Washington and Lee Law Review

Volume 25 | Issue 2 Article 9

Fall 9-1-1986

Tests Of Contractual Integration

Treating payments made by a feeder corporation to its parent charitable foundation as constructive dividends rather than charitable contributions is in accord with eleemosynary reality. The beneficial ownership doctrine enunciated in *Knapp Shoe* disallows charitable deductions for payments made by a feeder corporation to the entity which possesses the economic interest and enjoyment of the feeder corporation. The doctrine of beneficial enjoyment does not necessitate judicial inquiry into either the motive for payments made by a feeder corporation to its parent foundation, or as to who possesses the managerial or operational control of the feeder corporation.

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TESTS OF CONTRACTUAL INTEGRATION

The parol evidence rule is an accepted rule of American law which states that evidence of prior or contemporaneous agreements and negotiations is inadmissible to contradict or vary the terms of a later written agreement which the parties have agreed is the total embodiment of their understanding.[1] If the instrument is found to contain the parties' complete understanding, then such an instrument is said to be totally integrated.[2] While the rule seems simple and straightforward, an examination of case law in this area will show the confusion that actually exists. The problem is not the parol evidence rule itself, but the antedecent determination of what method should be followed in deciding whether the written instrument is totally integrated.[3] The resolution of this problem may lead to a decline of the parol evidence rule itself.

A recent California decision, *Masterson v. Sine*,[4] rejected the traditional method of determining contractual intergration in favor of a more flexible rule based on intent. In 1958 plaintiff-wife and her

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Holding Co., 324 U.S. 331 (1945); Helvering v. F. & R. Lazarus & Co., 308 U.S. 252, 255 (1939).

[1] 3 A. CORBIN, CONTRACTS § 573 (1960); RESTATEMENT OF CONTRACTS § 237 (1932); UNIFORM COMMERCIAL CODE § 2-202.

[2] "An agreement is integrated where the parties thereto adopt a writing or writings as the final and complete expression of the agreement." RESTATEMENT OF CONTRACTS § 228 (1932).

[3] See the following cases for a discussion of the different methods of determining integration: Clark v. United States, 341 F.2d 691 (9th Cir. 1965); Brewood v. Cook, 207 F.2d 439 (D.C. Cir. 1953); Thompson v. Liddy, 34 Minn. 374, 26 N.W. 1 (1885); Hunt Foods & Indus., Inc. v. Doliner, 26 App. Div. 2d 41, 270 N.Y.S.2d 937 (1966).

[4] 436 P.2d 561, 65 Cal. Rptr. 545 (1968).

husband deeded a ranch to the husband's sister and her spouse with a stipulation which reserved for the grantors an option to repurchase the property on or before February 25, 1968.[5] Following the execution of this deed, grantor-husband was adjudged bankrupt. Grantor-wife and husband's trustee in bankruptcy sought a declaratory judgment to allow them to exercise the option to repurchase. The grantees, however, claimed that there had been a contemporaneous oral agreement between the parties that in order to keep the land in the family, this repurchase option could be exercised only by the grantors personally and was not assignable.[6] The grantees further claimed that the written deed did not contain their total agreement and, therefore, was not an integrated instrument. Thus, the question for the court to determine was what type of extrinsic evidence, if any, tending to show the written deed was not the total agreement of the parties, should have been admitted at the trial.

The majority in *Masterson* rejected the "four corners" doctrine previously followed by the courts of that state[7] and adopted the "reasonable man" approach of the *Restatement of Contracts*.[8] Under this theory, non-contradictory evidence as to what the parties intended is admissible even though the instrument appears totally integrated on its face, if the court determines under the circumstances a "reasonable man" might naturally have included such a collateral oral agreement as part of his total bargain. *Masterson* decided that a separate, oral agreement which forbade the assignment of the grantor's repurchase option might naturally have been made. As a factual determination, the court found that the family was inexperienced in land tranactions. Recognizing the difficulty of adapting collateral agreements to the formalized structure of a deed, the court reasoned that the grantors' right to repurchase from future purchasers would be protected by the inclusion of the repurchase option in the deed; its non-assignability might naturally be the subject of a separate agreement since the in-

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[5]*Id.* at 546.

[6]The trustee is not automatically vested with title where property and rights of action could not have been freely transferred by the bankrupt. Bankruptcy Act § 70(a)(5), 11 U.S.C. § 110(a)(5) (1953).

[7]*E.g.*, Thoroman v. David, 199 Cal. 386, 249 P. 513 (1926); Heffner v. Gross, 179 Cal. 738, 178 P. 860 (1919).

[8]The *Restatement* provides:

> An oral agreement is not superseded or invalidated by a subsequent or contemporaneous integration, nor a written agreement by a subsequent integration relating to the same subject-matter, if the agreement is not inconsistent with the integrated contract, and ... is such an agreement as might naturally be made as a separate agreement by parties situated as were the parties to the written contract.

RESTATEMENT OF CONTRACTS § 240(1) (1932).

clusion of the non-assignability clause in the deed would be unnecessary to protect the grantors' rights as against those of future purchasers. Fearing the effect this decision will have on both the reliability of land conveyance instruments and the increased ability to defraud creditors, the dissent condemned this departure from established California law.

Throughout the opinion, *Masterson* noted the four different tests used generally in determining whether extrinsic evidence tending to show the non-existence of an integration is admissible: (1) the traditional "four corners" doctrine that was discarded in *Masterson;* (2) the "reasonable man" standard of the *Restatement of Contracts* and Professor Samuel Williston, which *Masterson* adopted; (3) the acutal intent method of Professor Arthur Corbin; and (4) the recently promulgated test of the Uniform Commercal Code.

Under the "four corners" approach the question of a partial or total integration can only be determined by looking at the face of the instrument.[9] Extrinsic, non-contradictory evidence is admissible only to clarify ambiguities or supply missing terms whose absence have made the document on its face only partially integrated.[10] Under this test the court in *Masterson* would have disallowed evidence as to the non-assignability of the repurchase option, for the deed on its face appeared to be complete. Often a written agreement is deemed total on its face by supplying missing terms by means of judicial inferences even though these inferred terms may not have been the intent of either party.[11] As expressed in *Peterson v. Chaix:*

> [W]hatever the law implies from a contract in writing is as much a part of the contract as that which is therein expressed; and the extent that the contract, with that which the law

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[9]Fox Midwest Theaters, Inc. v. Means, 221 F. 2d 173 (8th Cir. 1955); Armstrong Paint & Varnish Works v. Continental Can Co., 301 Ill. 102, 133 N.E. 711 (1921); Marshall Hall Grain Co. v. P. H. Boyce Mercantile Co., 203 Mo. App. 220, 211 S.W. 725 (1919); Dawson County State Bank v. Durland, 114 Neb. 605, 209 N.W. 243 (1926).

[10]Fawkner v. Lew Smith Wallpapering Co., 88 Iowa 169, 55 N.W. 200 (1893) (dictum).

[11]Fogler v. Purkiser, 127 Cal. App. 554, 16 P.2d 305 (1932); Union Special Sewing Mach. Co. v. Lockwood, 110 Ill. App. 387 (1904); Blake Mfg. Co. v. Jaeger, 81 Mo. App. 239 (1899). See *Masterson, supra* note 4, at 549 n.3, for a criticism of this approach. But also note that in *Masterson,* not even the dissent would follow the device of using inferences to explain or supply missing contractual terms in order to create an instrument integrated on its face and thus not subject to explanatory, extrinsic evidence. On the contrary, the minority welcomes this type of evidence to explain terms of the conveyance that seems ambiguous. 65 Cal. Rptr. at 551.

> implies, is clear, definite and complete, it cannot be added to, varied, or contradicted by extrinsic evidence.[12]

Applying this doctrine, *Liljengren Furniture & Lumber Co. v. Mead*[13] held that where a contract to deliver window sashes was silent as to the time of delivery, the court would imply a reasonable time and would forbid the introduction of evidence of an oral contemporaneous agreement tending to prove that these sashes "were to be furnished and delivered as fast as needed in the construction of the building."[14]

The remaining three tests of contractual integration are based on the parties' intent. It should be noted that regardless of which test is used, all three are tools by which the judge passes on the credibility of the evidence and thereby allows its submission to the trier of fact. If evidence of the parties' intent is to be admitted, an important consideration involves which intent of the parties is the goal of judicial determination—their apparent intent or their subjective intent. A court applying an apparent intent test is establishing a stricter credibility standard than one using subjective intent. *Masterson* and other cases[15] have adopted the apparent intent, "reasonable man" standard of the *Restatement of Contracts*. Professor Samuel Williston's treatise on contracts is in agreement.[16] Williston would only admit evidence of a non-contradictory,[17] collateral agreement if a "reasonable man" might have made such an agreement. Williston states, "The point is not merely whether the court is convinced that the parties before it did in fact [so agree], but whether parties so situated generally would or might do so."[18] While Williston claims to make his determination based on the parties' apparent intent,[19] it seems that a collateral, non-contradictory oral agreement, made before any number of witnesses, would be ineffective if parties so situated would not generally make such oral agreement.[20]

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[12]5 Cal. App. 525, 90 P. 948, 954 (1907).

[13]42 Minn. 420, 44 N.W. 306 (1890).

[14]*Id.* at 308.

[15]Brewood v. Cook, 207 F.2d 439 (D.C. Cir. 1953); Hubacek v. Ennis State Bank, 159 Tex. 166, 317 S.W.2d 30 (1958). For a discussion of other problems concerning the *Restatement* test, see 3 A. CORBIN, CONTRACTS § 584 (1960).

[16]4 S. WILLISTON, CONTRACTS § 638 (3d ed. Jaeger 1961).

[17]The requirement that the collateral agreement be non-contradictory is itself one of various credibility tests the court uses in making its initial determination.

[18]4 S. WILLISTON, CONTRACTS § 638 at 1041 (3d ed. Jaeger 1961).

[19]4 S. WILLISTON, CONTRACTS § 638 (3d ed. Jaeger 1961).

[20]See 4 S. WILLISTON, CONTRACTS §§ 633, 638 (3d ed. Jaeger 1961). In *Gianni v. Russel & Co.*, 281 Pa. 320, 126 A. 791 (1924), evidence of a collateral oral agreement that plaintiff would have the exclusive soft drink concession in an office building in consideration for his written agreement in the lease to refrain from selling tobacco was excluded since the oral agreement would naturally and normally have been included in the written contract.

Williston argues that admission of all extrinsic evidence would cripple the parol evidence rule since the "rule would then be of importance only in establishing a presumption that prior and contemperaneous oral agreements and negotiations were merged in the writing..."[21] Williston's reasonable man test first determines the credibility, and, thereby, the admissibility, of extrinsic evidence. It then sheds its status as an admissibility standard and in its more common use is employed, among other tests, by the trier of fact to determine if the evidence actually admitted is truthful.

A different approach is taken by Professor Arthur Corbin, who advocates the application of the "actual" subjective intent of the parties[22] rather than the "reasonable man" standard of Williston and the *Restatement*.[23] He would admit evidence of a consistent agreement even though it would be unnatural for a "reasonable man" to make such an agreement. Corbin criticizes the *Restatement* approach claiming that "whether or not it was 'natural' for the parties to do as they did bears only on the credibility of the evidence offered."[24] Corbin would not be forced to reject an "unnatural" oral, collateral, non-contradictory agreement made before a large number of witnesses as would Williston. Evidence of the "unnatural" agreement would be admitted if the judge deems it credible. The "reasonable man" standard would be employed not as an absolute judicial admission standard, but merely as an aid to the judge, among other tests, in determining the credibility of the evidence sought to be admitted.

In *United States v. Clementon Sewerage Authority*,[25] extrinsic evidence of an oral agreement between the sewerage authority and the designing engineer to limit the construction costs to a specified amount was admissible in determining if the written contract was a total integration even though "it is unusual to omit so important a term from a writing as comprehensive as this one."[26] If *Masterson* had followed this "actual intent" approach, the result would have been identical since there the majority found the collateral agreement to

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[21]4 S. WILLISTON, CONTRACTS § 633 at 1014 (3d ed. Jaeger 1961).

[22]3 A. CORBIN, CONTRACTS § 582 (1960); Atlantic Airlines v. Schwimmer, 12 N.J. 293, 96 A.2d 652 (1953) (extrinsic evidence as to the parties' circumstances and actual intent is always admissible to aid the court in determining if there was a partial or total integration).

[23]For a discussion of objective versus subjective intent as expressed by Williston and Corbin, see Calamari & Perillo, *A Plea for a Uniform Parol Evidence Rule and Principles of Contract Interpretation*, 42 IND. L.J. 333 (1967). *Masterson* briefly mentions the existence of this test, but offers no criticism or evaluation. 65 Cal. Rptr. at 547.

[24]3 A. CORBIN, CONTRACTS § 584 at 480 (1960).

[25]365 F.2d 609 (3rd Cir. 1966) (decided according to New Jersey law).

[26]*Id.* at 614.

have been not only a natural intent of the parties so situated but also the actual intent of the parties.

Another criterion for judging the admissibility of extrinsic evidence is expressed in the Uniform Commercal Code § 2-202 where it is stated that the written agreement: "[m]ay be explained or supplemented . . . by evidence of consistent additional terms unless the court finds the writing to have been intended also as a complete and exclusive statement of the terms of the agreement." Comment 3 to § 2-202 states:

> [C]onsistent additional terms, not reduced to writing, may be proved unless the court finds that the writing was intended by both parties as a complete and exclusive statement of all the terms. If the additional terms are such that, if agreed upon, they would *certainly* have been included in the document in the view of the court, then evidence of their alleged making must be kept from the trier of fact.[27]

The UCC standard is a two-fold judicial test of admissibility. The court must first determine whether the parties intended their written contract to represent their entire agreement. If the court finds that the parties intended a consistent additional term to be part of their written contract, it will then determine if this additional term was of such a nature as might possibly not have been included in the written instrument. Only when an affirmative decision is made under both these tests and the evidence is thereby determined to be credible will the trier of fact be permitted to consider the evidence.

Masterson takes the position that the UCC test is broader than those of Williston and Corbin. The majority appears to reject this broader rule while pointing out that had it followed the UCC test, *a fortiori,* the holding would have been identical.[28] While California has enacted § 2-202 of the UCC as promulgated by the 1962 Official Draft, § 2-102 applies Article II to "transactions in goods."[29] Although the Code permits the application of Article II to non-sales situations,[30] it certainly does not require its application. Thus California remains free to adopt any test of contractual integration it wishes. In the few cases interpreting this section of the Code, it has been used to

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[27]UNIFORM COMMERCIAL CODE § 2-202, Comment 3 (emphasis added). The phrase "consistent additional terms" is synonymous with "non-contradictory" evidence as used by Williston and Corbin. Both phrases express a judicial credibility standard.

[28]65 Cal. Rptr. at 549. Since the court held it was "natural" for the parties to make this contemporaneous oral agreement it must also hold that parties would not have "certainly" included this oral agreement in the written one.

[29]UNIFORM COMMERCIAL CODE § 2-102.

[30]*See* UNIFORM COMMERCIAL CODE §§ 1-102, 2-313, Comment 2. For a complete discussion of the application of the UCC as a judicial principle, see Note, *The Uniform Commercial Code as a Premise for Judicial Reasoning,* 65 COLUM. L. REV. 880 (1965).

justify the admission of extrinsic evidence in a variety of commercial situations.

Hunt Foods & Industries, Inc. v. Doliner[31] involved an unconditional written stock purchase option given to the plaintiff. While the option seemed integrated and unconditional on its face, the court, in denying a motion for summary judgement, admitted extrinsic evidence to show that the option was not in fact an unlimited right. Because the court only discussed the question of the consistency of the option, it, by implication, must have previously reached the conclusion that the document was not intended to be the total agreement and that the option might possibly not have been included in the writing. The court recognized that this additional term might easily frustrate the ripening of the written agreement. Nevertheless, citing UCC § 2-202, and UCC § 2-202, Comment 3, the court held the oral agreement to be a "consistent additional" terms since "[t]o be inconsistent the term must contradict or negate a term of the writing."[32] Therefore, a term which does not contradict or negate a term of the writing is provable. Since the additional term was deemed consistent by the court, it became a question for the trier of fact to consider this additional evidence and to arrive at an ultimate determination of the actual agreement of the parties.[33] Under this New York ruling the additional evidence must specifically contradict or negate a term of the written agreement before proof of its existence can be excluded.[34] Unlike the apparent and subjective standards of the *Restatement* and Corbin, reasonableness in general in making such a collateral agreement is not considered by the court.

Masterson may be read as rejecting both the traditional "four corners" and the UCC rules and instead adopting the "reasonable man" approach of the *Restatement of Contracts.* Only the dissent actually states that the *Restatement of Contracts* test has been adopted. Nowhere, however, in the opinion is the broader UCC test specifically rejected. Referring to the judicial doctrine of not formulating a broader rule than is necessary to decide the controversy,[35] one could

[31]26 App. Div. 2d 41, 270 N.Y.S.2d 937 (1966).

[32]*Id.* at 940.

[33]In determining this agreement, the court does not specifically state which intent is the goal of the trier of fact, but it seems certain that the court means the actual, subjective intent of Corbin rather than the "reasonable man" intent of Williston.

[34]*See also* Ciunci v. Wella Corp., 26 App. Div. 2d 109, 271 N.Y.S.2d 317 (1966) (extrinsic evidence limiting a release that appeared all inclusive on its face was admitted as a consistent additional term).

[35]Ashwander v. Tennessee Valley Authority, 297 U.S. 288 (1936).

easily imagine the California court formally adopting the UCC rule if the *Restatement* rule were not broad enough to support the court's desired result. Thus, the California court might admit evidence of an oral agreement that a "reasonable man" would not naturally have made the subject of a separate agreement if the court is convinced such collateral negotiations actually occurred.

While the dissent condemns a more liberal admission standard, it must be remembered that throughout the field of commercial law there has been a loosening of requirements of form in order to better realize the expectations and agreements of the parties involved.[36] Although the dissenting justices in *Masterson* "doubt that trial judges should be burdened with the task of conjuring whether it would have been 'natural'," [37] it nevertheless seems that such a rule would further the expectations of the parties more than would a blind rule of form.

However, the "reasonable man" rule adopted by *Masterson* does not seem to be in accord with the modern trend. New York,[38] Tennessee,[39] and Rhode Island,[40] have expressly adopted the UCC standard. Furthermore, it has been predicted that the subjective intent doctrine of Corbin will be followed by the *Restatement (Second) of Contracts*.[41] Corbin's actual intent standard seems to be the most realistic and practical of the various rules in use today. By using the "reasonable man" standard merely as one credibility test rather than as an absolute exclusionary test, credible but "unnatural" evidence may be admitted. Such evidence may then be tested as to its truthfulness by the trier of fact using as one criteria the "reasonable man" standard. The injustice of being forced to reject evidence of a widely witnessed collateral bargain can be avoided without increasing the possibility of fraud or collusion any more than exists under the *Restatement* "reasonable man" view.

While none of the proposed admissibility tests directly affect the operation of the parol evidence rule, they may indirectly control its application. If there are such lenient credibility guidelines for admitting evidence to make the initial determinaion of the presence of a total integration, as under the UCC and Corbin tests, then it would seem that a greater number of such instruments would be termed only partial integrations. Thus, the parol evidence rule would not

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[36]UNIFORM COMMERCIAL CODE § 1-102.

[37]65 Cal. Rptr. at 555-56.

[38]Ciunci v. Wella Corp., 26 App. Div. 2d 109, 271 N.Y.S.2d 317 (1966).

[39]Hull-Dobbs, Inc. v. Mallicoat, 415 S.W.2d 344 (Tenn. Ct. App. 1966).

[40]*See* Golden Gate Corp. v. Barrington College, 98 R.I. 35, 199 A.2d 586 (1964).

[41]Calamari & Perillo, *A Plea for a Uniform Parol Evidence Rule and Principles of Contract Interpretation*, 42 IND. L.J. 333, 353 (1967).