of extrinsic evidence in interpreting contracts. Courts should first resist any temptation to apply an apparent plain meaning and should take a preliminary look both at the contracting context and at the parties' proffered interpretations. If the contract is reasonably susceptible to more than one meaning, then the finder of fact should hear extrinsic evidence relative to those meanings to determine what agreement the parties in fact made. If the contract is not reasonably susceptible to more than one meaning, then the interpretive process should conclude after the court has completed its preliminary look at the context and the extrinsic evidence. Despite the solid reasoning and clear lessons from *Pacific Gas*, courts have misapplied its approach—none more visibly and notoriously than United States Court of Appeals for the Ninth Circuit in *Trident Center v. Connecticut General Life Insurance Co.*<sup>130</sup>

## 2. *Trident Center v. Connecticut General Life Insurance Co.*

Judge Alex Kozinski authored the Ninth Circuit decision in *Trident Center* that took direct aim at the holding in *Pacific Gas*. The *Trident Center* opinion bemoaned that in *Pacific Gas* the California Supreme Court “turned its back on the notion that a contract can ever have a plain meaning discernible by a court without resort to extrinsic evidence.”<sup>131</sup> Judge Kozinski subsequently reiterated his regret, saying that the time has passed when “a clear contractual term means what it says.”<sup>132</sup> While busy criticizing *Pacific Gas* and

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*Pacific Gas*, 69 Cal. 2d at 37 n.2, 442 P.2d at 644 n.2, 69 Cal. Rptr. at 563-64 n.2 (citations omitted). Judge Kozinski described these citations as “unusual” in the course of his criticism of *Pacific Gas*. See *Trident Ctr. v. Connecticut Gen. Life Ins. Co.*, 847 F.2d 564, 569 n.5 (9th Cir. 1988).

130. 847 F.2d 564 (9th Cir. 1988).

131. *Id.* at 568.

132. *Wilson Arlington Co. v. Prudential Ins. Co. of America*, 912 F.2d 366, 369 (9th Cir. 1990). Judge Kozinski wrote:

There was a time, not all that long ago, when parties to a commercial transaction could rely on a simple maxim—a clear contractual term means what it says. Based on the notion that words can be used to convey a clear meaning, this principle formed the underpinnings of the parol evidence rule that made extrinsic evidence inadmissible to interpret, vary or add to the terms of an unambiguous written instrument . . . . [I]n *Pacific Gas & Electric* the California Supreme Court, without expressly abolishing the parol evidence rule, cut the life out of it by permitting the introduction of extrinsic evidence to demonstrate the existence of an ambiguity even when the language of a contract is perfectly clear.

*Id.* at 369-70 (citations omitted).

mythologizing its recognition of the inherent limits in human expression, Judge Kozinski failed to recognize that under *Pacific Gas* a court may well dispose of a case summarily once it determines that the proposed interpretation is unreasonable in light of the transactional context.

*Trident Center* involved a \$56.5 million loan agreement between two business entities for the construction of an office building in West Los Angeles.<sup>133</sup> Interest rates dropped after a few years and Trident, the debtor, sought to refinance the loan.<sup>134</sup> The lender, however, resisted and relied on provisions in the contract that restricted early prepayment of the loan.<sup>135</sup> The district court found the terms of the loan agreement to be clear and unambiguous and therefore dismissed Trident's complaint.<sup>136</sup> Moreover, the trial court, on its own initiative, sanctioned the plaintiff for filing a "frivolous lawsuit."<sup>137</sup>

Trident appealed and Judge Kozinski wrote the opinion reversing the trial court and remanding the case on the grounds that dismissal was improper under California state law.<sup>138</sup> Specifically, the Ninth Circuit reasoned that although the terms of the writing were clear and unambiguous on its face, California state law required the trial court to still consider extrinsic evidence because it might reveal a latent ambiguity or alternative meaning. Judge Kozinski wrote:

Under *Pacific Gas*, it matters not how clearly a contract is written, nor how completely it is integrated, nor how carefully it is negotiated, nor how squarely it addresses the issue before the court: the contract cannot be rendered impervious to attack by parol evidence. If one side is willing to

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133. See *Trident Center*, 847 F.2d at 566.

134. See *id.*

135. See *id.* The promissory note provided that the debtor "shall not have the right to prepay the principal amount hereof in whole or in part [during its first 12 years]." *Id.* Trident argued that because another clause provided that "in the event of a prepayment resulting from a default hereunder [during its first 12 years] the prepayment fee will be ten percent (10%)," it had the option of prepaying the loan and paying a 10% prepayment fee. *Id.* Judge Kozinski accurately pointed out that the second clause did not give the borrower the right to prepay in contradiction of the earlier provision, but rather was properly read to give the lender the right to declare default and require prepayment. See *id.* at 566-67. Declaring default, however, was not the only remedy available to the lender. See *id.* at 567-68 n.3.

136. See *id.* at 566. Trident had initiated an action for declaratory judgment in California state court and Connecticut General, the lender, successfully removed the suit to federal court. See *id.* at 566.

137. *Id.*

138. See *id.* at 570.

claim that the parties intended one thing but the agreement provides for another, the court must consider extrinsic evidence of possible ambiguity. If that evidence raises the specter of ambiguity where there was none before, the contract language is displaced and the intention of the parties must be divined from self-serving testimony offered by partisan witnesses whose recollection is hazy from passage of time and colored by their conflicting interests. We question whether this approach is more likely to divulge the original intention of the parties than reliance on the seemingly clear words they agreed upon at the time.<sup>139</sup>

Judge Kozinski expressed great dismay that notwithstanding the size and significance of the transaction, the presumed sophistication of the parties, the assistance of counsel, and the clarity of the terms, California law still would allow the written terms to be challenged by extrinsic evidence.<sup>140</sup> Judge Kozinski observed, in a hyperbolic fashion common to much of his writing,<sup>141</sup> that "*Pacific Gas* casts a long shadow of uncertainty over all transactions negotiated and executed under the law of California . . . . While this rule creates much business for lawyers and an occasional windfall to some clients, it leads only to frustration and delay for most litigants and clogs already overburdened courts."<sup>142</sup>

Judge Kozinski then reversed and remanded the case, but not without constant grumbling, along with instructions for the trial court

139. *Id.* at 569 (citations omitted). Justice Mosk's early criticism of *Pacific Gas* in *Delta Dynamics, Inc. v. Arioto*, 69 Cal. 2d 525, 531-32, 446 P.2d 785, 789, 72 Cal. Rptr. 785, 789 (1968) (Mosk, J., dissenting), also influenced Judge Kozinski. Justice Mosk wrote:

Once again this court adopts a course leading toward emasculation of the parol evidence rule. During this very year [*Masterson* and *Pacific Gas*] have contributed toward that result. Although I had misgivings at the time, I must confess to joining the majority in both of those cases. Now, however, that the majority deem negotiations leading to execution of contracts admissible, the trend has become so unmistakably ominous that I must urge a halt.

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Given two experienced businessmen dealing at arm's length, both represented by competent counsel, it has become virtually impossible under recently evolving rules of evidence to draft a written contract that will produce predictable results in court.

*Id.*

140. See *Trident Center*, 847 F.2d at 569.

141. See *United States v. Phelps*, 895 F.2d 1281 (9th Cir. 1990) (Kozinski, J., dissenting); David A. Golden, Comment, *Humor, the Law, and Judge Kozinski's Greatest Hits*, 1992 BYU L. REV. 507.

142. *Trident Center*, 847 F.2d at 569.

to give the plaintiff the opportunity to present extrinsic evidence relevant to the parties' intent at the time of drafting the contract.<sup>143</sup> Judge Kozinski also reversed the sanctions award, noting that the trial court had imposed them because it deemed the contract language so "crystal-clear" that Trident's attorneys must have brought the action in bad faith.<sup>144</sup> Because the Ninth Circuit Court felt obliged under California law to reverse on the issue of contract interpretation, Judge Kozinski also reasoned that the court must reverse the sanctions. In doing so, however, Judge Kozinski imparted some final shots at *Pacific Gas* by suggesting that the case invites frivolous lawsuits and by recommending that the California Supreme Court revisit the *Pacific Gas* holding and take the *Trident Center* case as an example of why the more traditional rule on extrinsic evidence is "far wiser."<sup>145</sup>

Judge Kozinski made three significant observations in his opinion, including two footnotes, that severely undercut his criticism of *Pacific Gas*. First, the judge clearly and expressly concluded that the loan contract was not reasonably susceptible to the interpretation proffered by the debtor.<sup>146</sup> Under the rule enunciated in *Pacific Gas*, if the trial court, after a preliminary look at the extrinsic evidence, reaches the same conclusion as it did before reviewing the evidence, then exclusion of the extrinsic evidence would be proper and dismissal or other summary disposal of the case would be appropriate. *Pacific Gas* only requires the trial court to take a preliminary look at the proffered interpretation and related extrinsic evidence before reaching a conclusion about the apparent "plain meaning" of the contract. This precaution is not unreasonable considering the procedural history of *Pacific Gas*, in which the trial and appellate courts deemed the same contract to have two conflicting plain meanings.<sup>147</sup> Nevertheless, if the court concludes that the contract is not reasonably susceptible to the proposed interpretation, then dismissal is

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143. See *id.* at 570. At different points in the opinion Kozinski paused to say that the court had "doubts about the wisdom of *Pacific Gas*," and that "[i]t may not be a wise rule we are applying, but it is a rule that binds us." *Id.* at 569-70 (citing *Erie R.R. Co. v. Tompkins*, 304 U.S. 64, 78 (1938)).

144. See *id.*

145. *Id.*

146. See *id.* at 568. Judge Kozinski wrote: "[The debtor] wishes to offer extrinsic evidence that the parties had agreed Trident could prepay at any time within the first 12 years by tendering the full amount plus a 10 percent prepayment fee. As discussed above, this is an interpretation to which the contract, as written, is not reasonably susceptible." *Id.*

147. See *supra* Part II.B.1.

proper at an early point in the proceedings.<sup>148</sup>

In his footnotes, Judge Kozinski also stated that the lender might obtain summary judgment after completion of discovery unless Trident could present some extrinsic evidence to raise a triable issue of interpretation—a dubious proposition given the relatively clear language of the contract.<sup>149</sup> The extreme nature of his criticism seems inappropriate given that Judge Kozinski recognized that the action could still be disposed of early in the proceedings. Finally, the judge stated that sanctions might even be appropriate for parties “urging an interpretation lacking any objectively reasonable basis in fact” for “facially unambiguous contracts.”<sup>150</sup> The import of Judge Kozinski’s latter suggestions is that a party may indeed offer a proposed interpretation of an agreement that is so inconsistent with the express terms, once context is considered pursuant to *Pacific Gas*, that the court would be proper in summarily disposing of the case without going further in the proceedings. Indeed, that may well have been the case in *Trident Center* had Judge Kozinski not been so determined to use it as a springboard for his criticism of *Pacific Gas*.<sup>151</sup>

### 3. More recent plain meaning cases, including *Waller v. Truck Insurance Exchange*

In contrast to Judge Kozinski’s exaggerated misreading of the *Pacific Gas* decision, many subsequent decisions in the California courts properly apply its approach. *Winet v. Price*,<sup>152</sup> represents a

148. See *Winet v. Price*, 4 Cal. App. 4th 1159, 1172-73, 6 Cal. Rptr. 2d 554, 562 (1992) (affirming grant of summary judgment based on proffered interpretation being inconsistent with written terms). Also see *infra* text accompanying notes 152-71.

149. See *Winet*, 4 Cal. App. 4th at 1172-73, 6 Cal. Rptr. at 562.

150. See *id.* at 570 n.9.

151. Others have noted the inaccuracy of the picture of *Pacific Gas* painted by Judge Kozinski. See *Banco Do Brasil, S.A. v. Latian, Inc.*, 234 Cal. App. 3d 973, 1011 & n.53, 285 Cal. Rptr. 870, 893 & n.53 (1991) (describing Judge Kozinski’s characterization of *Pacific Gas* as “unfortunate” and “inaccurate” and reaffirming that sophisticated parties to commercial transactions are capable of having writings which “fully and completely define a particular legal relationship”); *FPI Dev., Inc. v. Nakashima*, 231 Cal. App. 3d 367, 389 n.10, 282 Cal. Rptr. 508, 521 n.10 (1991) (observing that the *Pacific Gas* “view of meaning does not embody the unconstrained view of language that some ascribe to it” and that a court “is not required to accept implausible or semantically impermissible claims of meaning”); see also Martin-Davidson, *supra* note 69, at 16-19; Jeffery J. Devashrayee, Note, *Trident Center v. Connecticut General Life Insurance Co.: The Continuing Demise of the California Parol Evidence Rule*, 1989 UTAH L. REV. 991, 1008-11.

152. 4 Cal. App. 4th 1159, 6 Cal. Rptr. 2d 554 (1992).

good example of a court summarily rejecting a proposed interpretation of a contract. Defendant Price served as attorney for Winet, performing a number of legal tasks from 1973 to 1975.<sup>153</sup> A dispute arose between the parties in 1975 concerning the legal fees that Winet owed.<sup>154</sup> With legal counsel representing Winet, the parties settled the matter by execution of a general release in 1975 that very explicitly covered known and existing disputes, as well as unknown and subsequent claims.<sup>155</sup>

Fifteen years after signing the general release, Winet's partners sued him over a particular venture for which Price had drafted the partnership agreement.<sup>156</sup> In turn, Winet cross-complained against Price alleging that Price had committed malpractice in drafting the partnership agreement.<sup>157</sup> Price moved for summary judgment on the basis that the 1975 release clearly barred any claim by Winet.<sup>158</sup> Despite the release's broad language, Winet opposed the motion for summary judgment by alleging that he did not intend to waive all claims he might have against Price and that at the time he signed the release he was unaware that the dispute with his former partners might possibly arise.<sup>159</sup> The trial court granted summary judgment for Price, "concluding that the release was broadly designed to bar all claims of malpractice . . . that it was specifically negotiated with the help of counsel, and that the significance of Winet's waiver . . . was explained and understood by the parties."<sup>160</sup>

The appellate court had no difficulty affirming the grant of summary judgment in favor of Price, the lawyer.<sup>161</sup> The *Winet* court correctly followed the *Pacific Gas* rule by first noting that the test for admissibility of extrinsic evidence for interpretation purposes is whether the writing is ambiguous.<sup>162</sup> The court makes this determination not by a test of plain meaning or patent ambiguity but on the basis of whether the proffered evidence supports "a meaning to which the [contract] language is 'reasonably susceptible'" given the

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153. *See id.* at 1162, 6 Cal. Rptr. 2d at 555.

154. *See id.*

155. *See id.*

156. *See id.*

157. While the release expressly excluded from its scope a particular transaction, the one in question was not mentioned in the exclusion. *See id.* at 1163, 6 Cal. Rptr. 2d at 556.

158. *See id.*

159. *See id.* at 1164, 6 Cal. Rptr. 2d at 556.

160. *Id.*

161. *See id.* at 1172-73, 6 Cal. Rptr. 2d at 562.

162. *See id.* at 1165, 6 Cal. Rptr. 2d at 557.

transactional context.<sup>163</sup> The court also noted that the extrinsic evidence offered cannot be used “to flatly contradict the express terms of the agreement.”<sup>164</sup> The court went on to state:

The decision whether to admit parol evidence involves a two-step process. First, the court provisionally receives (without actually admitting) all credible evidence concerning the parties’ intentions to determine “ambiguity,” i.e., whether the language is “reasonably susceptible” to the interpretation urged by a party. If in light of the extrinsic evidence the court decides the language is “reasonably susceptible” to the interpretation urged, the extrinsic evidence is then admitted to aid in the second step—interpreting the contract.<sup>165</sup>

The appellate court quickly determined that *Winet* failed miserably as to the first step because the language of the contract was not at all susceptible to his proposed interpretation.<sup>166</sup> As the court stated, “*Winet* . . . seeks to prove that a release of unknown or

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163. *Id.* at 1167, 6 Cal. Rptr. 2d at 558 (citing *Pacific Gas*, 69 Cal. 2d at 37, 442 P.2d at 644, 69 Cal. Rptr. at 564). The court specifically noted that it should consider evidence about the circumstances at the making of the contract and its object, nature, and subject matter, so that it could understand the perception of the parties at the time the contract was made. See *Winet*, 4 Cal. App. 4th at 1168, 6 Cal. Rptr. 2d at 559; see also *Consolidated World Invs., Inc., v. Lido Preferred Ltd.*, 9 Cal. App. 4th 373, 379, 11 Cal. Rptr. 2d 524, 526-27 (1992) (following *Winet* in allowing extrinsic evidence to aid in determining whether contract language was ambiguous).

164. *Winet*, 4 Cal. App. 4th at 1167, 6 Cal. Rptr. 2d at 558 (citing *Stevenson v. Oceanic Bank*, 223 Cal. App. 3d 306, 317-18, 272 Cal. Rptr. 757, 764 (1990)); see also *Consolidated*, 9 Cal. App. 4th at 379, 11 Cal. Rptr. 2d at 526-27 (noting that parol evidence is only admissible to prove meaning to which the contract language is reasonably susceptible).

165. *Winet*, 4 Cal. App. 4th at 1165, 6 Cal. Rptr. 2d at 557 (citing *Blumenfeld v. R.H. Macy & Co.*, 92 Cal. App. 3d 38, 45, 154 Cal. Rptr. 652, 655 (1979)). The court noted that different standards of appellate review may be applicable to each of the two steps. See *id.* The trial court’s ruling on the question of “ambiguity”—or whether the proffered evidence is relevant to prove a meaning to which the language is reasonably susceptible—is a question of law, not of fact. See *id.* The second step, in the event that the language is deemed ambiguous, might involve differing standards of review, depending upon the nature of the parol evidence used to construe the contract. See *id.* at 1165-66, 6 Cal. Rptr. 2d at 557. If the parol evidence is in conflict and involves determinations of credibility, the appellate court must uphold the finding as long as it is supported by substantial evidence. See *id.* at 1166, 6 Cal. Rptr. 2d at 557. However, when the relevant parol evidence is not in conflict, construction of the instrument is a question of law, and the appellate court may engage in *de novo* review. See *id.* In *Winet* the extrinsic evidence was not in conflict. See *id.*

166. See *id.* at 1167, 6 Cal. Rptr. 2d at 558.



unsuspected claims was *not* intended to include unknown or unsuspected claims."<sup>167</sup> The court reinforced its decision by underscoring that all of the contracting circumstances indicated that the parties mutually intended the release of unknown claims of the very type advanced by *Winet*.<sup>168</sup> In this situation, the proper outcome under *Pacific Gas* is the exclusion of the proffered extrinsic evidence and, probably, the summary dismissal of the claim. While Judge Kozinski had trouble perceiving this as a proper application of Justice Traynor's test, the *Winet* court, and several others, have had little difficulty.<sup>169</sup>

Unfortunately, and in contrast to the solid reasoning in *Winet*, a line of cases exists which suggests that courts may find ambiguity by looking solely at the written contract itself without reference to extrinsic evidence, even as a provisional matter.<sup>170</sup> Although extrinsic evidence may occasionally reinforce or fail to remove an ambiguity,<sup>171</sup>

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167. *Id.* (emphasis added).

168. *See id.* at 1168, 6 Cal. Rptr. 2d at 559. The court also noted that *Winet* was represented by counsel, that he was aware of the possibility of malpractice claims against Price, that he signed a release referring specifically to California Civil Code section 1542 concerning the risk of unknown claims, and that the parties used language which excepted a certain transaction from the release. *See id.*

169. The *Winet* court relied considerably on *Edwards v. Comstock Ins. Co.*, 205 Cal. App. 3d 1164, 252 Cal. Rptr. 807 (1988). The *Edwards* court stated:

Appellants urge us to interpret the plain language in their release agreements discharging respondents from "any and all claims . . ." to mean "all claims except claims for bad faith . . ." Under the circumstances presented here, we decline to rewrite appellants' release agreements to include a concept they failed to enunciate at the time they accepted the terms of the settlement with their insurer.

*Id.* at 1167, 252 Cal. Rptr. at 809. Of importance to the court was the fact that the parties entered into the release without any evidence of lack of capacity or fault in the contract formation process. *See id.* at 1168-69, 252 Cal. Rptr. at 809-10. Another case, *S. Kornreich & Sons, Inc. v. Genesis Ins. Co.*, 56 Cal. App. 4th 407, 414-15, 65 Cal. Rptr. 2d 418, 421-22 (1997), properly applies Justice Traynor's test. In that case, the court found that an insurance policy was not reasonably susceptible to the insured's proposed meaning that the temporary policy—expressly limited to a ninety-day period—would convert automatically into a permanent policy. *See id.* at 423.

170. *See, e.g.,* *Southern Cal. Edison Co. v. Superior Court*, 37 Cal. App. 4th 839, 848, 44 Cal. Rptr. 2d 227, 232 (1995) (stating that whether a contract is reasonably susceptible to a party's interpretation can be determined from the language of the contract itself); *Ridgley v. Topa Thrift & Loan Ass'n*, 54 Cal. App. 4th 729, 739, 62 Cal. Rptr. 2d 309, 315 (1997) (stating that a contract is ambiguous when on its face it is capable of two different reasonable interpretations).

171. *See, e.g.,* *Edison*, 37 Cal. App. 4th at 849-50, 44 Cal. Rptr. 2d at 233.

The multiple contracts involved long-term agreements by Southern California Edison Company to purchase electricity generated by wind-powered turbines owned by Energy Development and Construction Corporation and San

a considerable chance also exists that an apparent facial ambiguity might actually be resolved by a provisional resort to extrinsic evidence as *Pacific Gas* dictates. Thus, a provisional resort to the extrinsic evidence may well provide the more efficient approach because it avoids engaging the court in a more extended process to resolve an ambiguity that does not really exist.

Despite the clear dictate of *Pacific Gas*, California courts continue to decide questions of interpretation based on the apparent plain meaning of the agreement without resort to extrinsic evidence and in contradiction of the parties' probable intent. *Ridgley v. Topa Thrift & Loan Association*<sup>172</sup> provides an example. The case involved an agreement for a "bridge loan" for construction of a luxury home that was to be sold upon completion.<sup>173</sup> Because a bridge loan temporarily covers the period after construction and before permanent financing of the home,<sup>174</sup> one would expect repayment of the loan shortly after the developer finds a buyer. Nevertheless, the lender initially proposed a two-year loan contract containing stock language with a prepayment penalty clause for a contract of at least five years.<sup>175</sup> After the borrower objected to this provision, a lending officer advised him that there would be no prepayment penalty after six months.<sup>176</sup> An addendum was added for this purpose but contained additional, qualifying language that read:

Provided all scheduled payments have been received not more than 15 days after their scheduled due date, and further provided that there have been no other defaults under the terms of this note or any other now existing or future obligation of borrower to Topa, then no prepayment charge

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Gorgonio Farms. The contracts were divided into a 10-year "first period" and a second period covering the remainder of the contract for which Edison would pay a higher price. *See id.* at 843-44, 44 Cal. Rptr. 2d at 229-30.

Addressing a dispute about the running of the first period, the trial court limited its review of the contract to the written terms and concluded that it had a plain meaning. *See id.* at 844, 44 Cal. Rptr. 2d at 230. The appellate court found, however, that not only did the contract contain patent ambiguity, but that extrinsic evidence also supported the finding of ambiguity. *See id.* at 849-50, 44 Cal. Rptr. 2d at 233.

172. 54 Cal. App. 4th 729, 62 Cal. Rptr. 2d 309 (1997).

173. *See id.* at 733, 62 Cal. Rptr. 2d at 311.

174. *See Ridgley*, 54 Cal. App. 4th at 733, 62 Cal. Rptr. 2d at 311.

175. *See id.* ("Borrower will pay to Lender a prepayment charge of six (6) months' interest at rate in effect at the time of prepayment on the amount prepaid . . . . No such prepayment charge will be made on prepayments made five (5) or more years after the date of this Note.")

176. *See id.*

will be assessed if this loan is paid in full after June 21, 1991.<sup>177</sup>

The parties executed the note on December 21, 1990, and the borrower made all payments in a timely fashion through January 1992 but failed to make timely payments for February and March 1992.<sup>178</sup> The April 1992 payment was satisfied, in essence, by payment of the balance of the loan when the property was sold.<sup>179</sup> The borrower objected when the lender asserted a prepayment charge based on the fact that the February and March 1992 payments were not made on time.<sup>180</sup> The lender interpreted the addendum to state that the borrower could not prepay without a penalty during the first six months and could do so after the first six months only if he had not defaulted on any payment up to the time of prepayment.<sup>181</sup> The borrower asserted, to the contrary, that his understanding of the contract was that as long as he made all payments on time for the first six months and kept the loan for at least six months, there would be no prepayment charge even if a default occurred after the first six months.<sup>182</sup> After first paying the penalty, the borrower sued to recover the charge.<sup>183</sup>

The trial court decided for the plaintiff borrower on the basis that the prepayment charge constituted an unenforceable forfeiture.<sup>184</sup> The appellate court reversed the judgment on this ground, deciding that the clause was a valid prepayment provision that constituted consideration for the lender accepting payment before it was obligated to do so.<sup>185</sup> The appellate court, however, did not stop there. It proceeded to decide the contract interpretation issue, holding that the lender was entitled to the prepayment charge under the only reasonable reading of the contract.<sup>186</sup>

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177. *Id.*

178. *See id.* at 734, 62 Cal. Rptr. 2d at 312.

179. *See id.* at 734-35, 62 Cal. Rptr. 2d at 312-13.

180. *See id.* at 735, 62 Cal. Rptr. 2d at 312-13.

181. *See id.* at 735, 62 Cal. Rptr. 2d at 312.

182. *See id.* at 733-34, 62 Cal. Rptr. 2d at 311.

183. *See id.* at 735-36, 62 Cal. Rptr. 2d at 313. The borrower sought to recover a total amount of \$114,622.42 plus interest, late fees assessed by the lender, and attorney's fees. The trial court awarded the borrower more than \$190,000. *See id.*

184. *See id.* at 736, 62 Cal. Rptr. 2d at 313.

185. *See id.* at 737, 62 Cal. Rptr. 2d at 314. This conclusion is premised on the principle that the debtor has no right to prepay the loan and must bargain with the lender to have his early payment accepted. *See id.*

186. *See id.* at 739, 62 Cal. Rptr. 2d at 315.

The appellate court justified its decision on the ground that an appellate court in California may independently determine a contract interpretation issue where there is no need for extrinsic evidence.<sup>187</sup> While the appellate court arguably did take the "provisional look" at extrinsic evidence that *Pacific Gas* mandates, the *Ridgley* court explicitly denied that it needed to consider any such evidence.<sup>188</sup>

Notably, the trial court found that there *was* a triable issue of fact because it found the contract language to be ambiguous.<sup>189</sup> Moreover, the dissenting appellate court justice also expressed concern that the clause in question might be ambiguous.<sup>190</sup> Finally, the nature of the bargaining history and the very nature of the temporary bridge loan lent some credibility to the borrower's claim that no prepayment was to be assessed after the first six months of the life of the loan. Such a clause certainly appears reasonable for a bridge loan.<sup>191</sup>

Nevertheless, the important observation about *Ridgley* is the appellate court's willingness to decide the important issue on the basis of the plain meaning rule, without bothering to take into account the extrinsic evidence, and holding that the contract was not susceptible to the borrower's asserted meaning. Indeed, the relevant portion of the appellate court's majority opinion is remarkably brief and contains no analysis of the competing interpretations.<sup>192</sup> Rather, this very recent decision seems to reflect the two majority judges' perception

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187. *See id.*

188. The court stated, "under the plain language of the provision, [the lender's] interpretation [was] the only reasonable one." *Id.* The court also said it could decide the issue because there was "no need for extrinsic evidence." *Id.*

189. The case was actually handled by two trial court judges. The first held that there was a triable issue of fact because the contract language was ambiguous, noting particularly that the first draft of the prepayment clause was designed for a five-year loan even though the term of the instant agreement was two years. *See id.* at 736, 62 Cal. Rptr. 2d at 313. Moreover, the first trial court judge also decided that the language could reasonably be read to mean that if no default occurred during the first six months, the prepayment penalty would be waived and could not be revived. *See id.*

190. *See id.* at 741-42, 62 Cal. Rptr. 2d at 316 (Johnson, J., dissenting). The dissent, however, rested primarily on the view that the prepayment charge was a penalty and an unenforceable forfeiture under relevant California law. *See id.* (Johnson, J., dissenting).

191. *See id.* at 733-34, 62 Cal. Rptr. 2d at 311-12.

192. The court briefly stated the two opposing interpretations of the parties before quickly concluding: "An appellate court may make an independent interpretation of a written contract when there is no need for extrinsic evidence. We conclude that under the plain language of the provision, defendant's interpretation is the only reasonable one." *Id.* at 739, 62 Cal. Rptr. 2d at 315 (citations omitted).

that their assessment of the language against their own linguistic backgrounds could be the only reasonable one, notwithstanding the contrary opinions of the trial and dissenting appellate court judges. Thus, the case reflects the continued application and appeal of the plain meaning approach despite the clear dictate of *Pacific Gas*.<sup>193</sup> Indeed, *Ridgley* failed to cite *Pacific Gas* at any point.

Another fascinating example of the continued application of the plain meaning rule lies in one of the more recent California Supreme Court decisions involving contract interpretation, *Waller v. Truck Insurance Exchange*.<sup>194</sup> *Waller* concerned a dispute between an insured and an insurance company about the insurance company's obligation to defend the insured under a commercial general liability policy ("CGL").<sup>195</sup> Chief Justice Malcolm Lucas's majority opinion cited the California Civil Code sections that clearly endorse a plain meaning approach to contract interpretation and thus purported to be applying that method.<sup>196</sup> Closer analysis of the opinion, however, reveals that the majority applied a contextual approach to determining the meaning of the language and, as noted by the concurring and dissenting opinion, placed as much emphasis upon industry practice as on the particular language of the contract.<sup>197</sup> In fact, the concurring and dissenting opinion of Justice Kennard persuasively asserted that the plain meaning of the policy language would not support the majority's reasoning.<sup>198</sup>

*Waller* involved a closely-held corporation with two initial shareholders, James Waller, who owned sixty percent of the stock, and Lester Amey, who owned forty percent of the stock.<sup>199</sup> After Waller sold his shares in even proportions to four employees without

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193. Cf. Kniffin, *supra* note 58, at 654-55 (suggesting that *Pacific Gas* has been followed in California decisions but citing primarily federal court decisions).

194. 11 Cal. 4th 1, 900 P.2d 619, 44 Cal. Rptr. 2d 370 (1995).

195. A general commercial liability policy provides insurance for businesses against responsibility for accidents. See *Waller*, 11 Cal. 4th at 16, 900 P.2d at 625, 44 Cal. Rptr. 2d at 376. The policies will usually identify the risks that are covered and then specify any exclusions from those general areas of risk. See *id.*

196. Chief Justice Lucas cited section 1639, which provides that intent is to be inferred, if possible, solely from the written provisions of the contract. See *id.* at 18, 900 P.2d at 627, 44 Cal. Rptr. 2d at 378. He also cited section 1638, providing that a court should look first to the language of the contract in order to ascertain its plain meaning or the meaning a layperson would ordinarily attach to it. See *id.*

197. See *id.* at 37-38, 900 P.2d at 640, 44 Cal. Rptr. 2d at 391 (Kennard, J., concurring and dissenting).

198. See *id.* (Kennard, J., concurring and dissenting).

199. See *id.* at 11, 900 P.2d at 622, 44 Cal. Rptr. 2d at 373.

giving Amey advance notice, the new co-owners acted to demote Amey as an employee and to minimize his participation in the control of the business.<sup>200</sup> Amey initiated litigation against Waller, the four new officers, and the corporation, alleging breach of fiduciary and statutory good faith duties, breach of contract, intentional infliction of emotional distress, and a number of other claims on related theories.<sup>201</sup> Waller sought defense from his insurer, Truckers Insurance Exchange, who denied coverage on the ground that the complaint arose from a shareholder dispute involving intentional acts and therefore did not fall within the scope of coverage.<sup>202</sup> Internal memoranda at Truckers Insurance Exchange revealed additional grounds for denying coverage, including the fact that the scope of the policy limited coverage to incidents involving personal injury.<sup>203</sup>

Waller and the other defendants then brought a subsequent suit against Truckers Insurance Exchange on the ground that it breached its duty to defend.<sup>204</sup> At trial the court made a number of legal rulings, including a decision that Truckers Insurance Exchange had breached the implied covenant of good faith and fair dealing by failing to fulfill its duty to defend.<sup>205</sup> Thereafter, the jury found that Truckers Insurance Exchange had contravened the statutory bad faith provisions and awarded almost \$2 million in compensatory damages and over \$60 million in punitive damages on all causes of action combined.<sup>206</sup>

Truckers Insurance Exchange appealed and won a complete reversal in the court of appeal on the basis that there was no duty to

200. *See id.*

201. *See id.*

202. *See id.* at 13, 900 P.2d at 623-24, 44 Cal. Rptr. 2d at 374-75.

203. The regional claims manager concluded that the CGL policy did not provide coverage under the alleged facts because: (1) there was not bodily injury or property damage; (2) any economic injuries suffered were expected or intended from the standpoint of the insureds; (3) "Amey [was] a named insured and the policy expressly excluded coverage for liability to named insureds; and [(4)] Amey was [an] employee, and the policy excluded coverage for bodily injury suffered by employees arising out of and in the course of employment." *Id.* at 13, 900 P.2d at 623, 44 Cal. Rptr. 2d at 374.

204. *See id.* at 14, 900 P.2d at 624, 44 Cal. Rptr. 2d at 375. Also named as a defendant with Truckers Insurance Exchange was Farmers Insurance Exchange, which served as Truckers Insurance Exchange's adjuster, responsible for handling claims filed by its insureds. *See id.* Waller and the other plaintiffs accused Truckers Insurance Exchange of breach of good faith and fiduciary duties as well as statutory bad faith. *See id.*

205. The trial court held Farmers Insurance jointly and severally liable as the insurer's adjuster. *See id.*

206. *See id.* at 14-15, 900 P.2d at 624-25, 44 Cal. Rptr. 2d at 375-76.

defend.<sup>207</sup> The court of appeal reasoned that the original complaint involved a claim of economic loss based on a business dispute and that economic losses simply were not covered under the policy.<sup>208</sup> The California Supreme Court upheld the reversal, offering a number of insights into the contract interpretation process generally, and into the interpretation of insurance contracts in particular.<sup>209</sup>

Although the majority eventually cited a veritable checklist of interpretative principles which clearly emphasized the plain meaning aspects of the California rules,<sup>210</sup> it began its analysis by looking to industry standards to identify common practice with regard to CGL policies, noting that such policies are usually limited in coverage to claims involving "bodily injury, sickness or disease" or "physical injury or destruction of tangible property."<sup>211</sup> The court also noted that CGL policies normally exclude coverage for losses not specifically named, such as economic losses, unless related to bodily injury or property damage.<sup>212</sup> Thereafter, the majority proceeded to examine the actual language of the policy in the case at hand.

The insureds argued that the plain meaning of the policy would cover bodily injury and that the alleged emotional and physical distress amounted to bodily injury.<sup>213</sup> The response of the majority opinion to this argument relied on trade custom that denied coverage for intangible property losses, including economic losses.<sup>214</sup> Rather than relying exclusively on a "plain meaning" reading of the policy language, however, the court held that industry practice, read in light of decisions by other courts, excluded claims of physical distress that were entirely derivative of noncovered economic loss.<sup>215</sup>

Similarly, the majority stated that "the result reached by the courts in [denying coverage for emotional distress based on economic loss] is consistent with the reasonable expectations of the parties."<sup>216</sup> In its reasoning, however, the majority was not looking to evidence of the negotiations between these particular parties but instead was looking to general practice in the industry.

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207. *See id.* at 15, 900 P.2d at 625, 44 Cal. Rptr. 2d at 376.

208. *See id.*

209. *See id.* at 15-37, 900 P.2d at 625-39, 44 Cal. Rptr. 2d at 376-90.

210. *See id.* at 18-19, 900 P.2d at 627, 44 Cal. Rptr. 2d at 378; *see also supra* note 196 (listing the California Civil Code Sections on which the majority relied).

211. *Id.* at 17, 900 P.2d at 626, 44 Cal. Rptr. 2d at 377.

212. *See id.* at 17-18, 900 P.2d at 626, 44 Cal. Rptr. 2d at 377.

213. *See id.* at 26, 900 P.2d at 632-33, 44 Cal. Rptr. 2d at 383-84.

214. *See id.* at 26-27, 900 P.2d at 633, 44 Cal. Rptr. 2d at 384.

215. *See id.* at 20-23, 900 P.2d at 628-30, 44 Cal. Rptr. 2d at 379-81.

216. *Id.* at 27-28, 900 P.2d at 633, 44 Cal. Rptr. 2d at 384.

The insured's plain meaning argument did not fall on completely deaf ears. Justice Kennard's separate opinion emphasized the same principle the California courts have consistently emphasized over the years: "by and large an insurance policy is interpreted no differently than any other contract, and that when the parties express their intent in unambiguous language in the policy, that intent governs."<sup>217</sup> Justice Kennard highlighted the policy language that provided coverage for all bodily injuries caused by an "occurrence," which was defined as any "event, or series of events . . . proximately caused by an act or omission of the insured . . . which results . . . in bodily injury . . . neither expected nor intended from the standpoint of the insured."<sup>218</sup> Justice Kennard asserted that nothing in the language of the policy excluded "coverage for bodily injuries resulting from events that either themselves are economic losses or cause economic losses in addition to bodily injury."<sup>219</sup> Justice Kennard also pointed out that neither party had offered extrinsic evidence relating to the making of the policy.<sup>220</sup>

The bodily injury arguably was evident in "headaches, back pains, and rashes" which the demoted shareholder/employee suffered as a result of the insureds' conduct.<sup>221</sup> Justice Kennard took the position that "[m]ost of the courts that have addressed the issue have held that any physical manifestations accompanying emotional distress are 'bodily injuries' as that term is used in insurance policies."<sup>222</sup> Although Justice Kennard did not actually conclude that the emotional distress should satisfy the requirement of bodily injury within the policy,<sup>223</sup> she recognized as viable the argument that the plain

217. *Id.* at 37, 900 P.2d at 640, 44 Cal. Rptr. 2d at 391 (Kennard, J., concurring and dissenting).

218. *Id.* at 37-38, 900 P.2d at 640, 44 Cal. Rptr. 2d at 391 (Kennard, J., concurring and dissenting).

219. *Id.* at 38, 900 P.2d at 640, 44 Cal. Rptr. 2d at 391 (Kennard, J., concurring and dissenting).

220. *See id.* at 40, 900 P.2d at 641, 44 Cal. Rptr. 2d at 392 (Kennard, J., concurring and dissenting).

221. *See id.* at 40, 900 P.2d at 641-42, 44 Cal. Rptr. 2d at 392-93 (Kennard, J., concurring and dissenting).

222. *Id.* at 40, 900 P.2d at 642, 44 Cal. Rptr. 2d at 393 (Kennard, J., concurring and dissenting) (citations omitted).

223. Justice Kennard concurred in the ultimate outcome of the case because she concluded that although there may well have been bodily injury within the plain meaning of the policy, there was not an occurrence because the policy did not cover injury or damage that is expected or intended by the insured. *See id.* at 49, 900 P.2d at 647-48, 44 Cal. Rptr. 2d at 398-99 (Kennard, J., concurring and dissenting). In this case the injured party claimed intentional infliction of emo-



meaning of the policy should result in a finding of sufficient bodily injury. Justice Kennard fairly hammered home that the language of the contract does not exclude bodily injury that results from economic distress and that the majority identified no other evidence of the parties' mutual intent that would otherwise exclude that form of bodily injury. Justice Kennard also emphasized that the injured party argued that the emotional distress was not simply derivative of the economic loss but was the direct result of intentional conduct by the insureds.<sup>224</sup>

In light of the majority opinion's very persuasive reasoning that the emotional distress did not fit within the scope of the policy as generally understood, Justice Kennard's position points to the fallacy of the plain meaning approach: It is entirely possible to assign a meaning that neither party intended nor reasonably expected in the particular context. Yet California courts often strongly suggest the plain meaning approach in the stated rules of interpretation for contracts generally, and for insurance contracts as well.<sup>225</sup>

### C. Contract Integration and the Parol Evidence Rule

*Pacific Gas* is best understood as involving a question of contract interpretation. That is, once the express terms are identified, the court must then assign meaning to those terms.<sup>226</sup> Apart from

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tional distress, and therefore the injury would necessarily have been intended and outside the scope of coverage. *See id.* at 41-43, 900 P.2d at 642-44, 44 Cal. Rptr. 2d at 393-95 (Kennard, J., concurring and dissenting).

224. *See id.* at 47-48, 900 P.2d at 647, 44 Cal. Rptr. 2d at 398-99 (Kennard, J., concurring and dissenting). Justice Kennard also rejected the majority's "reasonable expectations" argument on the grounds that it would be relevant only when the language of the policy presented an ambiguity, which the justice deemed not to be present. *See id.* (Kennard, J., concurring and dissenting). Moreover, she noted that if there were an ambiguity, the doctrine requires a court to resolve the ambiguity in favor of the insured by extending coverage to the insured. *See id.* at 48, 900 P.2d at 647, 44 Cal. Rptr. 2d at 398 (Kennard, J., concurring and dissenting).

225. *See, e.g.,* *Bank of the West v. Superior Court*, 2 Cal. 4th 1254, 1264, 833 P.2d 545, 552, 10 Cal. Rptr. 2d 538, 545 (1992) ("The fundamental goal of contractual interpretation is to give effect to the mutual intention of the parties . . . . If contractual language is clear and explicit, it governs." (citations omitted)); *AIU Ins. Co. v. Superior Court*, 51 Cal. 3d 807, 821-22, 799 P.2d 1253, 1264, 274 Cal. Rptr. 820, 831 (1990) ("Such intent is to be inferred, if possible, solely from the written provisions of the contract."). *But see* Kniffin, *supra* note 58, at 643-44 (noting that it may not be possible to know if there are two or more reasonable interpretations of a disputed contract term without looking at the surrounding circumstances).

226. *Brawthen v. H&R Block, Inc.*, 28 Cal. App. 3d 131, 136, 104 Cal. Rptr.

interpretation, an even more fundamental question is how to identify which terms comprise the express agreement. Normally, an issue arises concerning whether the parties intended a final writing to be a complete and exclusive agreement of the parties or whether instead the parties may have left some terms outside of the final writing. While the use of extrinsic evidence in resolving such questions of integration often mimics the use of extrinsic evidence for purposes of interpretation,<sup>227</sup> parties and courts will undoubtedly err in the interpretive function if they do not recognize the differences between the two processes and the implications of admitting extrinsic evidence.

The first question to be answered in the process of considering if terms were left out of a final writing is whether the writing can be dispositive of the integration question. This question often arises when a contract includes a merger clause.<sup>228</sup> A second way, at least theoretically, in which the writing could prove its completeness is by virtue of its patent "wholeness," leaving no room for outside terms. Before 1968 California law stated that the integration of a contract

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486, 490 (1972) (The rule of *Pacific Gas* should be restricted to its stated bounds of allowing use of extrinsic evidence to prove a meaning to which the contract language is reasonably susceptible.)

227. A good example of the close line between extrinsic evidence used to interpret and extrinsic evidence used to supplement a writing is found in *Delta Dynamics, Inc., v. Arioto*, 69 Cal. 2d 525, 446 P.2d 785, 72 Cal. Rptr. 785 (1968). The case involved an exclusive distribution contract for a firearm safety device which included a clause providing that if the distributor failed to buy a specified quota the manufacturer could terminate the agreement on thirty days' notice. *See id.* at 526-27, 446 P.2d at 786, 72 Cal. Rptr. at 786. After the distributor failed to meet the quota, the manufacturer terminated the agreement and brought an action to recover money damages for the unfulfilled part of the quota. *See id.* at 527, 446 P.2d at 786, 72 Cal. Rptr. at 786. The distributor sought to introduce evidence of conversations during negotiations to prove that the parties expressly agreed that the right to terminate was to be the sole remedy for failure to meet the quota. *See id.* After the trial court barred the extrinsic evidence on the basis of the parol evidence rule, the California Supreme Court decided in a 4-3 decision that the extrinsic evidence should have been admitted for purposes of interpreting the termination clause in the writing, as supporting a meaning to which the clause was reasonably susceptible. *See id.* at 528-29, 446 P.2d at 787, 72 Cal. Rptr. at 787. The very same evidence that was not allowed to supplement the writing was admissible to interpret the written terms. Thus, the case highlights the sometimes slender line between interpretation and supplementation. *Cf. Banco Do Brasil, S.A. v. Latian, Inc.*, 234 Cal. App. 3d 973, 1008-09, 285 Cal. Rptr. 870, 890-91 (1991) (holding parol evidence inadmissible to supplement writing on grounds that the purported term would have been included in writing if agreed to and also rejecting attempt to introduce the same evidence for interpretation purposes where the proposed meaning directly contradicted the written terms).

228. For example, a contract may contain a clause stating, "there are no previous understandings or agreements not contained in the writing." *Masterson v. Sine*, 68 Cal. 2d 222, 225, 436 P.2d 561, 563, 65 Cal. Rptr. 545, 547 (1968).

should be determined by looking solely at the face of the writing.<sup>229</sup>

### 1. *Masterson v. Sine*<sup>230</sup>

The California Supreme Court discredited the "facial completeness" approach in *Masterson v. Sine*. As discussed in more detail below, on its factual merits *Masterson* is best viewed as an example of a court trying to reach a just result where that objective cannot be easily defended.<sup>231</sup> The effort in *Masterson* may have resulted in stating its new standard more liberally than it should have by overemphasizing credibility of extrinsic evidence as a test for admission.

Nevertheless, *Masterson* does stand for the very defensible proposition that "the crucial issue in determining whether there has been an integration is whether the parties intended their writing to serve as the exclusive embodiment of their agreement."<sup>232</sup> Consequently, the fact that a writing contains a merger clause, or that it may otherwise appear facially complete, does not bar an examination of extrinsic evidence to help determine whether the parties intended the writing to be fully integrated.<sup>233</sup> *Masterson* states that the court should consider the status of the parties, the object of the contract, the circumstances of contracting, and other factors in deciding whether it may reasonably conclude that a term might have been left out of what might otherwise be a final writing.<sup>234</sup>

229. See *id.* at 226, 436 P.2d at 563, 65 Cal. Rptr. at 547; see also *FPI Dev., Inc. v. Nakashima*, 231 Cal. App. 3d 367, 388, 282 Cal. Rptr. 508, 520 (1991) ("The starch in the unreconstructed parol evidence rule was the doctrine that integration should be determined solely from the face of the instrument.").

230. See *Masterson*, 68 Cal. 2d at 222, 436 P.2d at 561, 65 Cal. Rptr. at 547.

231. See *infra* Part III.

232. *Masterson*, 68 Cal. 2d at 225, 436 P.2d at 563, 65 Cal. Rptr. at 547; see also *FPI Dev.*, 231 Cal. App. 3d at 388, 282 Cal. Rptr. at 520.

233. See *Masterson*, 68 Cal. 2d at 226-27, 436 P.2d at 563-64, 65 Cal. Rptr. 547-48; see also *Hayter Trucking v. Shell Western E&P, Inc.*, 18 Cal. App. 4th 1, 14, 22 Cal. Rptr. 2d 229, 237 (1993) (determining whether a contract is an integration is question of law for the court, and evidence of surrounding circumstances and prior negotiations may be admitted for this limited purpose); *Alling v. Universal Mfg. Corp.*, 5 Cal. App. 4th 1412, 1434, 7 Cal. Rptr. 2d 718, 732 (1992) ("Evidence of surrounding circumstances and prior negotiations may be admitted for the limited purpose of assisting the trial court in determining whether a document was intended to be the final agreement of the parties superseding all other transactions."); cf. *Banco Do Brasil*, 234 Cal. App. 3d at 1001, 285 Cal. Rptr. at 886 (stating that utilization of a merger clause "may well be conclusive on the issue of integration").

234. See *Masterson*, 68 Cal. 2d at 226, 436 P.2d at 563, 65 Cal. Rptr. at 547; see also *McLain v. Great American Ins. Cos.*, 208 Cal. App. 3d 1476, 1484, 256 Cal. Rptr. 863, 867 (1989) (In addressing the issue of contract integration, the court must consider such factors as

'the language and completeness of the written agreement and whether it

The *Masterson* approach is consistent with the standard in the *Restatement (Second)*<sup>235</sup> and the relatively recent approach of a number of jurisdictions.<sup>236</sup> In addition, it has been codified in California Code of Civil Procedure section 1856.<sup>237</sup> Before expanding on the facts and principles established in *Masterson*, it is important to recognize three other limitations on the integration concept. First, a contract may be only partially integrated. In a partially integrated agreement, the writing is final on some terms but is not an exclusive statement of the parties' agreement; therefore some terms may exist outside the writing.<sup>238</sup> Second, as noted above, whether partially or fully integrated, the contract's terms may require interpretation in light of relevant extrinsic evidence. Such extrinsic evidence is not permitted to contradict the writing but may explain a fully integrated agreement and may explain or supplement a partially integrated

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contains an integration clause, the terms of the alleged oral agreement and whether they contradict those in the writing, whether the oral agreement might naturally be made as a separate agreement, and whether the jury might be misled by the introduction of parol testimony

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(quoting *Mobil Oil Corp. v. Rossi*, 138 Cal. App. 3d 256, 266, 187 Cal. Rptr. 845, 851, (1982)).

235. RESTATEMENT (SECOND) OF CONTRACTS § 210 cmt. b (1981).

*Proof of complete integration.* That a writing was or was not adopted as a completely integrated agreement may be proved by any relevant evidence. A document in the form of a written contract, signed by both parties and apparently complete on its face, may be decisive of the issue in the absence of credible contrary evidence. But a writing cannot itself prove its own completeness, and wide latitude must be allowed for inquiry into circumstances bearing on the intention of the parties.

See *id.*; see also FARNSWORTH, *supra* note 36, § 7.3 (Courts traditionally gave effect to merger clauses, but the recent trend has been to deny conclusive effect.).

236. See *Masurovsky v. Green*, 687 A.2d 198, 203 (D.C. Ct. App. 1996) (stating that the presence or absence of merger clause may be a significant, though not conclusive, factor in determining whether parties intended writing to be completely integrated); *Siegner v. Interstate Prod. Credit Ass'n.*, 820 P.2d 20, 26-27 (Or. Ct. App. 1991) (merger clause not conclusive on the question of integration where the documents on their face did not completely contain the terms.); *Morgan v. Stokely-Van Camp, Inc.*, 663 P.2d 1384, 1388 (Wash. Ct. App. 1983) (Courts will examine extrinsic evidence to determine whether the parties intended to be bound by the merger clause.). *But see Nelson v. Elway*, 908 P.2d 102, 107 (Colo. 1995) (merger clause generally precludes consideration of extrinsic evidence to ascertain parties' intent).

237. A portion of the statute is set out *supra* note 66.

238. See *Hayter Trucking*, 18 Cal. App. 4th at 14, 22 Cal. Rptr. 2d at 237 (parties may intend the writing to be a final and complete expression only as to certain terms.); *Wallis v. Farmers Group, Inc.*, 220 Cal. App. 3d 718, 730, 269 Cal. Rptr. 299, 305-06 (1990); *Wagner v. Glendale Adventist Med. Ctr.*, 216 Cal. App. 3d 1379, 1385, 265 Cal. Rptr. 412, 416 (1989).

agreement.<sup>239</sup> Third, contract law in California and in general recognizes a number of other situations in which the parol evidence rule does not apply or applies in a restricted fashion, such as in cases of mistake, fraud, oral preconditions, illegality, and the like.<sup>240</sup>

Justice Traynor wrote the majority decision in *Masterson*, as he did in *Pacific Gas*, and again sought to illuminate a basic area of contract construction. The case establishes clear and cogent legal principles for determining whether a contract is fully integrated, but the majority's application of those principles to the facts of the case is questionable and perhaps leads to an overstatement of the importance of credibility as a test for the admission of evidence. *Masterson* involved the sale of land from Dallas and Rebecca Masterson to Medora and Lu Sine. Mr. Masterson was Ms. Sine's brother.<sup>241</sup> The grant deed included a reservation of an option for the Mastersons to

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239. See *Hayter Trucking*, 18 Cal. App. 4th 1, 14-15, 22 Cal. Rptr. 2d 229, 237-38; *Banco Do Brasil*, 234 Cal. App. 3d 973, 1002, 285 Cal. Rptr. 870, 886.

240. Several of the exceptions are built into the codified parol evidence rule: "mistake or imperfection in the writing," "validity of the agreement," and "illegality or fraud." The California courts take a somewhat restrictive approach to the exceptions, stating that the parol evidence rule is not a bar, but still looking for consistency with the writing rather than looking solely for credibility of the parol evidence. For example, the fraud exception to the parol evidence rule in California is more narrow than in some other jurisdictions by virtue of the prohibition against showing fraud that is directly at variance with the written terms. See *Alling*, at 1436, 7 Cal. Rptr. 2d at 733 (The fraud exception to the parol evidence rule applies only if the evidence of the alleged false promise is independent of or consistent with the final writing; the extrinsic evidence may not prove a promise directly at variance with the terms of the final writing.); *Price v. Wells Fargo Bank*, 213 Cal. App. 3d 465, 483-86, 261 Cal. Rptr. 735, 745-47 (1989) (Debtors who signed loan agreement at stated interest rate were barred from presenting that they had been promised a lower interest rate.). See generally CALAMARI & PERILLO, *supra* note 36, § 3-7 (Generally, proof of fraud in the inducement of a contract may be shown even it contradicts the writing or a merger clause.). A good example of the treatment of oral preconditions is *FPI Dev., Inc. v. Nakashima*, 231 Cal. App. 3d 367, 282 Cal. Rptr. 508 (1991). After the trial court held that the parol evidence rule stood as a categorical bar to an alleged oral precondition to the validity of a promissory note that was unconditional on its face, the appellate court held that the extrinsic evidence should not have been automatically barred. See *id.* at 387, 282 Cal. Rptr. at 520. Rather, under *Masterson* and section 1856, the appellate court reasoned that the extrinsic evidence should be examined to determine whether it directly contradicted the face of the writing or otherwise lacked credibility. See *id.* at 389, 282 Cal. Rptr. at 521. The appellate court proceeded to find that there was "no necessary contradiction" between a note that was unconditional on its face and an oral precondition to its validity. See *id.* at 395, 282 Cal. Rptr. at 525. This part of the court's reasoning is consistent with the general treatment of oral preconditions. See FARNSWORTH, *supra* note 36, § 7.3.

241. See *Masterson*, 68 Cal. 2d at 222, 65 Cal. Rptr. at 546.

repurchase the property within ten years for the "same consideration as being paid heretofore [plus the] depreciation value of any improvements [grantees make to the property up to two and a half years from this date]."<sup>242</sup> After Mr. Masterson was adjudged bankrupt during the option period, the trustee in bankruptcy and Rebecca brought a declaratory action to enforce the option.<sup>243</sup>

The trial court admitted extrinsic evidence for the purpose of interpreting the "consideration" and "depreciation" terms but refused to admit extrinsic evidence of an alleged oral term that the option was personal to the grantors because of a desire to keep the property in the Masterson family.<sup>244</sup> Both the majority and the dissenting opinions in the supreme court decision recognized the propriety of admitting the parol evidence to interpret the consideration and depreciation terms in light of the patent ambiguity of the contract's express terms.<sup>245</sup> The majority and the dissent, however, disagreed vehemently over the admissibility of the alleged collateral term limiting exercise of the option to the Mastersons. This disagreement went to both the relevant legal rule governing the determination of when a contract should be deemed fully integrated and a proper reading of the facts of the case.

Justice Traynor, in his majority opinion not only rejected the position that an agreement must appear facially incomplete to allow for the possibility of a collateral term, but he also rejected the view that a merger clause alone would be determinative.<sup>246</sup> Rather, Justice Traynor wrote that in either case the purported collateral term must be examined to determine whether the parties intended it to be excluded from the contract and that the circumstances at the time of writing may also be relevant.<sup>247</sup> The foregoing principles establish a rather liberal formulation of the parol evidence rule, but not far beyond the mainstream.<sup>248</sup> Justice Traynor, however, did not stop

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242. *Id.* at 224, 436 P.2d at 562, 65 Cal. Rptr. at 546.

243. *See id.*

244. *See id.* The consideration was \$50,000 and the depreciation was deemed to mean the total amount of any capital expenditures made by the Sines less the amount of depreciation allowed under United States income tax regulations. *See id.*

245. *See id.*

246. *See id.* at 224-25, 436 P.2d at 562-63, 65 Cal. Rptr. at 546-47; *see also FPI Dev.*, 231 Cal. App. 3d at 388-89, 282 Cal. Rptr. 508, 520.

247. *See Masterson*, 68 Cal. 2d at 225-26, 436 P.2d at 563, 65 Cal. Rptr. at 547.

248. *See, e.g., Sierra Diesel Injection Serv., Inc. v. Burroughs Corp.*, 890 F.2d 108, 112 (9th Cir. 1989) (applying the Uniform Commercial Code under Nevada law and holding that the presence of a merger clause is a strong sign that the par-

there. After noting that the parol evidence rule addresses concerns that writings are more accurate than human memory and that parties may testify fraudulently, Justice Traynor stated that the rule must ultimately "be based on the credibility of the evidence."<sup>249</sup> In turn, Justice Traynor wrote that the question of credibility would rest on the general circumstances and, in particular, whether the purported collateral term was one that might naturally have been omitted from the writing or that would have certainly been included in the writing if made.<sup>250</sup> Ultimately then, the Traynor formulation ties the credibility of the extrinsic evidence to the consistency between the purported collateral term and the final writing.<sup>251</sup> To the extent that *Masterson* is read to state that doubtful credibility is the only or the most important reason to exclude extrinsic evidence, however, the case may indeed be misleading. The case of *Gerdlund v. Electronic Dispensers International*,<sup>252</sup> discussed below, suggests as much.

The proffered evidence in *Masterson* appeared to be the testimony of Dallas Masterson, the person who had been adjudged bankrupt and who sought to frustrate the efforts of the trustee to gain an important asset that might be used to satisfy some of his creditors.<sup>253</sup> The majority decided that the purported collateral term might have been naturally omitted from the contract because the writing did not contain either a merger clause or a provision on the assignability of the option. The court also considered the parties' lack of sophistication and that the form of the deed did not lend itself to including the non-assignability restriction.<sup>254</sup> The majority thus decided that the trial court erroneously excluded the parol evidence of the restriction on

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ties intended an integration but is not conclusive as a matter of law); RESTATEMENT (SECOND) OF CONTRACTS § 214 (1981) (stating that writings do not prove themselves). Cf. *Redfern Meats, Inc. v. Hertz Corp.*, 215 S.E.2d 10, 18 (Ga. Ct. App. 1975) (Proof of express warranty in advertising brochure was barred by the inclusion of merger clause in subsequent written lease agreement.).

249. *Masterson*, 68 Cal. 2d at 227, 436 P.2d at 564, 65 Cal. Rptr. at 548.

250. See *id.* Justice Traynor took the tests from the first *Restatement of Contracts* section 240(1)(b) and the UCC section 2-202 cmt. 3. See *id.* at 227-28.

251. See *FPI Dev.*, 231 Cal. App. 3d at 388-89, 282 Cal. Rptr. at 520-21; see also *American Nat'l Ins. Co. v. Continental Parking Corp.*, 42 Cal. App. 3d 260, 266, 116 Cal. Rptr. 801, 804-05 (1974) (Under *Masterson*, evidence of purported collateral oral terms were properly excluded where they totally contradicted a thirty-three-page typed contract to lease a parking garage for twenty-five years, the purported collateral term dealt with a matter on which the lease was explicit, and the purported collateral term would not naturally have been made as a separate agreement.).

252. 190 Cal. App. 3d 263, 235 Cal. Rptr. 279 (1987).

253. See *Masterson*, 68 Cal. 2d at 231, 436 P.2d at 567, 65 Cal. Rptr. at 551.

254. See *id.* at 228, 436 P.2d at 565, 65 Cal. Rptr. at 549.

the option.<sup>255</sup>

Thus, the *Masterson* majority held not only that the trial court had applied an incorrect rule of law but also that under the proper rule of law the evidence should have been admitted. Alternatively, the majority could simply have directed the trial court to reconsider the question of admissibility under the test announced in this case without dictating what the outcome should be. Under such an approach, the trial court would first determine whether the contract was completely or partially integrated. If completely integrated, then no parol evidence would be admissible to supplement the agreement, although such evidence would still have been admissible to aid in interpreting the writing. If only partially integrated, as was likely the case in light of the apparent brevity of the writing and the lack of a merger clause, then the court would determine whether the purported collateral term was consistent with the writing and might naturally have been omitted. The majority answered these questions in its opinion, appearing to preempt the trial court from engaging in this analytical process.

In his dissent, Justice Burke, joined by Justice McComb, strongly disagreed about the proper legal standard for determining whether a contract is completely integrated and about whether the purported collateral term was one that might have naturally been omitted from the writing as a matter of fact. The dissent asserted that the legal rule adopted by the majority, rejecting the determination of complete integration based solely on the face of the agreement, was based on misreadings of California precedent and utilized questionable authority.<sup>256</sup> The dissent also argued that emphasizing the credibility of the evidence and whether the purported collateral term might have naturally been omitted from the writing was an “approach that open[ed] the door to uncertainty and confusion.”<sup>257</sup> Frankly, the dissent’s reluctance to abandon the facial completeness test for

255. *See id.* at 231, 436 P.2d at 567, 65 Cal. Rptr. at 551.

256. *See id.* at 235, 436 P.2d at 569, 65 Cal. Rptr. at 553-54 (Burke, J., dissenting).

257. *Id.* at 238, 436 P.2d at 571, 65 Cal. Rptr. at 555 (Burke, J., dissenting). The dissent questioned whether trial judges should be burdened with the need to determine whether a purported collateral term is one that might “naturally” have been omitted from the writing, noted that the standard is one that places a great deal of weight on the subjective judgment of each trial court judge and thus would likely lead to inconsistent decisions, and predicted that the rule will inevitably lead to the appellate courts making such determinations on a case-by-case basis. *See id.* at 238-39, 436 P.2d at 571-72, 65 Cal. Rptr. at 555-56 (Burke, J., dissenting).



determining questions of complete integration does not carry the day in light of subsequent developments in the law in this area. Indeed, the majority's new standard has been persuasive and, for the most part, now falls within the mainstream.<sup>258</sup>

The dissent's observations about factual determinations, however, are persuasive in arguing that the evidence of the collateral term should not have been admitted in any event. The dissent points out that the deed was prepared in escrow under written instructions from the parties, without mention in either the deed or the escrow instructions that the option was personal or nonassignable.<sup>259</sup> The dissent persuasively asserts that the restriction rendering the option nonassignable could have been easily inserted in the deed, which occurs often with other similar deed restrictions.<sup>260</sup> The dissent also refuted the majority's perception of the parties as "unsophisticates" who might be excused from omitting such an important restriction, noting that Dallas Masterson was an experienced businessman who used his attorney to draft the option language after explaining what the parties wanted to accomplish.<sup>261</sup> Finally, the dissent points out that the purported collateral term directly conflicts with a very strong presumption of the free assignability of property rights in a manner that would allow creditors to be defeated in bankruptcy.<sup>262</sup>

Ultimately, the majority in *Masterson* has proved to be more correct about the manner in which questions of integration should be addressed, but the dissent makes a much more persuasive argument about the effect of the test in the opinion than it does before the court. The divergent opinions and the weaknesses within the majority might have been expected to lead to subsequent confusion in the California courts. One can, however, identify a number of decisions that properly apply the legal principles of *Masterson*, including *Gerdlund v. Electronic Dispensers International*.<sup>263</sup>

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258. See *supra*, note 232 and accompanying text.

259. See *Masterson*, 64 Cal. 2d at 233, 436 P.2d at 568, 65 Cal. Rptr. at 552 (Burke, J., dissenting).

260. See *id.* at 239, 436 P.2d at 572, 65 Cal. Rptr. at 556. (Burke, J., dissenting); see also Olivia W. Karlin, *The California Parol Evidence Rule*, 21 SW. U. L. REV. 1361, 1367-69 (1992) (noting persuasive arguments of *Masterson* dissent and criticizing majority opinion).

261. *Id.* (Burke, J., dissenting).

262. See *id.* at 241-42, 436 P.2d at 573-74, 65 Cal. Rptr. at 557-58 (Burke, J., dissenting).

263. 190 Cal. App. 3d 263, 235 Cal. Rptr. 279 (1987).

## 2. *Gerdlund v. Electronic Dispensers International*

In addition to exemplifying the standards announced in the majority opinion in *Masterson*, *Gerdlund* also makes the important distinction between supplementation and interpretation of a contract by parol evidence. The dispute in *Gerdlund* arose from a contract between Electronic Dispensers International ("EDI"), a manufacturer of bar dispensing equipment, and Leroy and Susan Gerdlund.<sup>264</sup> After Leroy had worked for EDI as an independent sales representative from 1967 to 1970 and as director of marketing from 1970 to 1973, Leroy and Susan formed a partnership, S&L Sales, to develop a market for EDI products in California, Arizona, and Nevada, and by 1975 in Utah, Colorado and New Mexico.<sup>265</sup> The written agreement between the Gerdlunds and EDI regarding the effective period of the contract provided:

This agreement shall be effective until thirty (30) days after notice of termination given by either party. Notice of termination may be given at any time and for any reason, and the date of any such notice shall be the postmark date if mailed, or the transmission date if wired . . . . This agreement contains the entire agreement between the Company and the Representative. There are no oral or collateral agreements of any kind . . . .<sup>266</sup>

In 1976 EDI changed its commission terms and gave termination notice to all its sales representatives, including the Gerdlunds.<sup>267</sup> The Gerdlunds objected to some of the terms in the new proposed contract and eventually were terminated after negotiations with EDI failed.<sup>268</sup> Despite the written merger clause and the provision allowing for termination for any reason on thirty days' notice, the Gerdlunds sued EDI based on repeated oral promises that they would not be terminated "as long as they did a good job" with their territory.<sup>269</sup> At the time of termination, EDI did not dispute that the Gerdlunds had performed well. After early years in which they had expended considerable personal effort and resources in building the EDI customer base in the western states, the Gerdlunds were consistently the top performers for EDI and apparently accounted for approximately

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264. *See id.* at 267, 235 Cal. Rptr. at 280.

265. *See id.*

266. *Id.* at 268, 235 Cal. Rptr. at 280.

267. *See id.*

268. *See id.* at 268, 235 Cal. Rptr. at 280.

269. *Id.*

twenty-five percent of EDI's total United States sales of \$4.7 million in 1976.<sup>270</sup> The trial court admitted evidence of the oral assurances that the Gerdlunds would not be terminated as long as they performed well.<sup>271</sup> The jury returned a verdict against EDI for breach of the employment agreement and assessed damages in the amount of \$287,573.<sup>272</sup>

The *Gerdlund* appellate court correctly concluded that the trial court had erred in allowing in the evidence of the oral assurances under California law.<sup>273</sup> As noted in the appellate opinion:

The parol evidence rule generally prohibits the introduction of any extrinsic evidence to vary or contradict the terms of an integrated written instrument. It is based upon the premise that the written instrument is the agreement of the parties. Its application involves a two part analysis: 1) was the writing intended to be an integration, i.e. a complete and final expression of the parties' agreement, precluding any evidence of collateral agreements; and 2) is the agreement susceptible of the meaning contended for by the party offering the evidence?<sup>274</sup>

Thus, the *Gerdlund* court initially focused on whether the contract was fully integrated and therefore not subject to supplementation by some extrinsic term.<sup>275</sup> Distinguishing earlier cases including *Masterson*, the *Gerdlund* court concluded simply that "[b]y any standard, the

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270. *See id.* at 268, 235 Cal. Rptr. at 281.

271. *See id.* at 269, 235 Cal. Rptr. at 281.

272. *See id.*

The case was tried on two causes of action: 1) breach of the written agreement, incorporating both the express oral representations and the implied covenant of good faith and fair dealing; and 2) fraudulent misrepresentation against Wayne Easley individually. The jury found that EDI had breached the employment agreement . . . [but] that no fraud had been committed by Easley.

*Id.*

273. The contract actually provided for application of Nevada law to the contract. *See id.* Both parties, however, based their arguments on the law of California and the appellate court determined that there was no conflict between the law of the two jurisdictions. *See id.*

274. *Id.* at 270, 235 Cal. Rptr. at 282 (citations omitted); *see also Hayter Trucking*, 18 Cal. App. 4th at 13, 22 Cal. Rptr. 2d at 237 (stating that if parties incorporate the complete and final terms, then the writing may not be contradicted by collateral agreements).

275. *See Gerdlund*, 190 Cal. App. 3d at 270, 235 Cal. Rptr. at 282. The parties accepted that termination was to be governed by the last written agreement and did not argue that some subsequent unwritten agreement arose after the written contract was initially terminated. *See id.*

agreement before us is integrated.”<sup>276</sup> The *Gerdlund* court reasoned that the integration clause clearly refuted any argument that the contract was partially integrated, that Leroy Gerdlund had helped draft the entire agreement while working in management for EDI, that the agreement’s six pages appeared to cover all aspects of the employment relationship, and that the oral assurances that the Gerdlunds would not be terminated without cause directly contradicted the express written term that termination could be made by either party for *any reason*.<sup>277</sup> The *Gerdlund* court correctly noted that while *Masterson* adopted a liberalizing approach to the parol evidence rule, it also emphasized that the alleged oral term must not contradict or be inconsistent with the express written terms of the agreement.<sup>278</sup>

After concluding that the alleged oral term could not supplement the agreement, the *Gerdlund* court discussed whether the proffered extrinsic evidence could be used as an aid in interpreting the integrated written agreement.<sup>279</sup> The court stretched to consider the possibility that the written contract could be read to accommodate the Gerdlunds’ argument but rejected that argument stating:

Testimony by all parties at the *in limine* hearing was that all had the same general intent regarding the length of employment, namely that the Gerdlunds would not be terminated as long as they were doing a good job for EDI. On the basis of this evidence the Gerdlunds argued that the sentence which reads “Notice of termination may be given at any time and *for any reason*” should be interpreted to mean “for any *good* reason,” in order to be consistent with the parties’

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276. *Id.* at 271, 235 Cal. Rptr. at 283.

277. *See id.* at 272, 235 Cal. Rptr. at 283.

278. *See id.* at 270-71, 235 Cal. Rptr. at 282. Another interesting and thoughtful application of the *Masterson* decision can be found in *FPI Dev.*, 231 Cal. App. 3d at 385-90, 282 Cal. Rptr. at 518-22. The plaintiffs sued on a promissory note received from the defendants in exchange for an option on a golf course. *See id.* at 376, 282 Cal. Rptr. at 512. The defendants asserted that the promissory note, although unconditional on its face, was subject to a condition that the golf course be sold before the note would be due, essentially an argument for an oral precondition to the validity of the contract. *See id.* at 377, 282 Cal. Rptr. at 513. The trial court categorically refused to consider the evidence on the grounds that the parol evidence rule barred any evidence of an oral condition on an otherwise unconditional writing. *See id.* at 380, 282 Cal. Rptr. at 515. The court of appeals properly ruled that the trial court had erred in generally barring evidence of the oral precondition, but ultimately the appellate court also decided in favor of the plaintiffs on the grounds that the purported oral precondition was inconsistent with the writing. *See id.* at 396-97, 282 Cal. Rptr. at 525-26.

279. *See Gerdlund*, 190 Cal. App. 3d at 272-73, 235 Cal. Rptr. at 283-84.

stated understanding.

We do not find that the language of the contract lends itself to the proposed meaning. The term "any reason" is plainly all-inclusive, encompassing all reasons "*of whatever kind,*" good, bad, or indifferent. [(quoting Webster's Dictionary definition of "any")]. Adding the modifier "good" has a delimiting effect which changes the meaning entirely. As written the contract is one which is terminable at will; the interpretation sought by the Gerdlunds is that the contract is terminable only for good cause. The two are totally inconsistent. The trial court admitted the evidence on the ground that "both parties have testified as to what they interpreted the contract to mean." Testimony of intention which is contrary to a contract's express terms, however, does not give meaning to the contract: rather it seeks to substitute a different meaning. It follows under the *P.G. & E.* case that such evidence must be excluded.<sup>280</sup>

While the above quoted portion of the opinion seems to suggest that both sides conceded the existence of an oral agreement regarding termination only for cause, both Mr. Gerdlund and an EDI official testified that they understood the termination clause to give the right to terminate for reasons other than the representative performing poorly.<sup>281</sup>

Although other courts have erroneously applied the rules concerning both the supplementation and interpretation of written agreements, the *Gerdlund* decision exemplifies proper application of those rules. Though one may not like the outcome based on the equities of the case or may argue that the rules should be different, *Gerdlund* remains true to the fundamental concept in California and in general contract law that courts should give primacy to the parties' expressed intent, particularly when reduced to writing, but that courts should be open to reasonable interpretations of writings.<sup>282</sup>

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280. *Id.* at 273, 235 Cal. Rptr. at 284.

281. *See id.* at 274-76, 235 Cal. Rptr. at 285-86.

282. A contrasting example can be found in *Brawthen v. H&R Block, Inc.*, 28 Cal. App. 3d 131, 139, 104 Cal. Rptr. 486, 492 (1972) ("*Brawthen I*") (reversing trial court's order granting a nonsuit in favor of defendant in a breach of employment contract dispute) and *Brawthen v. H&R Block, Inc.*, 52 Cal. App. 3d 139, 149, 124 Cal. Rptr. 845 (1975) ("*Brawthen II*") (affirming the trial verdict in favor of plaintiff in a second trial following nonsuit). The plaintiff, Brawthen, agreed to become a manager for H&R Block tax return preparation service under a contract which stated: "This agreement shall be for a period of two years

Moreover, even with a concededly partially integrated agreement, the proposed term cannot contradict what is in the writing, either as a matter of supplementing the writing or interpreting the terms in the partially integrated contract. *Consolidated World Investments, Inc. v. Lido Preferred Ltd.*<sup>283</sup> provides an example.

### 3. *Consolidated World Investments, Inc. v. Lido Preferred Ltd.*

In *Consolidated*, the parties' contract for the sale of land contained a patently ambiguous provision concerning the time for performance.<sup>284</sup> While the contract stated that time was "of the essence" and that "[t]he anticipated period of escrow shall be 60 days from the date of this Agreement," it was unclear whether escrow was to be closed and title transferred within sixty days or if it would be enough for escrow to simply open within sixty days.<sup>285</sup>

After the prospective buyer neither opened nor closed escrow within sixty days and the seller expressly terminated the agreement, the buyer initiated a lawsuit alleging that, despite the terms in the writing, the parties understood that escrow would not open and that the sixty-day period would not start until the buyer received a loan

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from the above date, and thereafter shall automatically renew from year to year unless either party gives written notice of termination ninety days prior to renewal date . . . ." *Brawthen I*, 28 Cal. App. 3d at 133-34, 104 Cal. Rptr. at 488. During negotiations Mr. and Mrs. Brawthen allegedly received the assurances that they had "the word of Henry and Richard Bloch" that they would not be terminated as long as they did a good job in the new territory. *Brawthen II*, 52 Cal. App. 3d at 142-43, 124 Cal. Rptr. at 847. Brawthen developed the territory over the next six years and was terminated when he refused to sign a new contract which reduced his rate of compensation. See *Brawthen I*, 28 Cal. App. 3d at 134, 104 Cal. Rptr. at 488-89. After trial the court barred parol evidence about the negotiations, the appellate court reversed on grounds that the writing may not have been totally integrated. See *id.* at 138-39, 104 Cal. Rptr. at 491-92. The court noted that the writing did not contain a merger clause, the purported oral term did not contradict the writing, and the contract consisted of a mimeographed form with a few blank spaces and was not easily adaptable. See *id.* at 138-39, 104 Cal. Rptr. at 491. Moreover, the court reasoned that the circumstances suggested that the Brawthens might reasonably have raised concerns about the termination clause and might have accepted the oral assurances outside of the writing. See *id.* at 139, 104 Cal. Rptr. at 491-92. Very significantly, the Brawthen contract did not contain a termination at-will clause as found in *Gerd-lund*. See *id.* at 136, 104 Cal. Rptr. at 490.

283. 9 Cal. App. 4th 373, 11 Cal. Rptr. 2d 524 (1992).

284. See *id.* at 377, 11 Cal. Rptr. at 525-26.

285. *Id.* at 377-78, 11 Cal. Rptr. 2d at 525-26. The writing also specifically provided for the possibility of extending the date for "closing of escrow" if the buyer were unable to obtain a loan by the anticipated closing date, provided the buyer delivered "a written commitment to the Seller from the proposed lender." *Id.* at 377, 11 Cal. Rptr. 2d at 526.

commitment on the property.<sup>286</sup> Although one might think that the court should have summarily precluded the buyer from offering evidence on its proposed interpretation, the case proceeded to trial and the court granted the seller's motion for nonsuit after the buyer had presented all of its evidence.<sup>287</sup> The ground for dismissal was that while some ambiguity did exist in the contract, the terms still were not "reasonably susceptible" to the interpretation offered by the buyer.<sup>288</sup> The appellate court affirmed, noting that the buyer's interpretation contradicted both of the reasonable meanings that could be assigned to the express terms in the writing.<sup>289</sup>

#### 4. *McLain v. Great American Insurance Companies*

A line of cases also exists which permits a contract to be supplemented by terms that may have been left out of the final writing. The court in *McLain v. Great American Insurance Companies*<sup>290</sup> confronted a factual situation similar to *Gerdlund* in many ways but different in key aspects. Great American hired McLain from a previous position. McLain took a pay cut based upon representations of long-term advancement possibilities with Great American.<sup>291</sup> Before beginning employment, McLain submitted an incomplete application form.<sup>292</sup>

286. *See id.* at 377-78, 11 Cal. Rptr. 2d at 526.

287. *See id.* at 378, 11 Cal. Rptr. 2d at 526.

288. *Id.* at 79, 11 Cal. Rptr. 2d at 526-27.

289. *See id.* at 379-80, 11 Cal. Rptr. 2d at 527. The appellate court stated: Parol evidence is admissible only to prove a meaning to which the contractual language is 'reasonably susceptible;' not to flatly contradict the express terms of the agreement. Thus, if the contract calls for the plaintiff to deliver to defendant 100 pencils by July 21, 1992, parol evidence is not admissible to show that when the parties said 'pencils' they really meant 'car batteries' or that when they said 'July 21, 1992' they really meant 'May 13, 2001.'

*Id.* at 379, 11 Cal. Rptr. 2d at 527 (citation omitted); *see also Banco Do Brasil*, 234 Cal. App. 3d 973, 1002-05, 285 Cal. Rptr. 870, 887-88 (Assuming loan agreement was only partially integrated, terms which expressly stated that obligations to make payments were "absolute and unconditional" could not be reconciled with debtor's claim that the obligation to repay was conditioned on receipt of \$2 million line of credit from creditor.).

290. 208 Cal. App. 3d 1476, 256 Cal. Rptr. 863 (1989).

291. *See id.* at 1480, 256 Cal. Rptr. at 864-65. The plaintiff took a pay cut from \$40,000 in his former position to \$30,000 with the defendant company based upon representations made by a division manager for Great American. *See id.* at 1480, 256 Cal. Rptr. at 865. The manager also told the plaintiff that if he went to work for Great American he would be on probation for ninety days and then would become a "permanent" employee. *See id.*

292. The form did not reflect the employee's position or salary and a portion

The key provisions in the *McLain* contract were an at-will provision and related merger language. The contract read, in relevant part:

In consideration of my employment, I agree to conform to the rules and regulations of the Great American Insurance Company, and I agree that my employment and compensation can be terminated with or without cause, and with or without notice, at any time, at the option of either the Great American Insurance Company or myself. I also understand and agree that the terms and conditions of my employment may be changed, with or without cause, and with or without notice, at any time by the Great American Insurance Company. I understand that no representative of the Great American Insurance Company, has any authority to enter into an agreement for any specified period of time, or to make any agreement contrary to the foregoing.<sup>293</sup>

After working for more than a year and receiving a promotion to a managerial position,<sup>294</sup> McLain was suddenly terminated after a disagreement with his immediate supervisor.<sup>295</sup> He sued for breach of contract, alleging breach of an implied contract that McLain would not be terminated except for cause.<sup>296</sup> After a jury returned a verdict for McLain for \$62,000 in compensatory damages, Great American appealed on the ground that under the parol evidence rule, the express terms of the contract should have precluded evidence of the purported "for cause" limitation on the ability to terminate.<sup>297</sup>

The facts supported three slightly—but significantly—different arguments for McLain's position that he could be terminated only for

to be filled in by the employer was never completed. *See id.*

293. *Id.* While the key provisions for purposes of the litigation were contained on the backside of the form and the plaintiff testified that he never read the provisions and no one from the employer ever discussed or pointed the provisions out to him, he nevertheless signed the form just beneath those provisions. *See id.*

294. *See id.* at 1481, 256 Cal. Rptr. at 865. McLain's salary rose incrementally from \$30,000 to \$38,000 and he received favorable reviews of his work. *See id.*

295. *See id.* at 1481-82, 256 Cal. Rptr. at 865-66.

296. *See id.* at 1482-83, 256 Cal. Rptr. at 866-67. McLain stated causes of action based on "(1) wrongful termination; (2) breach of contract; (3) breach of the implied covenant of good faith and fair dealing; (4) violation of civil rights; (5) intentional infliction of emotional distress; (6) negligent infliction of emotional distress; and (7) wrongful termination based upon violation of public policy." *Id.* at 1482-83, 256 Cal. Rptr. at 866. Because the appellate court found that the breach of contract action supported the jury verdict for the plaintiff, it did not address the other causes of action. *See id.* at 1483, 256 Cal. Rptr. at 867.

297. *See id.* at 1483, 256 Cal. Rptr. at 867.



cause despite the statutory presumption that employment not for a specified duration is terminable at will.<sup>298</sup> First, McLain suggested that he received express, oral representations before he signed the employment form that he would be terminated only for cause after a three-month probationary period.<sup>299</sup> Second, McLain seemed to argue that Great American gave him implicit commitments at the time he started working that it would terminate him only for cause.<sup>300</sup> Third, the facts also supported an argument that the terms of the contract were modified over the course of his employment to add an “implied for cause” limitation on the employer’s ability to terminate.<sup>301</sup> The *McLain* court, like others, did not carefully delineate when it addressed issues of express or implied terms.<sup>302</sup> Only the first possibility—that apart from a final written contract, the parties had agreed to an oral side term—squarely invokes the parol evidence rule.

The *McLain* court’s treatment of the facts may be interpreted as alleging the side oral term that was left out of the writing. The court essentially applied the *Gerdlund* approach: first, determining whether the contract was a complete integration that would exclude extrinsic evidence of a collateral term not included in the writing; and second, consider whether the agreement is “susceptible of the meaning urged by the party offering the evidence,”<sup>303</sup> if the writing is not completely integrated.

The court noted that the writing did not actually contain a merger like the one found in *Gerdlund*.<sup>304</sup> Instead, the relevant language, while establishing employment at-will and providing that no representative had the authority to make a contrary agreement, also

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298. See *Alexander v. Nextel Communications, Inc.*, 52 Cal. App. 4th 1376, 1380, 61 Cal. Rptr. 2d 293, 295-96 (1997) (“Labor Code section 2922, which provides that an employment, having no specific term, may be terminated at the will of either party, establishes a presumption of at-will employment if the parties have made no express oral or written agreement specifying the length of employment or the grounds for termination.”).

299. See *McLain*, 208 Cal. App. 3d at 1486-87, 256 Cal. Rptr. at 869 (plaintiff testifying that he received assurance of status as a permanent employee after the probationary period had expired).

300. See *id.*

301. See *id.* at 1485, 256 Cal. Rptr. at 868.

302. See, e.g., *Alexander*, 52 Cal. App. 4th at 1378-80, 61 Cal. Rptr. 2d at 294-95 (reversing verdict for plaintiff employee where trial court neglected to instruct jury that it must find either express or implied term that employment could not be terminated except for good cause).

303. *McLain*, 208 Cal. App. 3d at 1483, 256 Cal. Rptr. at 867.

304. See *id.* at 1485, 256 Cal. Rptr. at 868.

provided that Great American could change the terms of employment at any time.<sup>305</sup> The court noted that “[t]his language not only suggests that the application was *not* integrated, but also indicates that the parties specifically intended their relationship to remain subject to change in terms and conditions.”<sup>306</sup> Additionally, a number of other factors persuaded the *McLain* court: the contract was a standardized two-page form that did not lend itself to adaptation to particular terms of a specific employment; the written form was very brief; and the parties neglected to fill out the form completely, failing to include McLain’s salary or position.<sup>307</sup> Finally, the court found that the purported oral term did not “flatly contradict” the written terms because of a provision that Great American could alter the contract at any time.<sup>308</sup> Essentially, the written terms were somewhat self-contradictory and allowed the court to find that the written contract was not completely integrated.<sup>309</sup> Thus, the appellate court concluded that the parol evidence had been properly admitted to establish the parties’ complete agreement and that substantial evidence supported the verdict for the plaintiff.<sup>310</sup>

#### 5. *Aragon-Haas v. Family Security Insurance Services, Inc.*<sup>311</sup>

Yet another helpful case for assessing the plain meaning approach, as well as the parol evidence rule, is *Aragon-Haas*. The plaintiff was employed under a written contract that provided for an initial one-year term and an automatic renewal for six additional one-year terms.<sup>312</sup> The contract was clearly subject to termination with or without cause during the first year but was less than perfectly clear about circumstances for termination thereafter.<sup>313</sup> The plaintiff testified

305. *See id.* at 1481, 256 Cal. Rptr. at 865.

306. *Id.* at 1485, 256 Cal. Rptr. at 868 (emphasis added).

307. *See id.*

308. *Id.*

309. *See id.*

310. *See id.* at 1486-87, 256 Cal. Rptr. at 869. The *McLain* court went on to state in dicta: “Even if we were to conclude that the application was integrated, the parol evidence would still be admissible . . . . As previously pointed out, the language that the terms of McLain’s employment could be changed demonstrates that the Great American application is ‘reasonably susceptible’ to the interpretation urged by McLain.” *Id.* at 1485-86, 256 Cal. Rptr. at 868-69.

311. 231 Cal. App. 3d 232, 282 Cal. Rptr. 233 (1991).

312. *See id.* at 236, 282 Cal. Rptr. at 235.

313. *See id.* The contract provided in relevant part:

Section 1.01. The Employer hereby employs the Employee and the Employee hereby accepts such employment upon the terms and conditions hereinafter set forth beginning July 29, 1986, and expiring one (1)

that the employer told her the first year was a probationary period, which she understood to mean that the employer could terminate her without cause during the first year and would terminate her only for good cause thereafter.<sup>314</sup> The plaintiff worked for more than three years, moving up the ranks from manager to executive vice president, before being terminated "without warning, explanation or just cause."<sup>315</sup> The plaintiff then initiated the lawsuit based on several causes of action, including breach of the written contract.<sup>316</sup>

The court dismissed the lawsuit based essentially on plain meaning grounds, noting that the written contract did not expressly state the initial year to be a "probationary period" and that the provision allowing for termination without cause did not contain limiting language restricting its provision to the first year.<sup>317</sup> The written contract also contained a merger clause, but the trial court appeared not to rely on the parol evidence rule and the concept that the writing was a complete integration as grounds for declining to proceed to a trial on the merits that might have included evidence of the alleged oral side term.<sup>318</sup>

year from said date, unless sooner terminated as provided in Section 7.01 [*sic*; should be Section 8.01] of this Agreement. Thereafter this Agreement shall be automatically extended for six (6) consecutive one (1) year terms.

*Id.*

Section 8.01. This Agreement may be terminated by the Employer with or without cause upon the giving of written notice of termination to the Employee. Employee may terminate this Agreement with or without cause upon thirty (30) days written notice to the Employer.

*Id.* at 237, 238 Cal. Rptr. at 236.

314. *See id.* at 236, 282 Cal. Rptr. at 235-36.

315. *Id.* at 236, 282 Cal. Rptr. at 236. The plaintiff's annual job performance reviews were positive and never included any significant criticism. *See id.* Over the course of a one-year period, the plaintiff received a promotion, a salary increase and other financial incentives, as well as commendations on her job performance. *See id.* Less than two months after receiving her latest incentive, she was terminated without cause. *See id.*

316. The plaintiff stated other causes of action, including breach of the implied covenant of good faith and fair dealing, estoppel to terminate the contract without good cause, and fraud. *See id.* at 235-37, 282 Cal. Rptr. at 235-36.

317. *See id.* at 238 n.3, 282 Cal. Rptr. at 237 n.3.

318. *See id.* at 237 n.2, 282 Cal. Rptr. at 237 n.2. The employment agreement included the following provisions:

This Agreement contains all of the terms, conditions and promises of the parties hereto. Employee represents that she is not relying upon any representation or promise not contained in this Agreement, and Employee expressly agrees that Employee has not executed this Agreement in reliance upon any such representation or promise . . . . This agreement modifies and supersedes any and all previous agreements if any existing between the parties hereto.

*Id.*

The appellate court reviewed de novo the contract language and concluded that it was both ambiguous and "reasonably susceptible" to the meaning the plaintiff alleged.<sup>319</sup> Thus, while the plaintiff ultimately might not have succeeded in proving that her purported meaning would constitute the proper reading of the contract, the appellate court held that it was error for the trial court to dismiss the action on demurrer.<sup>320</sup> The appellate court also properly noted, citing *Pacific Gas*, that the merger clause in the contract would not bar the admission of extrinsic evidence for the purpose of resolving an ambiguity in the written terms.<sup>321</sup> Rather, the court noted that "rational interpretation requires at least a preliminary consideration of all credible evidence offered to prove the intention of the parties."<sup>322</sup> Thus, the appellate court correctly held that the trial court erred in applying the plain meaning approach.

Although neither the trial nor appellate court confronted the issue squarely, it should be noted that even if the terms in the written contract did not provide for the probationary period, the plaintiff could have argued that the side oral assurance that she would be terminated only for cause after the first year was consistent with the written terms and therefore could supplement the writing. The court would have needed to decide as a preliminary matter, using the *Masterson* test, that the writing was a partially integrated agreement and was not a complete, final, and exclusive statement of the contract terms, before deciding whether the collateral term was consistent with the writing. Although the *Aragon-Haas* contract contained a merger clause,<sup>323</sup> its presence would not be conclusive under *Masterson*.<sup>324</sup> The facts relevant to the making of the contract would also aid the court in determining integration.<sup>325</sup> *Aragon-Haas* thus presents another good model for harmonious application of *Pacific Gas* and *Masterson*.

#### *D. Plain Meaning, Contract Integration, and Usage of Trade*

A party may also assert that a term becomes part of a contract by virtue of trade usage, course of dealing, or course of performance.<sup>326</sup> This type of argument, however, often raises issues concerning

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319. *Id.* at 239, 282 Cal. Rptr. at 238.

320. *See id.*

321. *See id.* at 239-40, 282 Cal. Rptr. at 238.

322. *Id.* at 240, 282 Cal. Rptr. at 238.

323. *See id.*

324. 68 Cal. 2d at 225, 436 P.2d at 562, 65 Cal. Rptr. at 546.

325. *See Aragon-Haas*, 231 Cal. App. 3d at 239, 282 Cal. Rptr. at 238.

326. *See infra* discussion of *Hayter Trucking, Inc. v. Shell Western E&P, Inc.*,

the interaction between these sources and express terms. Trade usage deals with industry-wide practices that the parties are assumed to accept as part of the contract.<sup>327</sup> Course of dealing involves prior contracts between the same two parties that are deemed to reflect a practice that becomes part of the agreement.<sup>328</sup> A course of performance involves repeated occasions for performance under one contract.<sup>329</sup> Course of performance is distinguishable from the two other preceding terms because it may serve one of two different purposes in establishing contractual obligations. First, course of performance may later reflect what the parties intended at the time they made the contract. Second, course of performance may be deemed to reflect a modification or waiver of the original contract terms.<sup>330</sup> Course of performance, therefore, cannot actually be a source of a contract term when the contract is made, and the parol evidence rule should not bar the evidence.<sup>331</sup>

The Uniform Commercial Code ("UCC") takes the clear position that it is very difficult to bar evidence of trade usage or course of dealing.<sup>332</sup> *Hayter Trucking, Inc. v. Shell Western E&P, Inc.*<sup>333</sup> reflects a similar approach in California that allows evidence of trade usage or course of dealing in most circumstances. Hayter Trucking entered

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18 Cal. App. 4th 1, 22 Cal. Rptr. 2d 229 (1993); notes 333-52 and accompanying text.

327. See U.C.C. § 1-205(2) & cmt. 4.

328. See *id.* § 1-205(1) & cmt. 2.

329. See *id.* § 1-208(1).

330. See *id.* § 2-208(3).

331. See Helen Hadjiyannakis, *The Parol Evidence Rule and Implied Terms: The Sounds of Silence*, 54 *FORDHAM L. REV.* 35, 80 (1985) (indicating that evidence of course of performance can never be excluded by the parol evidence rule because it is subsequent to integration of the writing).

332. See U.C.C. § 2-202 cmt. 2. Usage of trade and course of dealing can be barred only by a careful negation of the parties—which probably means an express provision in the contract indicating that terms derived from those sources are not to be deemed to supplement the writing—or, at least theoretically, by a showing that the terms contradict the express terms. The latter qualification is made because there are some cases and other authority that strongly suggest that the express terms ought to yield to properly proven usage of trade and course of dealing. See, e.g., *Nanakuli Paving and Rock Co. v. Shell Oil Co.*, 664 F.2d 772, n.17 (9th Cir. 1981) (noting with approval that some writers assert that express terms may sometimes yield to usage of trade and course of dealing); *Urbana Farmers Union Elevator Co. v. Schock*, 351 N.W.2d 88, 92 (N.D. 1984) (stating that courts have regarded usages and practices as more reliable indicators of the parties' intentions than imperfect or incomplete language); *American Machine & Tool Co., Inc. v. Strite-Anderson Mfg. Co.*, 353 N.W.2d 592, 597 (Minn. Ct. App. 1984) (discussing trend of courts toward extending themselves to reconcile trade usage and course of dealing with seemingly contradictory express terms).

333. 18 Cal. App. 4th 1, 22 Cal. Rptr. 2d 229 (1993).

into a contract with Shell Western to perform vacuum truck services at an oil well site in California.<sup>334</sup> The relationship began in the fall of 1987 and ended in November 1990 when Shell Western gave thirty days' notice of termination without stating any reason for ending the contract.<sup>335</sup>

The contract covering the relationship contained three relevant provisions: a general provision allowing for termination upon thirty days' written notice by either party;<sup>336</sup> a provision allowing for "immediate termination" by Shell Western if it deemed itself to be at risk from Hayter Trucking's performance;<sup>337</sup> and a merger clause.<sup>338</sup> Despite the express terms granting Shell Western a broad right to terminate, Hayter Trucking brought suit against Shell Western alleging breach of contract by virtue of a purported trade usage requiring termination only for good cause.<sup>339</sup> Shell Western demurred and the trial court rendered judgment against Hayter Trucking, finding, essentially, that the plain meaning of the express terms precluded the alleged usage of trade from becoming part of the contract.<sup>340</sup>

Interestingly, the trial court interpreted a more recent California Supreme Court decision to reflect movement away from the *Pacific Gas* decision and toward an approach that prefers the plain meaning of words in integrated agreements.<sup>341</sup> The trial court believed this

334. *See id.* at 6-7, 22 Cal. Rptr. 2d at 232-33.

335. *See id.* at 6-9, 22 Cal. Rptr. 2d at 232-34.

336. The contract provision stated: "This order is effective 2/01/90 and shall remain in effect through 1/31/92 unless cancelled by either party by giving thirty (30) days' written notice to the other party." *Id.* at 7, 22 Cal. Rptr. 2d at 233.

337. *See id.* at 8, 22 Cal. Rptr. 2d at 233-34.

338. The merger clause read: "It is agreed that the order and the Attachments thereto set forth the entire agreement between BUYER and CONTRACTOR with respect to the work, that no oral agreements made heretofore shall be binding, and that no modification or supplement thereto shall be made except by written agreement signed by both parties." *Id.* at 8, 22 Cal. Rptr. 2d at 234.

339. Hayter Trucking asserted that there existed a trade usage that contracts for vacuum services could be terminated only for good cause and that the practice was industry wide, known to both parties at the time of contracting, and therefore properly deemed part of the contract. *See id.* at 9, 22 Cal. Rptr. 2d at 234. Hayter Trucking further asserted that the clause allowing for termination with thirty days' notice "governed the manner in which the contract could be terminated rather than the basis upon which the contract could be terminated" and that the other clause granting Shell Western the right to terminate addressed only "emergency or extreme circumstances . . . and was not intended by the parties to govern in non-emergency or non-extreme circumstances." *Id.*

340. *See id.* at 11-12, 22 Cal. Rptr. 2d at 235-36.

341. *See id.* at 11, 22 Cal. Rptr. 2d at 235. The trial court stated:

[I]t seems that [the California Supreme Court] is saying [in *AIU Ins. Co. v. Superior Court*] that the language of the contract, if it's in plain terms,

plain meaning approach precluded not only extrinsic evidence of a collateral term—or a written or oral side agreement between the parties—but also a term derived from usage of trade.<sup>342</sup> Specifically, the court reasoned that trade usage directly contradicted the plain meaning of the express written terms and therefore could not be part of the contract.<sup>343</sup> The trial court obviously was unreceptive to Hayter Trucking's argument that evidence of trade usage should be more compelling than extrinsic evidence of a collateral term that was simply left out of the final writing.<sup>344</sup>

The appellate court, however, recognized that evidence of trade usage should stand on different footing than evidence of a collateral term. The court stated:

Generally speaking, words in a contract are to be construed according to their plain, ordinary, popular or legal meaning, as the case may be. However, particular expressions may, by trade usage, acquire a different meaning in reference to the subject matter of a contract. If both parties are engaged in that trade, the parties to the contract are deemed to have used them according to their different and peculiar sense as shown by such trade usage and parol evidence is admissible to establish the trade usage even though the words in their ordinary or legal meaning are entirely unambiguous.<sup>345</sup>

The appellate court further held that the trial court erred in deciding the case on a presumed plain meaning where the plaintiff properly alleged a meaning that was ascribed to the contract based on trade usage.<sup>346</sup> First, as a matter of general construction, the court clearly emphasized that evidence of trade usage is admissible to show a meaning of words shared by the parties regardless of the ordinary meaning that the words might have.<sup>347</sup> Second, the court noted that California Code of Civil Procedure section 1856(c) expressly provides that the terms set forth in an integrated agreement "may be

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governs the interpretation. And there has to be some showing. It's very critical of [*Pacific Gas*], for example . . . . It's a little hard to reconcile that holding [in *AIU Ins.*] with the earlier holdings of the Supreme Court on which [plaintiff attempts] to rely. It seems to me there is a weather change in the works here.

*Id.* (alterations in original) (citations omitted).

342. *See id.* at 10-11, 22 Cal. Rptr. 2d at 235.

343. *See id.*

344. *See id.*

345. *Id.* (citing *Paramount Television Prods., Inc. v. Bill Derman Prods.*, 258 Cal. App. 2d 1, 10-11, 65 Cal. Rptr. 473 (1968)).

346. *See id.* at 18-21, 22 Cal. Rptr. 2d at 240-42.

347. *See id.* at 20, 22 Cal. Rptr. 2d at 241-42.

explained or *supplemented* by course of dealing or usage of trade or by course of performance."<sup>348</sup> The court thus indicated that the requirement of termination for cause only might be consistent with the express terms related to termination. If the written contract had stated expressly that cause was not required, the court could not have reached that conclusion.<sup>349</sup> The court also would have been prevented from reaching the result if the contract had negated the application of trade usage. The contract as drafted, expressly precluding oral supplementation of the contract, did not preclude supplementation by usage of trade.<sup>350</sup> Finally, the appellate court emphasized the effect of *Pacific Gas* in liberalizing the parol evidence rule by rejecting the plain meaning rule and also refuted the trial court's view that the California Supreme Court had undermined *Pacific Gas* in subsequent decisions.<sup>351</sup> Indeed, Justice Traynor explicitly recognized in *Pacific Gas* the possibility of trade usage giving a different or special meaning to terms in a contract.<sup>352</sup>

The question still remains of what to do when the express terms simply fail to address certain circumstances. In those situations the interpretation rules so adroitly applied in *Gerdlund* and stated in so many other cases will produce no true result. In those cases, the courts may in fact, and should in candor, apply the just result principle in resolving disputes.

### III. THE "JUST RESULT" PRINCIPLE AS A RULE OF INTERPRETATION

In a number of circumstances, the normal rules of contract interpretation and construction do not lead to a clear result. The goal of

348. *Id.* at 20, 22 Cal. Rptr. 2d at 242 (quoting CAL. CODE CIV. PROC. § 1856(c) (emphasis added)).

349. *See* *Wagner v. Glendale Adventist Med. Ctr.*, 216 Cal. App. 3d 1379, 1393-94, 265 Cal. Rptr. 412, 421-22 (1989) (Implied terms cannot be at complete variance with express terms, and therefore, contract with express at-will termination clause could not have implied "for cause" limit on termination.).

350. *See id.* at 20-21, 22 Cal. Rptr. 2d at 242.

351. *See id.* at 20, 22 Cal. Rptr. 2d at 241-42. The trial court had relied upon an insurance contract case, *AIU Ins.*, 51 Cal. 3d 807, 799 P.2d 1253, 274 Cal. Rptr. 820 (1990), and the appellate court noted that with insurance contracts special rules do come into play, such as the principle of protecting the objectively reasonable expectations of the insured and resolving ambiguities in favor of the insured. *See Hayter Trucking v. Shell Western E&P, Inc.*, 18 Cal. App 4th at 19-20, 22 Cal. Rptr. 2d at 241 (1993). The appellate court also explicitly ruled that there was no portion of *AIU Ins.* which explicitly or implicitly overruled *Pacific Gas*. *See id.* at 20, 22 Cal. Rptr. 2d at 242.

352. *See Pacific Gas*, 69 Cal. 2d at 39, 442 P.2d at 645, 62 Cal. Rptr. at 565.



contract interpretation is to discover the intent of the parties, but there are times when the parties simply have not expressed an intent for the courts to discover. Section 204 of the *Restatement (Second)* raises at least two possibilities. First, the parties may simply fail to foresee a situation or a development and therefore may fail to expressly address the circumstance in the contract.<sup>353</sup> Second, the parties may anticipate a situation but neglect to address it because the circumstance is not clearly in focus, seems unimportant or unlikely to occur, or does not lend itself to ready resolution.<sup>354</sup>

Another possibility is that the parties, perhaps due to extreme optimism about the contractual relationship, fail to address the possibility of breach, even though the circumstance is clearly foreseeable at the time of contracting.<sup>355</sup> Further, the parties may simply fail to address a foreseen circumstance, perhaps because they assume that they will be able to resolve the situation at a later date when the contingency arises.<sup>356</sup> In all of these types of cases, the parties may well have rendered a great deal of performance on one or both sides before the difficulty presented by the absence of terms becomes apparent.

Under the applicable standards for contract interpretation in California, if the parties have expressly provided for a situation—even one in the distant future or with a result that might seem uneven in some respect—the courts are bound to respect that expressed intent.<sup>357</sup> A good example of such a case is *Winet v. Price*.<sup>358</sup> In that

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353. See RESTATEMENT (SECOND) OF CONTRACTS § 204 cmt. b (1979). Professor E. Allan Farnsworth further divides the unforeseen situations into those that were foreseeable but that the parties failed to foresee and those involving developments that could not have been foreseen at the time of contracting. See E. Allan Farnsworth, *Disputes Over Omission in Contracts*, 68 COLUMBIA L. REV. 860, 871-72 (1968).

354. See RESTATEMENT (SECOND) OF CONTRACTS § 204 cmt. b (1979).

355. See Melvin Aron Eisenberg, *The Limits of Cognition and the Limits of Contract*, 47 STAN. L. REV. 211, 213-16 (1995); see also Patterson, *supra* note 45, at 236-37 (describing two sources of contract incompleteness: substantive incompleteness when parties leave terms open and interpretive incompleteness relating to unforeseen events or changed circumstances).

356. The classic lease renewal case, where the parties sign an agreement to agree upon a new rental price, provides one illustration. See, e.g., *Etco Corp. v. Hauer*, 161 Cal. App. 3d 1154, 1156, 208 Cal. Rptr. 118, 119 (1984) (The lease provided that new rent would be determined by mutual agreement upon renewal.).

357. See *supra*, notes 26-38 and accompanying text; see also *In re Marriage of Iberti*, 55 Cal. App. 4th 1434, 1440, 64 Cal. Rptr. 2d 766, 769-70 (1997) (Agreement providing spousal support to wife as long as she was enrolled in college could not be reasonably interpreted as providing support after she withdrew from classes allegedly to assist her ill mother.); Corbin, *supra* note 59, at

case, the parties agreed in 1975 that a client would release his former lawyer from any claims, "known or unknown," that then existed or that might arise later.<sup>359</sup> When the client wished to sue for malpractice some fifteen years later, both the trial and appellate courts rather summarily concluded that the express terms of the contract provided for this future situation and precluded an action against the lawyer.<sup>360</sup>

Similarly, in some cases, the parties may not have clearly expressed their intent within the written terms of the contract, but the courts may find a mutual intent by looking at the contract in light of the extrinsic evidence. An example is *Golden West Baseball Co. v. City of Anaheim*,<sup>361</sup> a case involving the lease of an Anaheim stadium to the California Angels baseball team in 1964 for use during home games for a period as long as sixty-five years, beginning in 1966.<sup>362</sup> Although the express terms failed to make explicit provision, substantial extrinsic evidence proved that a key inducement for the baseball club was the requirement that the stadium have a minimum of 12,000 parking spaces on level or "flat land parking."<sup>363</sup> Indeed, the parties did not dispute that this goal greatly influenced the Angels's decision to leave Dodger Stadium, where they had previously played their home games.<sup>364</sup>

A dispute arose, however, when the city began negotiations with the Los Angeles Rams football team to play in the stadium and proposed to engage in extensive commercial development of the stadium parking lot that would reduce the amount of flat parking area.<sup>365</sup> The

170-71 (stating that court is never justified in altering or perverting contract language to reach just or equitable result).

358. 4 Cal. App. 4th 1159, 6 Cal. Rptr. 2d 554 (1992). See *supra* text accompanying notes 152-171.

359. *Id.* at 1162-63, 6 Cal. Rptr. 2d at 555. The former client was represented by independent counsel when he signed the release. See *id.* at 1164, 6 Cal. Rptr. 2d at 556.

360. See *id.* at 1164-65, 6 Cal. Rptr. 2d at 556-57.

361. 25 Cal. App. 4th 11, 31 Cal. Rptr. 2d 378 (1984).

362. See *Golden West*, 25 Cal. App. 4th at 25, 31 Cal. Rptr. 2d at 388.

363. *Id.* at 22-25, 31 Cal. Rptr. 2d at 385-88. In 1960 Gene Autry, the legendary singing cowboy movie star and owner of Golden West Broadcasting Corporation, purchased a new major league baseball franchise for the Los Angeles area. See GLENN DICKEY, *THE HISTORY OF AMERICAN LEAGUE BASEBALL SINCE 1901* 203 (1980). After five years (1961-1965) of playing as a co-tenant at Dodger Stadium, Autry initiated the move of the baseball club to the new stadium in Anaheim and changed the team's name to the California Angels. See *id.*

364. See *Golden West*, 25 Cal. App. 4th at 19-20, 31 Cal. Rptr. 2d at 384.

365. See *Golden West*, 25 Cal. App. 4th at 20, 31 Cal. Rptr. 2d at 384. Carroll Rosenbloom, the owner of the Rams, joined with developers Cabot, Cabot & Forbes to form Anaheim Stadium Associates which negotiated with Anaheim for four years until plans were finalized in 1982. See *id.*

city contended that it could provide the minimum 12,000 parking spots in any manner that it chose, including multi-level parking structures.<sup>366</sup> Although the express terms of the contract merely provided that the City of Anaheim was to provide "a multi-purpose stadium with a seating capacity of approximately 45,000, and suitable parking facilities adequate to accommodate a minimum of 12,000 cars for stadium customers,"<sup>367</sup> the detailed negotiation history clearly supported the reading of the contract that the city should provide the 12,000 minimum spaces by flat level parking and not through parking structures.<sup>368</sup>

While *Winet* exemplifies a case in which parties expressly contracted for future uncertainties and *Golden West* presents a case in which the extrinsic evidence provided a clear indication of the parties' intent for future developments despite contract language lacking specificity, not all cases lend themselves to definitive resolution based on mutual intent derived from the contract language or extrinsic evidence. As noted above, it is common for contracting parties to fail to foresee or otherwise expressly provide for a situation. As further noted above, some of the gaps in contracts result specifically from the parties' inability to foresee future developments in the project at hand or, perhaps, a rather independent technological development. The courts, however, tend to respond to such cases by purporting to divine from the contract an intent as to the unforeseen or unaddressed situation or to provide a term deemed consistent with those terms that the parties did make. This approach shows allegiance to the dated concept that courts only interpret agreements and never make them for the parties.

As Professor Farnsworth established in a writing on the use of

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366. See *id.* at 21, 31 Cal. Rptr. 2d at 385. While there was conflicting testimony about whether future parking structures were discussed during negotiations, the trial court implicitly found that such discussions did not take place. See *id.* at 22 n.4, 31 Cal. Rptr. 2d at 386 n.4.

367. *Id.* at 25, 31 Cal. Rptr. 2d at 387.

368. See *id.* at 40, 31 Cal. Rptr. 2d at 397. The appellate court stated:

The trial court correctly concluded the parties intended the parking would be on ground level. Although there was some testimony to the contrary, a consistent theme during the original negotiations was GWBC's [Golden West Baseball Company] desire for more convenient parking than existed at Dodger Stadium and for ground-level spaces. The stadium parking lot was built that way using plans and specifications agreed to by GWBC and Anaheim, and although GWBC assented to relocation of parking spaces over the years, it never allowed parking structures.

*Id.*

implied terms, the fiction that the courts are able to divine the parties' intentions masks what the courts are in fact doing in cases where circumstances were unforeseen or not addressed by the parties.<sup>369</sup> The best way for courts to resolve such cases is to explicitly indicate that they are seeking a "just or fair result" based upon the equities and then allow the parties to present argument in that vein. As courts explicitly apply the "just result" principle in such cases, they will establish precedent that will promote consistency and predictability. Section 204, comment d of the *Restatement (Second)* essentially adopts this position, noting that "where there is in fact no agreement, the court should supply a term which comports with community standards of fairness and policy rather than analyze a hypothetical model of the bargaining process."<sup>370</sup>

The "sense of justice" concept as an interpretative principle can be compared to the *Restatement (Second)* principle that the remedy for detrimental reliance may be limited as justice requires.<sup>371</sup> The *Restatement (Second)* also embodies that concept in the provisions for the proper remedy when a contract violates public policy.<sup>372</sup> The "sense of justice" is also similar to the broader notions of good faith as found in the *Restatement (Second)* and the UCC.<sup>373</sup>

The standard interpretive rules in California also lend at least limited support to the just result principle. California courts endorse the principle that "[a] contract must receive such an interpretation as will make it lawful, operative, definite, reasonable, and capable of being carried into effect, if it can be done without violating the intention of the parties."<sup>374</sup> In addition, the courts must avoid any interpretation that "will make a contract extraordinary, harsh, unjust, or inequitable."<sup>375</sup> Contract law scholars have also advocated for application of a "fairness principle" in other aspects of contract law as well. Looking

369. See Farnsworth *supra* note 355, at 866-68.

370. RESTATEMENT (SECOND) OF CONTRACTS § 204 cmt. d (1981).

371. See RESTATEMENT (SECOND) OF CONTRACTS § 90 (1981).

372. See RESTATEMENT (SECOND) OF CONTRACTS § 197 (1981).

373. See RESTATEMENT (SECOND) OF CONTRACTS § 205 (1981).

374. CAL. CIV. CODE § 1643; *Powers*, 54 Cal. App. 4th 1102, 1111, 63 Cal. Rptr. 2d 261, 266 (1997); *Foothill Properties*, 46 Cal. App. 4th at 1550, 54 Cal. Rptr. 2d at 492; see also *Edison*, 37 Cal. App. 4th at 853-54, 44 Cal. Rptr. 2d at 235-36 (disfavoring interpretation of ambiguous contract for wind turbine generated electricity that could not be implemented through available technology or that would cause improper discrimination inconsistent with public utility commission directives or state or federal law).

375. *Powers*, 54 Cal. App. 4th at 1111-12, 63 Cal. Rptr. 2d at 266 (quoting *Strong v. Theis*, 187 Cal. App. 3d 913, 920, 232 Cal. Rptr. 272, 276 (1986)).

particularly at problems of impracticability, Professor Robert Hillman has suggested that the courts should first see whether the parties have expressly addressed the risk. When, however, the contract does not explicitly address the issue, Hillman argues that courts should apply fairness norms in deciding whether or not to excuse performance that has been rendered more difficult by some supervening event.<sup>376</sup>

A trio of relatively recent California cases exemplify the potential for application of the "just result" principle in contract interpretation cases. Those cases are *Okun v. Morton*,<sup>377</sup> involving a contract for joint participation in Hard Rock Cafes, *City of Manhattan Beach v. Superior Court*,<sup>378</sup> involving ownership rights of railway right-away land worth as much as \$100 million some one hundred years after execution of a deed, and *Lee v. Walt Disney Co.*,<sup>379</sup> involving a dispute over an actor's right to share in profits from the sale of video cassettes some almost forty years after execution of the contract. These cases will be discussed in turn.

#### A. *Okun v. Morton—the "Hard Rock Cafe" Case*<sup>380</sup>

Peter Morton and a partner were operating the original "Hard Rock Cafe" in England in the early 1970s when Milton Okun contacted Morton about the possibility of investing in the business. Morton declined the offer but indicated that he might contact Okun later about restaurant investment opportunities in the United States.<sup>381</sup> In 1978, after Okun had returned to this country, Morton contacted Okun, and the two succeeded in opening and operating a restaurant in the Los Angeles area known as "Morton's."<sup>382</sup> Four years later, in 1982, the parties opened a "Hard Rock Cafe" in Los Angeles, which proved to be quite successful.<sup>383</sup> The agreement governing Okun's

376. Robert A. Hillman, *An Analysis of the Cessation of Contractual Relations*, 68 CORNELL L. REV. 617, 625-29 (1983).

377. 203 Cal. App. 3d 805, 250 Cal. Rptr. 220 (1988).

378. 13 Cal. 4th 232, 914 P.2d 160, 52 Cal. Rptr. 2d 82 (1996).

379. No. B058897 (Cal. Ct. App. Sept. 30, 1992) (unpublished opinion), *cert. denied*, 1992 Cal. LEXIS 6172 (Dec. 16, 1992).

380. 203 Cal. App. 3d 805, 809, 250 Cal. Rptr. 220, 222 (1988), *cert. denied*, 203 Cal. App. 3d at 829.

381. *See Okun*, 203 Cal. App. 3d 805, 809-10, 250 Cal. Rptr. 220, 222.

382. *See id.* at 810, 250 Cal. Rptr. at 222. Morton's was patterned after another restaurant in London of more modest size and concept than the Hard Rock Cafe. *See id.*

383. *See id.* at 812, 250 Cal. Rptr. at 223. In July 1981 Morton entered into a settlement agreement with his London partner, Isaac Tigrett, which provided

participation with Morton in the opening of the Los Angeles Hard Rock Cafe eventually led to a contractual dispute and ultimately a lawsuit when Morton began exploiting opportunities in other cities.

After considerable negotiations, Okun agreed to invest \$100,000 in the Los Angeles Hard Rock Cafe in exchange for part ownership of the Los Angeles restaurant, as well as the right to participate in future opportunities utilizing the Hard Rock name.<sup>384</sup> Okun agreed to provide essentially one hundred percent of the general partnership's contribution to the financing of the Los Angeles restaurant, but it was agreed that his obligation to contribute as a general partner to future ventures would be limited to the same percentage as his share of the general partnership—twenty percent.<sup>385</sup>

The contract provision governing future opportunities, contained in paragraph nine of the agreement, and entitled "Business Opportunities," read:

All business opportunities which arise in connection with the business of HRC [general partnership], the [L.A. Hard Rock] partnership or that which utilizes the name and mark 'Hard Rock Cafe' must be offered to HRC [general partnership]. If HRC [general partnership] does not avail itself of

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that Morton would have the exclusive right to use the Hard Rock name and logo in California, Arizona, and Illinois while Tigrett would have rights in New York, Florida, and Texas. *See id.* at 814, 250 Cal. Rptr. at 224. Unnamed states would be available for exploitation on a "first come, first serve" basis. *See id.* at 810, 250 Cal. Rptr. at 222. Morton failed to disclose the existence of the agreement with Tigrett in his solicitation of investments for the Los Angeles Hard Rock Cafe. *See id.* at 812, 252 Cal. Rptr. at 223. Rather, Morton asserted that he was the sole shareholder of the Hard Rock Cafe Corporation ("HRC") and that he had personally licensed HRC to use the Hard Rock name in the United States. *See id.* at 810-11, 250 Cal. Rptr. at 222.

Subsequently, Morton initiated a lawsuit against Tigrett in federal court over the right to use the Hard Rock name in the United States and, although Okun was surprised to learn of the dispute, he agreed to contribute the 20% of the costs of litigation. At trial, the court found that Morton defrauded Okun by failing to disclose Tigrett's interest prior to the initial agreement between the parties for the Los Angeles Hard Rock Cafe. *See id.* at 815, 250 Cal. Rptr. at 226.

384. *See id.* at 811, 250 Cal. Rptr. at 223. Morton's original plan was to be the sole owner of the general partnership which would operate the restaurant and possess the right to future exploitation of the Hard Rock name. *See id.* at 816 n.8, 250 Cal. Rptr. 226 n.8. Morton sought Okun's participation as an investor in the limited partnership for the Los Angeles restaurant only. *See id.* at 810, 250 Cal. Rptr. at 222. After the original plan failed to come to fruition, Morton agreed to give Okun 20% ownership in the Hard Rock Cafe general partnership along with the right to participate in future opportunities using the Hard Rock name. *See id.* at 810-11, 250 Cal. Rptr. at 222-23.

385. *See id.* at 811, 250 Cal. Rptr. at 223. The restaurant opened at its Beverly Center location in October 1982 and proved to be a commercial success. *See id.*

such opportunity, we shall then have the right to exploit such opportunity together in a manner mutually agreeable in the same ratio which we currently hold stock in HRC [general partnership]. If you elect not to participate in such opportunity after reasonable notice, I shall be free to exploit such opportunity in any manner I choose.<sup>386</sup>

In 1983 the San Francisco restaurant was the next Hard Rock Cafe to be developed. Although Morton used participation in this new venture as leverage to obtain Okun's financial assistance in litigation involving his partner in the British Hard Rock Cafe, the parties eventually agreed on joint participation in the San Francisco restaurant on essentially the same basic terms as the Los Angeles business.<sup>387</sup> Morton, however, sought to change the terms of Okun's participation with regard to planned ventures for Houston and Chicago and sought a general change in the terms of the original 1982 agreement for joint ownership of the Hard Rock Cafe general partnership.<sup>388</sup> Morton later sought to exclude Okun from participating altogether in the two restaurants, as well as one planned for Honolulu, when Okun insisted that the new restaurants be operated under the terms of the 1982 agreement.<sup>389</sup> The exclusion of Okun from the Chicago, Houston and Honolulu restaurants then led Okun to file suit against Morton.

At trial, Morton argued that the 1982 agreement was an illusory, nonbinding contract that was not sufficiently precise in terms to be specifically enforced.<sup>390</sup> The trial court rejected Morton's claims, found the contract specifically enforceable, and awarded \$360,000 in general and specific damages.<sup>391</sup> The trial court also issued a decree allowing Okun participation in the restaurants from which he had been excluded, as well as in all future investments.<sup>392</sup> Morton

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386. *Id.* at 812, 250 Cal. Rptr. at 223.

387. *See id.* at 813-14, 250 Cal. Rptr. at 224-25.

388. *See id.* at 814 n.5, 250 Cal. Rptr. at 224 n.5

389. *See id.* at 814-15, 250 Cal. Rptr. at 224-25. Morton aborted the Houston venture at one point but apparently revived it later. Morton at some time offered Okun participation in the Chicago restaurant before ultimately excluding him from participation when Okun insisted on operating under the 1982 agreement. Okun was apparently never offered participation in the Honolulu restaurant. *See id.* at 815, 250 Cal. Rptr. at 225.

390. *See id.*

391. *See id.* at 809, 250 Cal. Rptr. at 221.

392. *See id.* at 815-16, 250 Cal. Rptr. at 225-26. The trial court also found that the defendant:

(1) committed fraud by his failure to disclose the limitations on his right

appealed the judgment and again sought to prove that paragraph nine of the agreement, covering future business, was an unenforceable "agreement to agree,"<sup>393</sup> lacking in the necessary specificity to be enforceable. More specifically, Morton argued that the agreement was faulty because it failed to specifically state the manner in which the parties would share liabilities, failed to elaborate on the effect of offering other investors the opportunity to participate in any given deal, and failed to include a provision describing when and how he must offer Okun the option to invest.<sup>394</sup> The appellate court admitted that the contract was very short on specifics for investment in future opportunities. The appellate court stated:

Although the agreement admittedly does not deal in specifics, neither law nor equity requires that every term and condition be set forth in the contract . . . . In light of the fact that neither defendant nor plaintiff could predict with any degree of certainty the success of the Los Angeles operation, it is not surprising that Paragraph 9 was drafted broadly enough to accommodate changing circumstances and unforeseen developments. Because of [Morton's] expertise, however, he was left with the discretion to formulate and structure the ownership for each venture so long as he maintained the 20/80 ratio. That he believed himself bound by the agreement needs little discussion. Suffice it to say that the organizational structure and development of [the Hard Rock Cafes for San Francisco and Houston] alone evidence defendant's manifest intent to abide by the terms of Paragraph 9.<sup>395</sup>

While the *Okun* court acknowledged that an "agreement to agree" is

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to use and exploit the Hard Rock trademark prior to the execution of the March agreement; (2) breached the covenant of good faith and fair dealing by attempting to limit and/or exclude plaintiff from participating in various business opportunities utilizing the Hard Rock name; (3) breached the March agreement by withholding profit and management fee distributions due plaintiff as an HRC shareholder and as a party to the contract; and (4) tortiously breached the March agreement by denying in bad faith the existence of contractual terms giving plaintiff a right to participate in ventures other than HRC and the Los Angeles restaurant.

*Id.* at 817, 250 Cal. Rptr. at 226.

393. *Id.* at 816, 250 Cal. Rptr. at 226.

394. *See id.* at 818, 250 Cal. Rptr. at 228.

395. *See id.* at 818, 250 Cal. Rptr. at 228 (citing *Burrow v. Timmsen*, 223 Cal. App. 2d 283, 288, 35 Cal. Rptr. 668, 671 (1963); *King v. Stanley*, 32 Cal. 2d 584, 588, 197 P.2d 321, 324 (1948)).



usually unenforceable,<sup>396</sup> the court very candidly acknowledged that such a rule of construction ought to be tempered by considerations of justice and equity. The court stated: "The defense of uncertainty has validity only when the uncertainty or incompleteness of the contract prevents the court from knowing what to enforce."<sup>397</sup> At bottom,

"[if] the parties have concluded a transaction in which it appears that they intend to make a contract, the court should not frustrate their intention if it is possible to reach a fair and just result, even though this requires a choice among conflicting meanings and the filling of some gaps that the parties have left."<sup>398</sup>

Thus, the *Okun* court, rather remarkably, explicitly embraced the idea that the court may properly fill gaps in contracts if the parties clearly had the intent to contract and it is necessary to reach a just and fair result. Concededly, the court reinforced its decision by reasoning that the gaps or ambiguities in the agreement could be clarified in light of extrinsic evidence at the time the contract was made and in light of the parties' conduct in performance of the contract before the dispute arose.<sup>399</sup> Ultimately, however, the appellate

396. See *id.* at 817, 250 Cal. Rptr. at 227. The court stated:

A contract which leaves an essential element for future agreement of the parties is usually held totally uncertain and unenforceable . . . . Since either party by the terms of the promise may refuse to agree to anything to which the other party will agree, it is impossible for the law to affix any obligation to such a promise.

*Id.* at 817, 250 Cal. Rptr. at 227 (quoting *Ablett v. Clawson*, 43 Cal. 2d 280, 272 P.2d 753 (1954)).

397. *Id.* (quoting *Hennefer v. Butcher*, 182 Cal. App. 3d 492, 500, 227 Cal. Rptr. 318, 322 (1986)).

398. *Id.* at 817, 250 Cal. Rptr. at 227 (quoting *Hennefer* at 500, 227 Cal. Rptr. at 322 and 1 CORBIN ON CONTRACTS § 95 (1952)).

399. See *id.* at 817, 250 Cal. Rptr. at 227. The court stated:

[W]e are of the view that the provisions of Paragraph 9 which defendant characterizes as fatally uncertain, are either sufficiently certain on their face, or were made sufficiently certain by the introduction of extrinsic evidence at trial . . . . Considered as a whole, the foregoing terms were sufficient to establish from the outset the ways in which future ventures were to be financed, owned, and operated by the parties. The fundamental structure of all such undertakings was to [be] based on the 20/80 ratio established for the creation of the L.A. Hard Rock. This essential term effectively defined the extent of the parties' capital contributions and their right to participate in all manner of future investment schemes commensurate with their ownership interest in [the Los Angeles Hard Rock Cafe general partnership].

*Id.* at 817-18, 250 Cal. Rptr. 227-28.

With regard to conduct in performance of the contract, the court stated:

Here, the conduct of the parties subsequent to the execution of the 1982 agreement and before any controversy had arisen, is persuasive evidence

court relied on its sense of a “just result” in finding the contract sufficiently definite to uphold the trial court’s decree of specific performance, despite the lack of clear and comprehensive terms in the written contract.<sup>400</sup> In deciding what a fair result would be, the court undoubtedly considered the misconduct by Morton, the harsh effect on Okun if it held the contract unenforceable, and the disappointment of Okun’s expectation under the contract. A similar, but less candid, outcome is found in the California Supreme Court’s decision in *City of Manhattan Beach v. Superior Court*.

### B. *City of Manhattan Beach v. Superior Court*<sup>401</sup>

The California Supreme Court had occasion to apply its rules of interpretation in the recent case of *City of Manhattan Beach*, which involved a deed conveying an interest in land to a railroad company.<sup>402</sup> As highlighted in the introduction to this Article,<sup>403</sup> the heirs

in determining the meaning of Paragraph 9 . . . . Between the formation of [the San Francisco Hard Rock Cafe] in 1983 and the Chicago offering in 1985, both defendant and plaintiff acted in strict accord with the provisions of the contract. This is not to say that they did not dispute the extent of their responsibilities under Paragraph 9, they did. But regardless of those disagreements, defendant continued to offer to plaintiff the opportunity to become a 20% participant in all ventures utilizing the Hard Rock name. Plaintiff, in turn, agreed to contribute 20% of the capital requirements of those operations.

*Id.* at 819, 250 Cal. Rptr. at 228 (citations omitted).

400. The appellate court did reverse the trial court on the award of \$200,000 in punitive damages for bad faith denial of contract. The reversal was based on the reasoning that the bad faith denial action founded on *Seamans* requires the existence of a type of special or fiduciary relationship between the parties, and the court concluded that the relationship was not that “special.” See *Okun*, 203 Cal. App. 3d at 825-27, 250 Cal. Rptr. at 233-34. Similarly, the appellate court also reversed the trial court’s finding of fraud and its award of approximately \$75,000 on that basis because Okun did not prove that he detrimentally relied on the misrepresentations that were made by Morton concerning his right to exploit the Hard Rock name. See *id.* at 827-28, 250 Cal. Rptr. at 234-35.

401. 13 Cal. 4th 232, 914 P.2d 160, 52 Cal. Rptr. 2d 82 (1996).

402. The Redondo Land Company (“Land Company”) executed the deed in favor of Redondo Beach Railway Company (“Railway”). As quoted by the court, it read in relevant part:

Witnesseth: That said parties of the First part [Land Company and Charles Silent] for and in consideration of the sum of One Dollar to them in hand paid by said party of the Second part [Railway], the receipt of which is hereby acknowledged do by these presents remise, release and quit-claim unto said party of the second part the right of way for the construction, maintenance and operation of a Steam Railroad, upon over and along the following tract and parcel of land . . . .

This Grant is made upon condition that the side-track now constructed upon said right of way shall be maintained and shall be used as a Station to receive and discharge freight; that such convenient crossings, not less than four, shall be made and maintained, with sufficient

of the parties who granted the interest to the railroad company argued that the conveyance gave only an easement to the railroad company with conditions attached. Therefore, they argued that the easement was terminated under the conveyance's terms due to the cessation of the railroad operation.<sup>404</sup> The defendants took the position that the grant was in fee simple, that the railway continued its ownership despite the discontinuance of rail services, and that it had the ability to convey title to the city.<sup>405</sup>

In a dazzling display of point and counterpoint, the majority and the dissent demonstrated that almost every aspect of the document, as well as the extrinsic evidence, could be turned to support opposing meanings of the contract. In doing so, the judges considered the possibility of the contract having a plain meaning, the import of extrinsic evidence, and the use of applicable maxims or interpretive principles to resolve the dispute.<sup>406</sup>

The majority first addressed the express terms and observed that the deed used the language "remit, release and quit-claim" to describe the conveyance to the railway, that those operative words are commonly used in simple quit-claim deeds, and that quit-claim deeds usually transfer whatever present right or interest the grantor has in the property.<sup>407</sup> Thus, the majority observed that the court had often decided "that a quitclaim deed conveys the absolute fee-simple title if the party executing it had such title"<sup>408</sup>—as did the grantor in this case—and that the use of such language was not consistent with an

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cattle guards, at such point on said right of way, as may be necessary for the full use and enjoyment of the lands adjoining said right of way, and so as to give access to and from the lands on either side thereof; that such culverts shall be constructed and maintained as may be necessary for the free passage of water across the same, and so located that the lands adjacent to said right of way will not be flooded on account of the roadbed of said railroad forming an embankment, and upon failure to comply with said conditions, or any of them, said right of way to revert to said parties of the first part and their successors in interest.

To have and to hold all and singular the rights aforesaid unto said party of the second part and its assigns and successors forever, subject however to and upon the terms and conditions aforesaid.

*Id.* at 250-51, 914 P.2d at 172-73, 52 Cal. Rptr. 2d at 94-95 (Mosk, J., concurring and dissenting).

403. See *supra* notes 7-30 and accompanying text.

404. See *City of Manhattan Beach*, 52 Cal. Rptr. 2d at 85-86.

405. See *supra* note 23 and accompanying text.

406. See *City of Manhattan Beach*, 13 Cal. 4th 232, 914 P.2d 160, 52 Cal. Rptr. 2d 82.

407. *Id.* at 239, 914 P.2d at 165, 52 Cal. Rptr. 2d at 87.

408. *Id.* at 239, 914 P.2d at 165, 52 Cal. Rptr. 2d at 87 (citation omitted).

intent to convey only an easement.<sup>409</sup> Thus, certain aspects of the express terms supported the finding that full title was transferred.

At the same time, however, the majority observed several times that the deed used the term "right of way," a phrase that is usually construed to grant only an easement even if the terms of the deed otherwise might seem to convey a fee simple.<sup>410</sup> Then again, however, the majority pointed out that the term "right of way" is often used to describe both the interest in the land and the strip of land itself upon which the railroad would run.<sup>411</sup> Thus, the majority concluded that the express terms of the document left unresolved the question of the interest granted.

After noting that the applicable maxims of interpretation tended to lean toward the reading of the deed as granting a fee simple,<sup>412</sup> the majority nevertheless deemed those rules not dispositive and continued to construe the deed. The majority considered whether the purpose of the conveyance would illuminate the meaning of the deed but once again found the factor ambiguous. On the one hand the majority seemingly acknowledged that a conveyance for the purpose of operating a railroad tended to support the granting of an easement. On the other hand, however, the court noted that the mere indication of a purpose for the conveyance would not prevent the finding of a fee, especially if the purpose was for the benefit of the general public and not specifically for the benefit of the grantors.<sup>413</sup> The majority also stated the phrasing that the railroad was to operate

409. *See id.* at 239-40, 914 P.2d at 165-66, 52 Cal. Rptr. 2d at 87-88.

410. *See id.* at 240-41, 914 P.2d at 165-66, 52 Cal. Rptr. 2d at 87-88.

411. *See id.*

412. The maxims of interpretation have been codified in California. The majority cited section 1105 of the California Civil Code, which provides that the law presumes "[a] fee simple title is . . . intended to pass by a grant of real property, unless it appears from the grant that a lesser estate was intended." *Id.* at 242, 914 P.2d at 167, 52 Cal. Rptr. at 89. (citing CAL. CIV. CODE § 1105). While the majority observed that Civil Code section 801 classifies a "right-of-way" as an easement and therefore tends to support finding an easement, other statutory provisions supported the finding of a fee: Civil Code section 1070 states that if different parts of a contract are absolutely irreconcilable, "the former part prevails;" Civil Code section 1067 would favor "quit claim" as being more definite in meaning than "right-of-way" because of the latter term's dual meaning; and Civil Code section 1069 supports the maxim that an unclear modifying or limiting clause in a deed would yield to a clause granting a fee interest, as well as a general rule that doubtful clauses in the deed are to be construed most strongly against the grantor. *See id.* at 242, 914 P.2d at 167, 52 Cal. Rptr. 2d at 89 (citing CAL. CIV. CODE §§ 801, 1067, 1069, 1070 (West 1982)).

413. *See City of Manhattan Beach*, 13 Cal. 4th at 243-44, 914 P.2d at 167-68, 52 Cal. Rptr. 2d at 89-90.

“upon[,] over and along the following tract and parcel of land” and “over and through the lands of the grantors” appeared “to limit the railway to a right of passage and exclude title to the land beneath” but that subsequent references to “a strip of land” in conjunction with precise and technical designation of the location generally indicated an intention to grant title in fee simple and not just a limited right to pass over the property.<sup>414</sup> Continuing its progress through the interpretive factors, the majority also observed that the fact that the grantors reserved space for a warehouse would be inconsistent with the grant of an easement only to the railway.<sup>415</sup> Additionally, the court found that the reference to the conveyed interest “rever[ting]” to the grantor suggested a fee was given because an easement would be “extinguished,” whereas the grant of fee title would lead to “reversion” if returned upon the occurrence of some condition.<sup>416</sup> The majority also recognized that the nominal consideration of \$1.00 suggested the transfer of only an easement. The court noted that nowhere in the conveyance was the word “easement” used, thereby suggesting that a fee simple grant was intended,<sup>417</sup> but neither did the deed use the term “fee,” which would have also clarified the interest being conveyed.<sup>418</sup> The majority then concluded that:

Having canvassed the four corners of the deed, we end our search frustratingly little more informed of the parties' intention than we began. Judging by the terms “remise, release and quit-claim” and “right of way,” the grantor appears to have intended at one and the same time to convey to the railway the entire fee estate and a limited interest confined to an easement for railroad purposes. The remainder of the language is

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414. *Id.* at 244, 914 P.2d at 168, 52 Cal. Rptr. 2d at 90.

415. *See id.*

416. *Id.*

417. *See id.* at 245, 914 P.2d at 169, 52 Cal. Rptr. 2d at 91.

“In construing the instrument we cannot overlook the fact that if the grantors really intended to convey only an easement, they could have easily so expressed that purpose . . . . Their failure to do so must be considered together with the presumption that a fee simple title passed (Civ. Code, § 1105) and the rule that a grant is to be interpreted in favor of the grantee. (Cal. Civ. Code § 1069).”

*Id.* (quoting *Basin Oil Co. v. City of Inglewood*, 125 Cal. App. 2d 661, 666, 271 P.2d 73, 77 (1954)).

418. *See id.* The majority also noted a good number of additional, conflicting signals. For example, the signature of the mortgage holder suggested that all rights and title were being conveyed to the railway and that the mortgagee was implicitly agreeing to forebear further enforcement of his mortgage interest. *See id.* at 239 n.5 & 245, 914 P.2d at 165 n.5 & 169, 52 Cal. Rptr. 2d at 87 n.5 & 91.

equally ambiguous, both supporting and contradicting one or the other conclusion. We thus turn to extrinsic evidence in the hope of enlightenment.<sup>419</sup>

Based on the general principle that a deed or any other contract may have ambiguities resolved by the conduct of the parties, the court cited *Pacific Gas* for the proposition that extrinsic evidence is admissible when offered to prove a meaning of a contract to which the language is reasonably susceptible.<sup>420</sup> The majority then identified the extrinsic evidence as including the fact that the grantor executed a number of subsequent documents that indicated the grantors deemed the railway to have taken a fee interest.<sup>421</sup> More significantly, the Land Company instituted an action in 1901 to quiet title as part of its process of divesting its holdings and in that action excepted the "land" conveyed to the railway by the 1888 deed. The majority found this evidence—that the Land Company no longer considered itself to have any interest in the railway's property—to be "virtually incontrovertible evidence the grantor intended the 1888 deed to convey the property to the railway in fee simple."<sup>422</sup> Further, when the Land Company dissolved as a corporation, the decree of dissolution indicated that all property had been disposed. The continued holding of title to the railway property with only the grant of an easement to the railway was something the majority labeled as "at least implausible" if not unreasonable.<sup>423</sup>

Perhaps revealing an unspoken pursuit of a just result, the majority also noted the very significant role that the railway played in making the Manhattan Beach area accessible, and therefore marketable, and asserted that conveyance of full title to the railway would have been consistent given the value received in return by the grantor.<sup>424</sup>

419. *Id.* at 245-46, 914 P.2d at 169, 52 Cal. Rptr. 2d at 91.

420. *See id.* at 246, 914 P.2d at 169, 52 Cal. Rptr. 2d at 91.

421. In 1897 the Land Company and the railway's successor entered into an unrecorded indenture with a third party that modified the reversionary conditions of railroad operations and that referred to the 1888 conveyance by stating that the earlier "deed shall remain a grant as therein expressed." *Id.*, 914 P.2d at 170, 52 Cal. Rptr. 2d at 92. Additionally, in 1896 the Land Company began divesting itself of its holdings by partition and excluded from all transactions the "right-of-way . . . granted" to the railway as well as parcels of land deeded to other third parties, an exception that would not have been necessary if the Land Company had conveyed only an easement to the railway that would simply have passed as an easement upon the transferred property. *Id.* at 246-47, 914 P.2d at 170, 52 Cal. Rptr. 2d at 92.

422. *Id.* at 247, 914 P.2d at 170, 52 Cal. Rptr. 2d at 92.

423. *Id.*

424. *See id.* at 248, 914 P.2d at 171, 52 Cal. Rptr. 2d at 93.

The majority rather summarily rejected extrinsic evidence offered by the heirs to support their position that only an easement was given.<sup>425</sup> The majority ultimately concluded that the document was ambiguous. Accordingly, their reliance on extrinsic evidence was proper, and the extrinsic evidence rather conclusively proved that the grantors transferred a fee simple interest to the railway.<sup>426</sup>

As noted in the introduction to this Article, the dissenting justices presented a counterpoint for almost every one of the majority's arguments.<sup>427</sup> Justice Mosk, in his dissenting opinion, indicated a particular inclination to stay within "the four corners of the instrument" in the case of a recorded deed.<sup>428</sup> Justice Mosk also noted a recorded deed provides public notice to third parties as to the interest conveyed and therefore engenders public reliance on its facial

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425. The subsequent conduct included: 1) an 1896 deed executed by the Land Company which conveyed property to Duncan Blanton that, according to description, included a middle portion of the strip previously deeded to the railway; 2) failure of a partition map made during dissolution to include the railway property; and 3) the representations that the railway only owned an easement made during property tax assessment litigation in 1954 and Interstate Commerce Commission abandonment hearings in 1982. *See id.* at 248-50, 914 P.2d at 171-72, 52 Cal. Rptr. 2d at 93-94.

426. Justice Arabian concluded in this fashion:

As should be clear from the discussion, we do not find the instant deed a paradigm conveyance but rather to the contrary, requiring us to ferret out the parties' intentions by less direct and less preferable considerations. In reaching our conclusion, we emphasize that the peculiar facts of this case dictate the narrow, perhaps unique, basis of our holding. Further, we reaffirm the importance of careful drafting to insure property transactions consistent with the parties intended and desired result. The court's only function and concern should be to effectuate their manifest intent; for, as we have reiterated, that must control.

*Id.* at 250, 914 P.2d at 172, 52 Cal. Rptr. 2d at 94 (citation omitted).

427. Justice Mosk wrote the principal dissent in which he was effectively joined by Justices Kennard and Werdegar. *See id.* at 267-68, 914 P.2d at 183-84, 52 Cal. Rptr. 2d at 105-06 (Kennard, J., dissenting). Justice Mosk provided the counter argument that the deed conveyed only an easement and not the grant of a fee simple interest to the railway. *See id.* at 258, 914 P.2d at 177, 52 Cal. Rptr. 2d at 99 (Mosk, J., concurring and dissenting). Although Justice Mosk labeled his opinion as concurring and dissenting in an act of pique because he believed that the majority agreed with the greater part of his analysis, he actually dissented in full. *See id.* at 250, 914 P.2d at 172, 52 Cal. Rptr. 2d at 94 (Mosk, J., concurring and dissenting). Justice Kennard wrote a second dissent, joined by Justice Werdegar, in which she disagreed with Justice Mosk only on the question of whether Santa Fe should be jointly liable with the City of Manhattan Beach to the heirs for inverse condemnation. *See id.* at 52 (Kennard, J., dissenting). Justices Kennard and Werdegar believed that the trial court had correctly ruled that Santa Fe should be jointly liable. *See id.* (Kennard, J., dissenting).

428. *Id.* at 252-53, 914 P.2d 173-74, 52 Cal. Rptr. 2d at 95-96 (Mosk, J., concurring and dissenting).

meaning.<sup>429</sup>

Having asserted that the court should look primarily within the language of the document to determine what interest was conveyed, Justice Mosk then argued that the granting language clearly conveyed a mere easement and there was no need to resort to extrinsic evidence.<sup>430</sup> Justice Mosk's "plain meaning" argument rested almost entirely on the idea that the granting of a "right of way" to build a railroad would have been universally understood in 1888 to convey only an easement.<sup>431</sup> Justice Mosk further buttressed his conclusion that only an easement was conveyed by noting that the document did not use language clearly signaling a transfer of a fee simple interest<sup>432</sup> and by recognizing that the indication within the deed that the right-of-way was to be used for the purpose of operating a railroad would be generally expected to convey only an easement unless a contrary intent was revealed.<sup>433</sup>

Justice Mosk observed that the majority actually agreed that the use of the term "right of way" supported the conclusion that a mere easement was granted and proceeded to point out that the majority went astray by placing too much emphasis upon other language in the deed.<sup>434</sup> While the majority had concluded that the grantor's use of

429. *See id.* at 253, 914 P.2d at 174, 52 Cal. Rptr. 2d at 96. (Mosk, J., concurring and dissenting).

430. *See id.* at 253, 914 P.2d at 174, 52 Cal. Rptr. 2d at 96 (Mosk, J., concurring and dissenting).

431. *See id.* at 250-55, 914 P.2d at 172-75, 52 Cal. Rptr. 2d at 94-97 (Mosk, J., concurring and dissenting). Justice Mosk wrote:

The foregoing language gave the railroad a servitude on land . . . rather than an estate in it . . . . It was universally understood at the time that such language conveyed only a right-of-way-i.e., an easement . . . . As the majority's analysis may fairly be read to acknowledge, a conveyance of a "right of way" "over" the grantor's land is a conveyance of an easement. This must be so, because the language shows that the land company conveyed an appurtenant use to the railroad. (Civ. Code, § 801) ["right[s]-of-way" "may be attached to other land as incidents or appurtenances, and are then called easements"] . . . Hence[,] the undeviating body of California law explaining that language of this type conveys an easement.

*Id.* at 253-54, 914 P.2d at 174-75, 52 Cal. Rptr. 2d at 96-97 (Mosk, J., concurring and dissenting) (citations omitted).

432. Justice Mosk wrote: "The 1888 deed's unvarying and repeated use of the term 'right of way' without reference to a conveyance of 'land' or 'title' is simply fatal to any conclusion that fee title was conveyed . . . . It is different, of course, when 'land' or a 'parcel' is conveyed." *City of Manhattan Beach*, 13 Cal. 4th at 255, 914 P.2d at 175, 52 Cal. Rptr. 2d at 97 (Mosk, J., concurring and dissenting).

433. *See id.* at 256, 914 P.2d at 176, 52 Cal. Rptr. 2d at 98 (Mosk, J., concurring and dissenting).

434. *See id.* at 256-57, 914 P.2d at 176, 52 Cal. Rptr. 2d at 98 (Mosk, J., concurring and dissenting).



the term quit-claim tended to show the grant of a fee simple estate if the grantor has such an interest to convey, Justice Mosk responded by noting that a party can quit-claim *any* interest in property, including an easement, citing cases from other states.<sup>435</sup> Revealing a weakness in this argument, Justice Mosk acknowledged that California decisions tended to treat a “quit-claim” deed as conveying a fee simple interest if the grantor had such title because the quit-claim gives whatever the interest the grantor may have.<sup>436</sup> Nevertheless, Justice Mosk asserted, however weakly, that the case at hand was different because “the face of the deed shows *unequivocally* that only a right-of-way was conveyed.”<sup>437</sup> Although Justice Mosk presented his argument with great vigor, he essentially recognized that the express terms gave conflicting signals as to the interest in land conveyed by the deed. Application of a plain meaning approach to the case is very dubious in light of this fact.

Moreover, Justice Mosk acknowledged that in saving the space for the warehouse “it was inartful drafting to both ‘reserve’ and ‘except’ some land from the right-of-way” because the reservation term implied the grant of a fee interest with a lesser interest being kept by the grantor, but he dismissed the argument as simply reflecting the use of loose language.<sup>438</sup> Similarly, Justice Mosk recognized

435. *See id.* at 257, 914 P.2d at 176-77, 52 Cal. Rptr. 2d at 98 (Mosk, J., concurring and dissenting).

436. Justice Mosk wrote:

If “it has been often decided by this court that a quitclaim deed conveys the absolute fee-simple title if the party executing it had such title” (Spaulding v. Bradley (1889) 79 Cal. 449, 456, 22 P. 47), that is likely so because the grantor wished to eliminate his or her entire estate or interest, whatever it might be, without “mak[ing any] assurance to the grantee that he or she actually has good title to, or even any interest at all in, the property . . .” (6A Powell on Real Property (1995 ed.) P. 897[1][b], p. 81A-29.)

*Id.* at 257, 914 P.2d at 177, 52 Cal. Rptr. 2d at 99 (Mosk, J., concurring and dissenting).

437. *Id.* (Mosk, J., concurring and dissenting) (emphasis added). Similarly, Justice Mosk asserted that the majority “makes too much of” the fact that the deed refers to “a strip of land” as supporting the likely grant of a fee interest, responding rather persuasively that any “right of way is a strip of land” and that the use of the word “land” was inconsequential. *Id.* (Mosk, J., concurring and dissenting). Justice Mosk further argued that the fact that relevant property consisted of a strip of land only 100 feet wide and two to three miles long meant that conveyance of a fee title would have been impractical and thus supports the conclusion that only an easement was conveyed. *See id.* at 261, 914 P.2d at 179, 54 Cal. Rptr. 2d at 101 (Mosk, J., concurring and dissenting).

438. *Id.* at 254, 914 P.2d at 178, 54 Cal. Rptr. 2d at 100 (Mosk, J., concurring and dissenting).

that the use of the term "revert" also implied the grant of a fee interest but again asserted that the inaccurate use of the term "revert" was widespread in railway conveyances.<sup>439</sup> Justice Mosk dismissed the lack of inclusion in the deed of the term "easement" because he considered the term "right-of-way" to be more precise.<sup>440</sup> These implicit concessions by Justice Mosk further undermine his plain meaning reading of the contract.

Ultimately, the dissenting opinion took the strong position that the deed was unambiguous, despite its recognition that some terms were misused and that "quit-claim" usually meant conveyance of a fee title if the grantor possessed it. The dissent took this position because it did not want to consider the extrinsic evidence. Justice Mosk made this point clear at the beginning of his discussion of the extrinsic evidence by starting with a criticism of *Pacific Gas*.<sup>441</sup> Justice Mosk cited both Judge Kozinski's criticism of *Pacific Gas* in *Trident Center v. Connecticut General Life Insurance Co.*<sup>442</sup> and his own criticism in an earlier dissent.<sup>443</sup> Both criticisms argue that resorting to extrinsic evidence too quickly creates unreliability in a document's written terms.<sup>444</sup> Justice Mosk asserted that this uncertainty was all the more objectionable in the case of a deed, which serves a public notice function, as compared to other more private contracts such as the one at issue in *Pacific Gas*.<sup>445</sup> Thus, Justice Mosk stated a preference for an objective reading of the document, even if extrinsic evidence would show a different intent on the part of the parties. On the other hand, even Justice Mosk would agree that if the deed or other contract is ambiguous, then it is proper to resort to extrinsic evidence.<sup>446</sup> Thus, Justice Mosk found it necessary to address the

439. *See id.* at 260, 914 P.2d at 178-79, 54 Cal. Rptr. 2d at 100-01 (Mosk, J., concurring and dissenting).

440. *See id.*, 914 P.2d at 179, 54 Cal. Rptr. 2d at 100 (Mosk, J., concurring and dissenting).

441. *See id.* at 252, 914 P.2d at 173, 52 Cal. Rptr. 2d at 95 (Mosk, J., concurring and dissenting).

442. 847 F.2d 564, 569 (9th Cir. 1988). *See supra* note 429.

443. *See City of Manhattan Beach*, 13 Cal. 4th at 261-62, 914 P.2d at 180-81, 52 Cal. Rptr. 2d at 101-02 (Mosk, J., concurring and dissenting) (citing *Delta Dynamics, Inc. v. Arioto*, 69 Cal. 2d 525, 531, 446 P.2d 785, 789, 72 Cal. Rptr. 785, 789 (1968) (Mosk, J., dissenting)).

444. *See City of Manhattan Beach*, 13 Cal. 4th at 253, 914 P.2d at 174, 52 Cal. Rptr. 2d at 96 (Mosk, J., concurring and dissenting); *Trident Ctr. v. Connecticut Gen. Life Ins. Co.*, 897 F.2d 564, 568-69 (9th Cir. 1988).

445. *See id.* at 262, 914 P.2d at 180, 52 Cal. Rptr. 2d at 102 (Mosk, J., concurring and dissenting).

446. *See id.*

extrinsic evidence considered by the majority and by the trial court.

Examining the extrinsic evidence, Justice Mosk thought it relevant that some seven to eight years after the deed was executed to the Railway, the Land Company executed deeds in favor of a third party that more clearly conveyed a fee simple interest.<sup>447</sup> In addition, part of the land deeded away included a portion of the Railway's right-of-way.<sup>448</sup> Justice Mosk conceded to the majority that the exclusion of the land grant to the Railway from a 1901 action to quiet title to all the Land Company's property supported the conclusion that the Land Company deemed itself to no longer have an interest in the land.<sup>449</sup> On the other hand, Justice Mosk correctly pointed out that a judgment entered in the 1901 case that excepted "those certain parcels of land heretofore granted" to a third party and "that certain right of way heretofore granted" to the railroad and thus the judgment suggested a difference between the fee simple interest conveyed to the third party and the interest conveyed to the railroad.<sup>450</sup>

Justice Mosk also took an evasive and overly technical approach to the 1903 decree of the Land Company's dissolution, which stated in part:

And it appearing further that all of the property of said corporation has been disposed of and that all of the business of said corporation has come to an end [Para] Now therefore it is ordered and adjudged that the said corporation, The Redondo Land Company, be, and the same is hereby dissolved, and its corporate existence ended . . . .<sup>451</sup>

While the majority found this decree to be a very strong indication that the Land Company had no further interest in the railway property,<sup>452</sup> Justice Mosk was adamant that the appellate court should not have taken judicial notice of the decree because the parties stipulated at trial not to introduce new evidence after the trial ended.<sup>453</sup> The

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447. *See id.* at 262-63, 941 P.2d at 180, 52 Cal. Rptr. 2d at 102 (Mosk, J., concurring and dissenting).

448. *See id.* at 261-62, 941 P.2d at 180, 52 Cal. Rptr. 2d at 102 (Mosk, J., concurring and dissenting).

449. *See id.* at 263, 941 P.2d at 181, 52 Cal. Rptr. 2d at 103 (Mosk, J., concurring and dissenting).

450. *Id.* at 264, 941 P.2d at 181, 52 Cal. Rptr. 2d at 103 (Mosk, J., concurring and dissenting). Justice Mosk noted that the evidence considered was not the original document but merely a transcription and he questioned whether the evidence was competent at all. *See id.* (Mosk, J., concurring and dissenting).

451. *Id.* (Mosk, J., concurring and dissenting).

452. *See id.* at 247, 914 P.2d at 170, 52 Cal. Rptr. 2d at 92.

453. *See id.* at 264, 914 P.2d at 181, 52 Cal. Rptr. 2d at 103 (Mosk, J., concur-

decree came to the parties' attention after the trial concluded and while the case was pending before the appellate court.<sup>454</sup> Rather than address the substantial argument that the decree, from which the railway property had been excepted,<sup>455</sup> reflected a view by the Land Company that the property had been conveyed permanently in fee simple, Justice Mosk simply decided that it was improperly admitted.<sup>456</sup> Again, this approach reflected Justice Mosk's position that it is better to go with the apparent meaning of the written document rather than look to extrinsic evidence for a more accurate picture of the parties' intent. Justice Mosk embraced this position despite the fundamental guiding principle of contract interpretation: to ascertain the intent of the parties.<sup>457</sup>

Ultimately, the words of conveyance in the deed at the heart of *City of Manhattan Beach* tended to favor creation of an easement but failed to do so in a clear fashion, therefore leaving room for the reasonable argument that a greater interest was intended to be conveyed. With this predicate for its consideration, the extrinsic evidence strongly, but not irrefutably, indicated that the grantors, at least at later times, treated the conveyance to the railway as a fee simple. The parties clearly held concerns about the initial operation of the railway because of the express reversion provisions covering short term issues but almost certainly did not consider cessation of rail services one hundred years later. The greatest likelihood is that at the time of the original grant, the parties simply did not see the cessation of rail services as a likely event in the distant future.

If the case is one in which the parties may have had an intent at the time of the deed's execution, but after one hundred years it is simply indecipherable or, more likely, one in which the parties failed to address the particular turn of events as a realistic possibility, what is a court to do? It is in this very situation that the court may appropriately fill the gap in the contract by resorting to its "sense of justice." The question asked by Justice Kennard, probably as a rhetorical matter, suggests a reasonable aid in interpreting such a contract.<sup>458</sup>

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ring and dissenting).

454. The appellate court agreed to take judicial notice of the contents of the decree, but concluded that it was of "marginal" significance. *Id.* at 264-65, 941 P.2d at 181-82, 52 Cal. Rptr. 2d at 103-04 (Mosk, J., concurring and dissenting).

455. *See id.*

456. *See id.*

457. *See id.* at 252-54, 941 P.2d at 181, 52 Cal. Rptr. 2d at 95-96 (Mosk, J., concurring and dissenting).

458. *See id.* at 267-68, 914 P.2d at 183-84, 52 Cal. Rptr. 2d at 105-06 (Mosk, J., concurring and dissenting).

Where neither the writing, the context, nor the extrinsic evidence reveals a relatively clear, objectively discernible intent jointly held by the parties, the court should consider the equities and do what is in the interest of justice.

The *City of Manhattan Beach* presents a unique opportunity to get a sense of the court's perception of the equities of the case due to a published account of the oral arguments before the supreme court.<sup>459</sup> That account reflects rather clearly that the majority, by deciding in favor of the city, was concerned about opportunistic if not unethical behavior on the part of the plaintiff heirs and their heir hunter sponsors.<sup>460</sup> The majority must also have been keenly aware that a decision against the city could result in the imposition of millions of dollars of liability in favor of the plaintiffs, whose interest in the property in question was remote in every sense.<sup>461</sup> Moreover, the original developers had obtained what they wanted from the Railway and its successors.<sup>462</sup> The property in the Manhattan Beach area had been made accessible, and therefore much more valuable, during its developmental period.

The dissent, on the other hand, was willing to ignore the equities in favor of a more neutral search for the mechanical determination of title.<sup>463</sup> Counsel for the heirs and heir hunters argued that the case was about title, not virtue.<sup>464</sup>

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459. See Graham, *supra* note 1, at 1.

460. Justice Armand Arabian (retired from the California Supreme Court, but sitting by designation), who would later write the majority decision favoring the city, asked the city attorney: "This doesn't come from a grieving widow someplace, this comes from an heir-hunting operation . . . . At common law we called it barratry—stirring up strife and litigation. Is that how this case gets here?" Graham, *supra* note 1, at 1.

461. "According to the city, the heirs have claimed the property is worth as much as \$100 million." Kowsky, *supra* note 8, at B3.

462. See *id.*

463. In response to Justice Arabian's suggestion that the law suit had arisen due to questionable instigation by the heir hunters, Michael M. Berger, the city's attorney, described the case as "created, concocted and stirred up" improperly. However, "Justice Kathryn Mickle Werdegar politely interrupted Berger to tell him, 'I don't see what impact this has.'" Graham, *supra* note 1, at 1.

464. The "heir hunters" were John Percival Farquhar and Ricardo B. Johnson who reportedly were descendants of land barons who first owned much of the land in the western side of Los Angeles County. See Rainey, *supra* note 11, at 6. The heir hunters initiated a number of similar actions to the one that spawned *City of Manhattan Beach v. Superior Court*, reportedly generating hundreds of thousands of dollars in recoveries for the found heirs. See *id.* The other cases involved a challenge to ownership of property upon which the Santa Monica Courthouse is located, a parcel of property purchased from a railway by the city of West Hollywood, a challenge to a sale of land in Brentwood by the federal

The dissenting justices were clearly influenced by that sort of thinking.

C. *Lee v. Walt Disney Co.*<sup>465</sup>

Peggy Lee, a popular music recording artist,<sup>466</sup> entered into a letter agreement with the Walt Disney Company in October 1952 to sing and record the spoken dialogue for an animated movie, *Lady and the Tramp*.<sup>467</sup> The contract provided that Lee would be paid \$3500 for six days' work, plus \$250 for each additional day.<sup>468</sup> At the time Lee executed the contract with Disney, she already had an exclusive phonograph recording contract with Decca Records.<sup>469</sup> For that reason, Lee's contract with Disney prevented Disney from making phonograph recordings of Lee's performances.<sup>470</sup> At the same time, the contract clearly aimed to grant Disney very broad power to show the movie.

Thus, the contract provided, in part:

You [Lee] will be obligated to perform your services in the recording on film (sound track) for reproduction and/or transmission by any means or methods now known or which may hereafter be devised or developed . . . .

The said rights to reproduce and transmit shall include, but shall not be limited to, motion pictures produced or exhibited

government to a developer, and a challenge to a land transfer from a railway to the city of Hermosa Beach. *See id.*

465. No. B058897 (Cal. Ct. App. Sept. 30, 1992) (unpublished opinion), *cert. denied*, 1992 Cal. LEXIS 6172 (Dec. 16, 1992).

466. Peggy Lee's career blossomed in 1941 when famed Big Band leader Benny Goodman heard her sing over the airwaves and asked her to sing with him. Throughout the 40s and 50s, Lee enjoyed great popularity for her jazz stylings. Two songs, *Is That All There Is?* and *Fever*, are among her most popular hits. *See* Howard Reich, *Peggy Lee: A Marvelous Merging of Life and Lyric*, CHI. TRIB., July 25, 1993, Arts, at 8.

467. *See Lee*, No. B058897, slip op. at 7. Lee and Joseph F. "Sonny" Burke had previously entered into an initial contract with Disney to write songs for the same movie. *See id.* The songwriting contract was not implicated in the lawsuit. Lee eventually provided voices for four characters in the movie and sang three of the five songs that she co-wrote. *See id.* at 15.

468. *See id.* at 7. Lee also received small amounts of pay for promoting "Lady and the Tramp" at other times, including total payment of \$500 at the time Disney initially released the movie and on its re-release, and a \$500 honorarium for promotional work when Disney released the movie on videocassette. *See id.* at 14-16.

469. *See id.* at 9. Lee's contract of April 2, 1952, gave Decca Records the rights to Lee's "exclusive personal services in connection with the production of phonograph records" for one year. *Id.*

470. *See id.* at 34.

with and/or accompanied by sound and/or voice recording, reproducing and/or transmitting devices, radio devices, television and all other improvements and devices which are now or which hereafter may be used in connection with the production, exhibition and/or transmission of any present or future kind of motion picture productions.<sup>471</sup>

While the foregoing portion seemingly granted Disney very broad powers, the contract also provided protection for Lee from Disney's releasing of musical recordings:

Anything herein to the contrary notwithstanding, it is agreed that nothing in this agreement contained shall be construed as granting to us the right to make phonograph recordings and/or transcriptions for sale to the public, wherein the results or proceeds of your services are used.<sup>472</sup>

Although the parties drew a rather clear line between Disney's ability to engage in public showings of the movie and its inability to sell phonograph recordings for private listening,<sup>473</sup> the parties could not have foreseen at the time the potential for home viewing of movies through the medium of video cassettes and the immense profits that Disney would eventually draw from such sales. *Lady and the Tramp* was released on videocassette in October 1987<sup>474</sup> for a limited period of eight months and generated profits in the amount of \$46 million.<sup>475</sup> Indeed, a number of Disney contracts with artists who performed in its animated films have been subject to challenges on the question of sharing profits with actors or similar parties. Such films include *Fantasia*,<sup>476</sup> *Snow White and the Seven Dwarfs*,<sup>477</sup> *Sleeping*

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471. *Id.* at 7 (emphasis omitted).

472. *Id.* at 9 (emphasis omitted). The appellate court noted:

When Lee was given a copy of the October 20, 1952 agreement to review before signing it, she expressed concern over the rights she was being asked to convey to Disney. In response, she was told she was reserving important rights for herself, and the language of paragraph 12(b) was pointed out for her. She stated: "I then read the language, which states in clear English that Disney must obtain my permission before it can sell copies of the movie or any part thereof to the public. I was granting Disney the rights that it required to exploit the movie in theatres and by television broadcast. I would be entitled to participate in the profits derived from sales to the public."

*Id.* at 16.

473. *See id.* at 7-9.

474. *See id.* at 20.

475. *See id.* at 10. Buena Vista Home Video, a Disney subsidiary and co-defendant in the case actually release the video. Gross receipts from the English version were \$72 million and net revenues exceeded \$46 million. *See id.* at 20.

476. The release of *Fantasia* on video led to litigation against Disney in three

*Beauty*,<sup>478</sup> *Pinocchio*,<sup>479</sup> and *Cinderella*.<sup>480</sup> Other movie studios and similar copyright holders have also experienced similar lawsuits involving new technology uses of older materials.<sup>481</sup>

When the parties filed opposing motions for summary judgment, the trial court looked to the contract language to discern whether Disney had the right to distribute the videocassettes without Lee's permission.<sup>482</sup> The trial court granted summary judgment for Lee, finding as a matter of law that Disney breached the contract with Lee by selling videocassettes of *Lady and The Tramp* to the public without securing Lee's permission.<sup>483</sup> As a result, Lee was entitled to a jury trial to determine damages.<sup>484</sup> Subsequently, the jury awarded Lee \$3,830,000 damages on all four causes of action presented, but the judge ultimately limited recovery to \$2,305,000.<sup>485</sup> Lee appealed

different actions. See *Philadelphia Orchestra Ass'n v. Walt Disney Co.*, 821 F. Supp. 341, 343 (1993) (lawsuit filed by Philadelphia Orchestra against Disney seeking \$60 million, or half of amount Disney profited from video sales on the film *Fantasia*); *Muller v. Walt Disney Co.*, 871 F. Supp. 678 (S.D.N.Y. 1994) (Lawsuit filed by estate of Leopold Stokowski, conductor of the Philadelphia Orchestra, which performed in *Fantasia*, for share of profits from home video sales); *Boosey & Hawkes Music Publishers v. Walt Disney Co.*, 934 F. Supp. 119 (S.D.N.Y. 1996) (challenge to Disney's right to use Igor Stravinsky composition in video release of *Fantasia*).

477. See Michael Blowen, *Say it Ain't So, Moe*, BOSTON GLOBE, July 7, 1993, at 50. Adriana Caselotti, the voice of the Snow White character, originally earned \$970 in 1937. At the time the dispute arose, she was 77 years old and did not wish to be dragged through a long court ordeal. She requested a settlement with Disney. See *id.*

478. See *Disney Settles with Singer in 'Sleeping Beauty' Claim*, WALL ST. J., June 3, 1991, at B4. Mary Costa, the voice of the Sleeping Beauty character, sued Disney for \$2 million after the movie's release on home video. The parties settled out of court for an undisclosed amount. See *id.*

479. See *Bourne Co. v. Walt Disney Co.*, 68 F.3d 621 (2d Cir. 1995), *cert. denied*, 116 S. Ct. 1890 (1996) (lawsuit challenging Disney's ability to use the compositions, including music from *Pinocchio* and *Snow White* in videos).

480. See Beth Kleid, *Movies*, L.A. TIMES, Dec. 31, 1990, Home ed., at F2 (Ilene Woods Shaughnessy, the voice of Cinderella, filed a \$20 million lawsuit claiming a right to share in profits from videocassette sales.).

481. See generally Barbara J. Shulman, *Old Materials, New Issues: Licensing for Interactive Media*, 211 N.Y. L.J. 1, 4-5 (1994) (noting that technological innovations such as home video and interactive video create new marketing options for motion picture and record libraries, thereby raising the question of whether the copyright holder has unfettered or only limited rights); Barbara D. Griff, Note, *A New Use for an Old License: Who Owns the Right?*, 17 CARDOZO L. REV. 53, 53 (1995) (noting history of new technology issues from invention of "talkies" movies to present day multimedia formats).

482. See *Lee*, No. B058897, slip op. at 2-3.

483. See *id.*

484. See *id.*

485. See *id.* at 5-6. The jury awarded \$2,305,000 for breach of contract,



on the issue of damages and Disney appealed the decision on the merits in favor of Lee.<sup>486</sup>

The appellate court identified as key to the case the interpretation of the term "transcriptions" as used in paragraph 12(b), which prohibited Disney's sale of "transcriptions" to the public.<sup>487</sup> Disney contended that "transcriptions" had a very "plain specific meaning," referring to a special purpose phonograph record used by radio stations primarily to play advertisements, prerecorded programs, or spot announcements.<sup>488</sup> The court noted that a number of trade definition sources supported this argument and that Disney's use of the term in other contracts which suggested the limited meaning of transcription.<sup>489</sup> Disney also presented a number of declarations and affidavits from relevant industry sources that transcriptions and electrical transcriptions were used interchangeably during the early 1950s to refer to the oversized phonograph records used primarily for radio broadcasting. Disney had in fact offered a set of "transcriptions" to theater owners for the purpose of promoting the movie *Lady and the Tramp*. Finally, Disney also noted that its founder, Walt Disney, had employed a consistent practice of paying performers in his animated films on a "flat fee" basis so that he would have absolute ownership of the finished product, a practice which changed only when Disney eventually accepted the Screen Actors Guild agreement which provided for residuals for performers.<sup>490</sup>

Lee argued, essentially, that the term "transcription" had a different plain meaning that covered "[a]ny form of recording or copying for sale to the public," including videocassettes.<sup>491</sup> Lee argued that the limited meaning that Disney wished to assign was covered by the more specific term "electrical transcription" or "ET." The appellate court noted that in fact Disney did use the more precise term "electrical transcriptions" in a number of contracts executed between 1952 and 1955.<sup>492</sup>

Another forceful argument Lee raised, and the trial court relied

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\$500,000 on an unjust enrichment theory, \$400,000 for unauthorized use of Lee's name or voice in foreign sales, and \$625,000 for unauthorized use of Lee's name or voice in domestic sales. *See id.* The trial court ruled that all the awards were for the same injury and limited Lee's recovery to the single largest award. *See id.*

486. *See id.* at 22-25.

487. *See id.* at 10.

488. *See id.* at 17-18.

489. *See id.* at 10-12.

490. *See id.* at 21.

491. *Id.* at 13.

492. *See id.* at 12-13.

upon, was that Disney, in an earlier case, had argued that the term "transcription" included video cassette recordings of movies.<sup>493</sup> In its trial brief from the earlier case, Disney argued that its rights as copyright owner "[t]o make or procure the making of any transcription or record" included making videocassettes and that those rights were violated when another party made videotapes of its movies.<sup>494</sup>

The appellate court began its analysis by noting that summary judgment is a drastic procedure and is proper only if no question of fact as to the issue is to be decided.<sup>495</sup> The court went on to state more specifically that summary judgment on an issue of contract interpretation may be appropriate if there is no extrinsic evidence or the extrinsic evidence is uncontradicted.<sup>496</sup> The appellate court cited a virtual litany of maxims or rules in aid of interpretation, including, most importantly, that the contract should be interpreted in accordance with the reasonable, objective-based understanding of the promisee at the time the contract was made.<sup>497</sup> The court also noted that "[a]ny ambiguities in the agreement must be resolved in favor of a fair and reasonable interpretation" and "[t]he agreement must be interpreted to avoid an extraordinary, harsh, unjust or absurd result."<sup>498</sup>

493. *See id.* at 17.

494. *See id.* The case was *Walt Disney Prods. v. Alaska Television Network*, 310 F. Supp. 1073 (W.D. Wash. 1969). The court did not resolve this issue in the course of its decision. *See id.* at 17.

495. *See id.* at 26-27.

496. *See id.* at 27. The court summarized by stating that "[i]n short, in the face of an ambiguous contract and *conflicting* extrinsic evidence, summary adjudication is not appropriate." *Id.* at 28 (emphasis added).

497. *See id.* at 28-29. For example, the court cited section 1649 of the California Civil Code, noting:

If the language of the agreement is ambiguous or uncertain, i.e., it is reasonably susceptible to more than one interpretation, it must be interpreted in the sense in which the promisor believed, at the time of making it, that the promisee understood it.

However, this interpretation is made consistent with the objective standard, i.e., how a reasonable promisor would have believed the promisee understood the terms. The objective standard looks to words and conduct, rather than undisclosed intentions.

*Id.* at 28-29. (citing CAL. CIV. CODE § 1649) (citations omitted). The court also cited such maxims as words are to be understood in their ordinary and popular sense, rather than their strict legal meaning, unless there a special meaning based on a technical sense or usage of trade, *see id.* (citing CAL. CIV. CODE §§ 1644, 1645); the contracting circumstances may be taken into account, *see id.* (citing CAL. CIV. CODE § 1647); if the other the interpretive rules and the extrinsic evidence cannot resolve the ambiguity, it is to be construed against the drafter. *See id.* (citing CAL. CIV. CODE § 1654).

498. *Id.* (citing *Ecco-Phoenix Elec. Corp. v. Howard J. White, Inc.*, 1 Cal. 3d

In assessing the propriety of the trial court's decision that video-cassettes were transcriptions within the meaning of the contract and therefore could not be sold without Lee's permission, the appellate court first concluded that the term "transcription" has dual meanings within the music and entertainment business: a general meaning of any "copy" of a recorded item and a more specific meaning of a type of "phonograph record" or "electrical recording."<sup>499</sup> Based on the arguments and evidence the parties presented, the appellate court found it reasonable that either meaning may have been intended specifically for the Disney-Lee contract.<sup>500</sup> Thus, the appellate court proceeded to examine which meaning should prevail in the case at hand, looking first to the general contractual provisions but also taking into account extrinsic evidence consistent with the precedent in *Pacific Gas*.<sup>501</sup>

On the one hand, the appellate court noted that interpreting the term "transcriptions" in the contract to convey the term's more narrow, technical meaning of oversized discs or "electrical recordings for use by radio stations" would fit reasonably and would not create any conflict; Disney would be prohibited from selling electrical records, but not video cassettes, to the public.<sup>502</sup> The court noted Disney did retain broad rights "to reproduce Lee's *film* performance by any means known or developed in the future" and the narrow, technical meaning would not "conflict with Disney's rights to reproduce the motion picture."<sup>503</sup> Under this view, Disney's retained rights would then include the right to sell videocassettes and would be consistent with the fact that Lee had an exclusive phonograph recording contract with Decca Records.<sup>504</sup> Disney's internal records reflected this

266 (1969)); *Northridge Hosp. Found. v. Pic 'N' Save No. 9, Inc.*, 187 Cal. App. 3d 1088, 1095, 232 Cal. Rptr. 329, 333 (1986); *Howe v. American Baptist Homes of the West, Inc.*, 112 Cal. App. 3d 622, 627 (1980).

499. *See Lee*, No. B058897, slip op. at 31-32.

500. *See id.* at 32.

501. *See supra* note 112.

502. *Lee*, No. B058897, slip op. at 33.

503. *Id.* at 33-34. The court cited California Civil Code sections 1641 and 1650 and quoted paragraph 11 from the contract:

Specifically, Disney sought to retain all rights to reproduce "*motion pictures* produced or exhibited with and/or accompanied by sound and/or voice recording, reproducing and/or transmitting devices, radio devices, television and *all other improvements and devices which are now or which hereafter may be used in connection with the production, exhibition and/or transmission of any present or future kind of motion picture productions.*"

*Id.*

504. *See id.* at 34.; *see supra* notes 468-69.

understanding of the contract.<sup>505</sup>

In the counterbalance, the court noted several substantial arguments for Lee's interpretation. First and foremost, if the term "transcriptions" were given its technical meaning of oversized discs or electric records made specifically for use in radio broadcasts, then the provision concerning transcriptions it would have "no meaning," as the appellate court phrased it.<sup>506</sup> Paragraph 12(b) referred to "phonograph recordings and/or transcriptions for sale to the public."<sup>507</sup> Since "transcriptions" in its more narrow, technical sense would not involve sales to the public, that portion of the contract would be self-contradictory and have no practical application. Indeed, the term "transcriptions" would add nothing to Lee's rights under paragraph 12(b) if the court accepted Disney's interpretation. This observation was particularly significant for the court because of the maxim of interpretation that "[a]n agreement should be interpreted to give effect to each of its parts."<sup>508</sup>

Secondly, Lee also pointed out that the more precise term of "electrical transcriptions" was also used within the entertainment business at the relevant time and the use of the more general term "'transcriptions' alone in a contract might suggest to the parties that a general rather than a technical meaning was intended."<sup>509</sup> Disney itself used the more precise term "electrical transcriptions" in other contracts in the early 1950s.<sup>510</sup> The appellate court noted that the fact that Disney used both terms would support an inference that Disney gave different meanings to each.<sup>511</sup> The concurrent use of the term "electrical transcription" also supported a reasonable understanding on Lee's part as promisee that "transcriptions" had a broader meaning, of which Disney as promisor should have been reasonably

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505. *See Lee*, slip op. at 34. Disney, in a December 3, 1952, Talent Contract Brief, interpreted the October 20, 1952, agreement with Lee to mean that it had acquired all rights from Lee, with the sole exception of making phonograph records or albums. *See id.* at 9. Disney released *Lady and the Tramp* in June 1955 and Decca Records produced a soundtrack sometime thereafter. *See id.*

506. *Id.* at 34-35.

507. *Id.* at 35.

508. *Id.* at 34 (citing CAL. CIV. CODE § 1641). The appellate court reasoned that while it was conceivable that the "electrical transcriptions" could have been made in a smaller than normal diameter for potential sales to the public, there was no evidence that this was ever done and therefore a promisee might not reasonably believe that transcriptions was limited to its technical use. *See id.* at 34-35.

509. *Id.* at 33.

510. *See id.* at 36.

511. *See id.*

aware.<sup>512</sup>

Lee's third and final argument relied on the fact that Disney had interpreted the term "transcriptions" to include videocassettes in an earlier lawsuit.<sup>513</sup> Disney had argued in its trial brief in that case, citing Webster's Third International Dictionary, that a transcription meant "a *tape*, disc, or other recording made for broadcast or re-broadcast of a radio or television program" and thus included videocassettes for home use.<sup>514</sup> The appellate court recognized that Disney's argument in the 1969 copyright case about the meaning to be assigned to federal copyright law would not be determinative of the meaning to be assigned to the 1952 contract with Lee.<sup>515</sup> The argument by Disney in the other case did show, however, that Disney at that time interpreted the term "transcription" broadly enough to include new technologies.<sup>516</sup>

Faced with substantial arguments on both sides of the interpretation debate, the appellate court ultimately held that the contract provisions granting broad rights to Disney and reserving limited rights to Lee were ambiguous and therefore should be construed against the drafter.<sup>517</sup> The court reasoned: "It is clear there is an irreconcilable conflict in the extrinsic evidence; either one interpretation of 'transcriptions' or the other is correct. The rules governing interpretation of contracts do not resolve the ambiguity in the agreement. Therefore, the agreement must be construed against Disney, as the drafter."<sup>518</sup> Thus, the appellate court ruled that "the agreement must be interpreted in favor of Lee and against Disney, [and the] question properly was summarily adjudicated in favor of Lee by the trial court."<sup>519</sup> The California Supreme Court denied

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512. *See id.* at 36-37. Lee had executed a contract with Capitol Records in 1949 which made use of the more precise term "electrical transcriptions." The court received evidence on the existence of "soundies," jukebox-like motion pictures that involved synchronized sound recordings that existed at the time of the Disney-Lee contract. Lee argued that the reproduction of soundies would have violated her contracts, just as the video cassettes did. *See id.*

513. *See id.* at 37 (citing *Walt Disney Prods. v. Alaska Television Network*, 310 F. Supp. 1073 (W.D. Wash. 1969)).

514. *Id.* at 37.

515. *See id.*

516. *See id.*

517. *See id.* at 39-40.

518. *Id.* at 39 (citing CAL. CIV. CODE § 1654); *see also* *Ranier Credit Co. v. Western Alliance Corp.*, 171 Cal. App. 3d 255, 263-64, 217 Cal. Rptr. 291, 295-96 (1985) (need parenthetical).

519. *Id.* at 40.

Disney's petition for review.<sup>520</sup>

In reaching the decision that the contract did not give Disney the right to sell the movies on videocassettes without Lee's approval, the court varied from other decisions which have construed grants of rights to the studios rather broadly.<sup>521</sup> While the court's decision in *Lee* might possibly be distinguished on the facts, it may be better explained that the court—faced with a contract that did not contemplate a future development—merely sought to reach a just result. The factors include Disney's corporate giant status and its reaping substantial profits from the invention of home video players and the resulting popularity of videocassettes. Indeed, children's videos have proven to be exceptionally profitable because of children's tendency to watch the same videos over and over again.<sup>522</sup> Despite a lack of overwhelming financial success with the initial release of *Lady and the Tramp*, Disney had already reaped profits from re-releases of the films, concededly due in large part to shrewd planning by Disney.<sup>523</sup> At the time of the lawsuit, Lee was at an advanced age and she had received very minimal compensation for initially performing the voices in the movie. In a situation where the parties have neither contemplated a future development nor expressly provided for it in the contract, the trial and appellate courts quite defensibly sought to reach a just result. A decision requiring the sharing of the unanticipated profits would strike most people as just. Explicit recognition of this basis for the decision would establish some precedent that would more clearly guide future courts in similar cases.

#### IV. CONCLUSION

The process of contract interpretation has never been precise because of the inherent difficulty that parties have in expressing wishes for their contractual relations.<sup>524</sup> Parties may sometimes

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520. See *Lee v. Walt Disney Co.*, 1992 Cal. LEXIS 6172 (Dec. 16, 1992). Justice Baxter alone voted to grant the petition for review. See *id.*

521. See generally Shulman, *supra* note 481, at 1 (noting most of the cases with a "future technologies" clause have held that the grant of rights was broad enough to incorporate home video or grants the licensee the right to use the materials in any medium "now known or hereinafter invented"). Cf. Griff, *supra* note 481, at 68-70 (noting that Second Circuit of Appeals tends to construe new technology clauses in favor of broader rights to the movie company and Ninth Circuit favors more narrow grant of rights).

522. See *Lee*, No. B058897, slip op. at 21.

523. See *id.* at 20.

524. See generally Kniffin, *supra* note 58, at 656 ("In a world where semantics is a science instead of an art we might be able to read a contract and understand

attach different meanings to the very same words or phrases, ignoring the other party's understanding. Because of a strong desire to go forward to with the transaction, parties may occasionally leave certain aspects of the contract open because of an inability to agree at the time of formation. Unanticipated changes or technological developments over the long-term, or even shorter time spans, may result in circumstances that the parties did not contemplate. Further, the passage of time alone may result in circumstances that the parties did not contemplate when they executed the contract.

While recent California contract decisions embrace enlightened approaches to issues of contract interpretation and the parol evidence rule, even when working best, those normal rules of interpretation fail to answer consistently the above interpretive dilemmas. In those situations, the courts often attempt to stretch the common rules of interpretation to resolve these situations. A tremendously better approach would be to simply recognize that, in such cases of *lacunae* within the contract terms, the courts are empowered to weigh a number of equitable factors and attempt to reach a just result. Those equitable factors would include addressing public interests and public good, allowing for sharing of unanticipated losses and gains, avoiding the award of a windfall to one party at the cost of denying recovery to the other side, and considering the parties' good or bad faith behavior. These factors do align very well with the progressive, equitable considerations adopted by the *Restatement (Second)*. Only when courts in jurisdictions such as California explicitly apply the "just result" principle will the law in this area be allowed to develop fully.

Justice Kennard effectively posed the question in the oral arguments of the *City of Manhattan Beach*: Should the court merely search for a mechanical application of rules to resolve the lack of clarity in the contract or should the court consider equitable factors that might lead to a just result when the express and implied terms in fact fail to yield an answer to the disputed issue?<sup>525</sup> While the majority grounded its resolution in favor of the City of Manhattan Beach on the rules of interpretation,<sup>526</sup> the decision might have been more honestly decided as favoring the public interest over the goals of heir hunters and remote heirs with no direct interest in the property other than seeking a windfall gain. In situations where the contract does

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it without a question.").

525. See Graham, *supra* note 1, at 1.

526. See *supra* notes 401-464; 13 Cal. 4th 232, 253, 914 P.2d 160, 174, 52 Cal. Rptr. 2d 82, 96 (1996) (Mosk, J., concurring and dissenting).

not provide an answer, the concerns of justice should certainly be relevant to contract interpretation and construction.



