

THE PAROL EVIDENCE RULE: A COMPARATIVE ANALYSIS AND PROPOSAL

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I INTRODUCTION

The parol evidence rule has long been a controversial element of the common law system. It has been frequently attacked for the injustices that result from its application and sometimes even for a lack of rationality in its justification.¹ This article results from the conviction that useful light can be shed on the problems surrounding the parol evidence rule by an examination of its status in other common law jurisdictions, where it has also been the subject of constant dispute throughout the previous half century.²

However, despite the similarity of the nature of the attacks launched against the parol evidence rule, it has maintained a vitality in some countries that it has rarely achieved in the jurisdictions of the United States.³ One of the primary

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1 See, eg, John D Calamari and Joseph M Perillo, ‘A Plea for a Uniform Parol Evidence Rule and Principles of Contract Interpretation’ (1967) 42 *Indiana Law Journal* 333; Arthur L Corbin, ‘The Interpretation of Words and the Parol Evidence Rule’ (1965) 50 *Cornell Law Quarterly* 161; Lawrence A Cunningham, ‘Toward a Prudential and Credibility-Centered Parol Evidence Rule’ (2000) 68 *University of Cincinnati Law Review* 269; Eric A Posner, ‘The Parol Evidence Rule, the Plain Meaning Rule, and the Principles of Contract Interpretation’ (1998) 146 *University of Pennsylvania Law Review* 533; Stephen F Ross and Daniel Tranen, ‘The Modern Parol Evidence Rule and Its Implications for New Textualist Statutory Interpretation’ (1998) 87 *Georgetown Law Journal* 195; Morris G Shanker, ‘In Defense of the Sales Statute of Frauds and Parole [sic] Evidence Rule: A Fair Price of Admission to the Courts’ (1995) 100 *Commercial Law Journal* 259; Justin Sweet, ‘Contract Making and Parol Evidence: Diagnosis and Treatment of a Sick Rule’ (1968) 53 *Cornell Law Review* 1036.

2 See, eg, *Pacific Gas & Electric Co v GW Thomas Drayage & Rigging Co*, 69 Cal 2d 33 (Cal, 1968) (Traynor J). Cf *Trident Center v Connecticut General Life Insurance Company*, 847 F 2d 564 (9th Cir, 1988); *Investors Compensation Scheme Ltd v West Bromwich Building Society Ltd* [1998] 1 WLR 896; *Bank of Credit and Commerce International SA (in liq) v Ali* [2002] 1 AC 251 (‘*Bank of Credit and Commerce*’); *Royal Botanic Gardens and Domain Trust v South Sydney City Council* (2002) 186 ALR 289; *Acorn Consolidated Pty Ltd v Hawkslade Investments Pty Ltd* (1999) 21 WAR 425; *Benjamin Developments Ltd v Robert Jones (Pacific) Ltd* [1994] 3 NZLR 189.

3 See below Part IV.

contentions of this article is that this disparity is best explained in terms of a difference between the fundamental views of contract adopted in the United States and in the other major common law nations. Specifically, this difference is between the subjective and objective theories of contracting.⁴

According to the subjective theory of contracting, which is dominant in the United States, the written document produced by the parties is merely a memorandum of the agreement that they have reached. Consequently, when a court attempts to resolve a dispute regarding the agreement, the written document is construed as persuasive evidence of what was agreed, and can be contradicted by other evidence tending to show that the actual agreement was something different.⁵ By contrast, the objective theory of contracting holds that the written document is in fact the agreement itself, so that in attempting to discern the nature of the bargain between the parties it is improper to admit evidence that contradicts the written document.⁶ Since the actual intentions of the parties are not being considered by the court,⁷ evidence that would tend to demonstrate that their intentions were something other than the written document reflects is simply irrelevant.

4 It is essential to note the distinction between the use of the term 'objective' as used in this article, and as often used in American discussions of the parol evidence rule, where it refers to the idea that individuals can be held to their 'objective' representations to the other party, whether they intended them to carry that meaning or not. In the current discussion, on the other hand, 'objective' refers to the complete rejection of the relevance of the intentions of the parties. For an in-depth discussion of the application of the American 'objective' approach to contract, see Joseph M Perillo, 'The Origins of the Objective Theory of Contract Formation and Interpretation' (2000) 69 *Fordham Law Review* 427. 'Nonetheless, the objective theory of contract formation and interpretation holds that the intentions of the parties to a contract or alleged contract are to be ascertained from their words and conduct rather than their unexpressed intentions'. See also *Ricketts v Pennsylvania RR Co*, 153 F 2d 757, 760–9 (2nd Cir, 1946); Keith A Rowley, 'You Asked for It, You Got It ... Toy Yoda: Practical Jokes, Prizes, and Contract Law' (2003) 3 *Nevada Law Journal* 526.

5 See Sanford Schane, 'Ambiguity and Misunderstanding in the Law' (2002) 25 *Thomas Jefferson Law Review* 167, 180 where Schane stated:

The subjective theory of contract, on the other hand, requires that there be a meeting of the minds – that without an agreement of intention, properly expressed, a contract has not been created. Judges adhering to this doctrine have no qualms about admitting extrinsic evidence in order to ascertain each party's intent, even where the parties thought that they had created a final expression of their agreement.

6 See *FL Schuler AG v Wickman Machine Tool Sales Ltd* [1974] AC 235, 261 ('*Schuler*'), where Lord Wilberforce stated that '[t]he general rule is that extrinsic evidence is not admissible for the construction of a written contract; the parties' intentions must be ascertained, on legal principles of construction, from the words they have used'. It is essential to note, however, that the reference to the parties' intentions does not mean the actual intentions of the parties, but the presumed intent of reasonable people, in the circumstances of the parties.

7 See *Codelfa Construction Pty Ltd v State Rail Authority of New South Wales* (1982) 149 CLR 337, 352 ('*Codelfa*') where Mason J stated:

Consequently when the issue is which of two or more possible meanings is to be given to a contractual provision we look, not to the actual intentions, aspirations or expectations of the parties before or at the time of the contract, except in so far as they are expressed in the contract, but to the objective framework of facts within which the contract came into existence, and to the parties' presumed intention in this setting. We do not take into account the actual intentions of the parties.

Even the simplest overview of these theories of contracting reveals that the subjective approach supports a rejection of the parol evidence rule, while the objective approach wholeheartedly embraces it. This article, however, will argue that despite the fact that every jurisdiction can be seen to explicitly embrace either one or the other of these theories of contracting, in fact both approaches hold an unavoidable appeal. Consequently, both can be seen to exert an influence in every jurisdiction's controversy over the parol evidence rule, regardless of whether the jurisdiction in question is supposedly 'objective' or 'subjective'. As stated by one commentator, '[i]n virtually every jurisdiction, one finds irreconcilable cases, frequent changes in doctrine, confusion, and cries of despair'.⁸

Part II of this article discusses the historical development of the parol evidence rule in order to illustrate the ideas that have traditionally been used to justify its existence. Part III considers the nature of the conventional American parol evidence rule, examining the way in which the American embrace of the subjective theory of contracting has informed its treatment of the rule. Part IV is concerned with the parol evidence rule as it is applied in Australian law, highlighting the differences with the American law that result from Australia's embrace of an objective approach to contract interpretation. Finally, Part V contains a theoretical discussion which attempts to explain the importance of both the subjective and objective approaches to contracting, and argues that the only solution to the ongoing conflict over the parol evidence rule is to bring both approaches within each jurisdiction, carefully delineating when each should properly be applied.

II THE HISTORY AND DEVELOPMENT OF THE PAROL EVIDENCE RULE

Although an objective approach to contracting could certainly be applicable in a legal regime that did not use written documents in contracting,⁹ there is nonetheless a strong connection between the spread of written contracts and the initial change in common law countries from a subjective to an objective theory of contracting.¹⁰ The goal of this section is to trace the historical developments

8 Posner, above n 1, 540. (referring solely to the various American states). See also Peter Linzer, 'The Comfort of Certainty: Plain Meaning and the Parol Evidence Rule' (2002) 71 *Fordham Law Review* 799, 802 where Linzer said '[t]he parol evidence rule has many variations. In fact, like that political anachronism, the Holy Roman Empire, the parol evidence rule fits none of the words in its name: it is not limited to parol – that is, oral – testimony, it is not evidentiary, and it is not really a rule'.

9 For example, the court system could simply focus its attention on the actual words spoken and not the intent behind them. However, historical records seem to be clear that this was not the approach adopted by courts before the spread of literacy. See generally John H Wigmore, 'A Brief History of the Parol Evidence Rule' (1904) 4 *Columbia Law Review* 338.

10 *Ibid.*

that gave rise to the parol evidence rule, and to illustrate that they also reflected a move from a subjective to an objective theory of contracting.¹¹

Despite the obvious link between the spread of literacy and the use of written contracts in proving the substance of an agreement,¹² the spread of judicial respect for written contracts was less rapid than might be expected if illiteracy was the only consideration. For example, such a concern would be inapplicable once it had been demonstrated that the parties involved in the dispute could both read.¹³ However, the historical records suggest that at the time literacy truly began to spread, at the beginning of the second millennium, a document was still treated as merely one more piece of evidence to be considered by the court, even when neither party claimed an inability to read.¹⁴ This lag in granting written documents a privileged status is probably best explained institutionally, as the court system had by this time already evolved approaches that were regarded as adequate for determining the true nature of an agreement, such as the use of multiple witnesses.¹⁵ Consequently, courts would have felt no strong compulsion to adopt a new system that privileged written documents, especially when those documents could misrepresent the actual agreement, and could be forged.

Nonetheless, it is clear that limitations on the spread of literacy were a significant retardant to any legal privileging of written documents. Even if the parties had prepared a written document, it would often have been drafted by scribes, with the illiterate principals required to trust the integrity of the scribe.¹⁶ Consequently, the policy of the courts at the time was that even though a written document might serve as evidence of the true nature of the bargain in question, once the accuracy of the document was challenged it could no longer stand on its own, but had to be supported by witnesses.¹⁷ It is important to emphasise, however, that the practice was not simply to allow witnesses to be called to challenge the document. Rather, once a challenge had been made, witnesses also had to be called to support the document's veracity. At this point, the document

11 For an account of the contemporary disagreements over when, how and why this change occurred see Perillo, above n 4.

12 Note that this is in relation to actually 'proving' the agreement, rather than the idea that the writing is the agreement. The latter idea is a clear conceptual step beyond anything that would come out of a simple increase in the prevalence of literacy.

13 See Anon, *Year Book* 20 Edw I 258 (1292) (Horwood's edition) in Wigmore, above n 9, 341–2, where a case was quoted in which a written document was disputed by witness testimony, even though it was not claimed that either of the parties to the transaction was unable to read.

14 Ibid.

15 Wigmore, above n 9, 339–42.

16 See Andreas Heusler, *Institutionen des Deutschen Privatrechts* (1885) 86 in Wigmore, above n 9, 340. As Heusler commented:

Nowadays, our documents of debt, or the like, we write ourselves, or at least sign them after perusal; we are masters of them, and we know that the thing we have written or signed is precisely what it is, and no fearsome mysterious thing. Quite otherwise with the Germanic peoples, confronted with the alien practice of legal writings, upon their invasions of Roman regions. The grantor of land, the borrower of money, could neither read nor write the document which might be executed in his name; he could but mark his cross at the bottom and hope that all was right.

17 'If the truth of its statements is disputed ... the terms of the transaction may and must be proved by calling the witnesses to it, regardless of any contradiction of the writing': Wigmore, above n 9, 341.

was not even privileged as a particularly persuasive form of evidence, and was treated as secondary to witness testimony.

This status of the document as merely one aspect of the complete agreement is captured by the following description of a land transaction from that era:

The act of delivery of the document was performed by the maker grasping the still blank parchment, lifting it from the earth (in land transfers at least, by Frankish usage), calling upon the witnesses to grasp it with him, handing it to the scribe to fill out the writing, and, after signatures affixed, delivering it to the grantee.¹⁸

In this transaction the written document is so enveloped by the old non-written form of land transfer that it is lifted from the land being transferred, as though it were merely a piece of earth being symbolically handed over to the new owner¹⁹ – with the added benefit that it could also serve as a record of the proceeding.²⁰ Indeed, according to one authority, the primary role of the written document in these proceedings was to preserve the names of the witnesses, in case of a future dispute.²¹ The actual transaction, then, is clearly separate from the document – the document serves merely as a record of the transaction.

The question arises as to when the document itself began to attain the importance that it possesses today. Yet this question itself reflects a misunderstanding of the nature of the historical development being discussed. The change appears to have been an extended process that had already been significantly achieved, in some ways, while rituals such as those described above were still in common use. Perhaps the greatest influence was the increasing use of the seal.²² This practice, according to which a document would be closed with wax and imprinted with designs representing the contracting parties, initially gained prominence in England in the 1000s, but related only to the seal of the King. However, by the 1200s the use of a seal had spread to ordinary individuals.²³

To tie this history to the theme of the objective and subjective theories of contracting, it is important to recognise that the increasing use of a seal did not truly alter the place of a written document within the legal system. Nor did it signify a move to a more ‘objective’ system. Rather, the use of a seal functioned as a kind of waiver, in which the individual whose seal was imprinted on the document was seen to have already ‘testified’ that the document was an accurate

18 Heusler, above n 16, 86 in Wigmore, above n 9, 340–1.

19 For a brilliant discussion of the role of symbolism and form in medieval thought see Johan Huizinga, *The Autumn of the Middle Ages* (Rodney Payton and Ulrich Mammitzsch trans, 1996).

20 ‘Whatever virtue there is in the writing is testimonial only. It furnishes one sort of proof; but it is not a necessary kind of proof, and the main thing is something done apart from the writing’: Wigmore, above n 9, 343.

21 ‘In this stage, then, the *carta* merely plays a convenient part, first, by enabling the formal delivery of the land to be made symbolically away from the premises, and, next, by preserving against future forgetfulness the names of the witnesses’: *ibid* 341.

22 See Eric M Holmes, ‘Stature and Status of a Promise Under Seal as a Legal Formality’ (1993) 29 *Willamette Law Review* 617, 625–37.

23 See Wigmore, above n 9, 343.

representation of the agreement in question.²⁴ Hence he or she was prevented from bringing forth witnesses to challenge his or her own ‘testimony’.²⁵

Nonetheless, while the widespread adoption of the seal may not have signalled a rejection of the subjective theory of contracting, the accompanying notion of the use of the seal as a ‘waiver’ is nonetheless a significant early move away from the subjective approach. The written document was not yet regarded as the agreement itself, as the practice was not that the individual would be held to the terms of the written document regardless of what the parties actually agreed, but rather that he or she had already ‘testified’ as to the nature of the agreement, via the written document. The enhanced importance of the written document does not come from any newly recognised reliability of the document itself as evidence of the actual agreement. Rather, the existence of the sealed written document served to exclude contradictory evidence, no matter how persuasive it might have been. The legal structure of contracting, then, had developed one area which stated clearly that, in legal contractual disputes, the actual agreement reached between the parties is perhaps not the only goal of the inquiry for a court. Parties could properly be held to an agreement to which they had affixed their seal, even if the written terms in question could be proven not to accurately represent the actual terms of the agreement between the parties.

This first move towards an objective theory of contracting was simultaneously given further impetus by other elements of the legal system, particularly the long-standing concern of courts over the reliability of juries. As in contemporary times,²⁶ courts saw the practice of refusing to allow a written document to be challenged as a way of preventing juries from hearing evidence that could cause them to lend more weight to their sympathies than to the facts of the case.²⁷ The reality of this ‘problem’ with juries is perhaps reflected in the fact that the

24 Originally, the fact that the King’s seal was attached to a document may have conveyed a strong assurance as to the reliability of the terms of the document. This is because the King would have had available the services of high-quality scribes, who could be trusted not to risk the King’s wrath by inaccurately transcribing the agreement to which the King affixed his seal. Moreover, as noted by Wigmore, even if the contents of the document were inaccurate, a party may not have been willing to challenge them, since they were backed by the power of the King: *ibid* 342. However, as the use of a seal spread to commoners this rationale became clearly inadequate. The relevance of the seal was not that it prevented either party from challenging the document; rather, the party whose seal was affixed to the document could no longer challenge it: *ibid*. ‘The *rise of the seal* brings a new era for written documents, not merely by furnishing them with a means of authenticating genuineness, but also by rendering them indisputable as to the terms of the transaction and thus dispensing with the summoning of witnesses’: *ibid*.

25 Of course, a person could claim that the writing and the seal were both forgeries. However, during the period in which the status of the seal was at its greatest, a person was held to contracts signed with his or her seal, even if he or she could prove that the seal had been stolen: see Perillo, above n 4, 435.

26 See, eg, William C Whitford, ‘The Role of the Jury (and the Fact/Law Distinction) in the Interpretation of Written Contracts’ [2001] *Wisconsin Law Review* 931.

27 See, eg, *Lawrence v Dodwell* (1659) 1 Lutw 734; 125 ER 384 in Wigmore, above n 9, fn 27, ‘[t]he averment should be gathered from the words of the will; it is not safe to admit a jury to try the intent of a testator’. Perillo also asserts that ‘[t]here is evidence that the distrust of juries is one of the pillars of the parol evidence rule. The parol evidence rule is not applicable in equitable actions that traditionally were tried to the chancellor without a jury’: Joseph M Perillo, ‘Comments on William Whitford’s Paper on the Role of the Jury (and the Fact/Law Distinction) in the Interpretation of Written Contracts’ [2001] *Wisconsin Law Review* 965, n 6.

authority of the written document was established by the 1300s for commercial transactions,²⁸ which are the least likely to engender strong sympathies in a jury, but it was not until the 1600s that it was accepted in realty transactions,²⁹ and, of course, it is still being challenged today.³⁰

The rise of the concept of different ‘qualities’ of evidence represented the next significant step in the move toward an objective theory of contracting in the common law system. The doctrine states that evidence of a higher quality cannot be contradicted by evidence of a lower quality.³¹ For example, a sealed document is of a higher quality than an unsealed document. Consequently, a sealed document could not be challenged by an unsealed document, no matter how persuasive the unsealed document might be.³²

The importance of this new development did not lie in its practical effect, as this evidence would also have been excluded under the waiver theory.³³ Rather, the ‘quality of evidence’ doctrine reflected a new way of thinking about written documents. While the waiver theory still adhered to the subjective approach, by offering an explanation as to why the evidence should not be used to determine the true agreement made,³⁴ this new theory did not attempt to help the court discern the ‘true’ nature of the non-written agreement between the parties. Instead, it merely pointed to the ‘nature’ of the evidence itself, and insisted that the sealed document *should be taken* as decisive evidence of the agreement. That is, the sealed document was still construed as *evidence of* the agreement (and not the agreement itself), so the objective theory of contracting had not been fully embraced. However, the court had now abandoned the claim that its evidentiary procedures would accurately unearth the ‘true’ agreement between the parties. Instead, for the first time, we see a court stipulating clearly that the parties would be held to the terms of their sealed agreement, *simply because it is a sealed agreement*, no matter how poorly it may have represented the actual agreement between the parties. These courts, then, had moved into an area somewhere between the two theories, in which the subjective theory had been clearly rejected, but the objective theory had not yet been fully embraced.

28 See Wigmore, above n 9, 344, 346.

29 Ibid 345.

30 Finally, quite apart from any desire of the courts to prevent improper jury decision, the spread of literacy increased the acceptability of written documents as accurate evidence of a transaction, when compared with the unreliability of ordinary memory – ‘Finally, a general policy of regard for the *trustworthiness of writing*, as against the shiftiness of mere testimonial recollection, was beginning to be consciously avowed, irrespective of any discrimination against the jury’: *ibid* 347.

31 See *The Countess of Rutland’s Case* (1606) 6 Co Rep 52b; 77 ER 332. In this case parol evidence was not admissible because ‘every contract or agreement ought to be dissolved by matter of as high a nature as the first deed’. See also *Sharington v Stratton* (1565) 1 Plow 298; 75 ER 454, in which it was held that a sealed deed is of a higher nature than other evidence; Francis Bacon, *A Collection of Some Principal Rules and Maxims of the Common Lawes of England* (1963) 91, Regula 23, where Bacon stated that a patent ambiguity in a document may not be averred because ‘the law will not couple and mingle matters of specialty, which is of a higher account, with matter of averment, which is of inferior account in law’.

32 See *Lord Cheyne’s Case* (1591) 5 Co Rep 68b, 77 ER 158, where it was decided that parol evidence may not be used to challenge a sealed document.

33 Since by affixing his or her seal, the person ‘waives’ the right to bring forth the evidence in question.

34 Namely, that the person whose seal is fixed to the document is taken to have already testified that the document is accurate.

The final step in the move to a full embrace of the objective theory of contracting, and the initial appearance of a true parol evidence rule, occurred with the passage of the *Statute of Frauds and Perjuries 1677* (UK).³⁵ Although the statute itself only required proof of land transactions to be in writing, and did not apply to contracts in general, the fact that the writing in question did not have to be under seal was a significant recognition of the idea that all written contracts should be privileged.³⁶ Moreover, the terms of the statute affirmed that the writing in question did not merely represent or evidence the nature of the transaction. Rather, the writing constituted the transaction itself.³⁷ As such it fully embraced the objective theory of contracting.

Although, as noted above, the statute did not apply to contracts generally, courts at the time nonetheless read it as affirming the validity of an ‘objective’ approach, which was already a theme of contract law. Courts repeatedly appealed to the statute as setting out a rule for dealing with questions of parol evidence in transactions of all kinds.³⁸

Gradually, then, the doctrine that the written document itself actually constitutes, rather than merely represents, the agreement between the parties spread throughout the common law systems.³⁹ The parol evidence rule was eventually adopted in full, excluding all parol evidence as relevant only to the question of the true intentions of the contracting parties, a question that was no longer of concern to the courts.

III THE CONTEMPORARY AMERICAN PAROL EVIDENCE RULE: THE ‘SUBJECTIVE’ APPROACH

Although the objective approach to contracting dominated the American legal scene at the beginning of the 20th century,⁴⁰ it was gradually replaced by a subjective approach, which endorsed the view that the proper goal of a court in a contractual dispute is to ascertain the true intentions of the parties in entering into their agreement.⁴¹ This section is concerned with illustrating the correspondence

35 *Statute of Frauds and Perjuries 1677* (UK), 29 Car 2, c 3. ‘The Statute of Frauds and Perjuries, in 1678, seems to mark the modern epoch’s full beginning ... This statute appears of course as the mark rather than the cause of the final development’: Wigmore, above n 9, 350.

36 See Wigmore, above n 9, 350.

37 The *Statute of Frauds and Perjuries 1677* (UK), 29 Car 2, c 3 provided that ‘[t]he legal act was to be constituted, not merely proved, by the document, and the document might be an ordinary writing, not necessarily a “deed”, ie, under seal’: *ibid* 350–1.

38 ‘The scope of these provisions was limited; but their moral and logical influence was wide and immediate. The statute now began to be appealed to, in all questions of ‘parol evidence’, as setting an example and typifying a general principle’: *ibid* 352.

39 ‘A legal transaction when reduced in writing was now to be conceived of as constituted, not merely indisputably proved, by the writing’: *ibid* 353.

40 *Ibid*.

41 See Perillo, above n 4, 421, where Perillo states ‘[b]y giving effect to the parties’ intentions, the law of contracts is based on respect for party autonomy’.

between the embrace of a subjective theory of contracting and the emergence of challenges to the parol evidence rule throughout the United States.⁴²

Although the state-based nature of much United States law makes it somewhat inaccurate to speak of an ‘American’ parol evidence rule,⁴³ there is still a basic structure which is common to the various versions of the rule. The current section discusses this structure.⁴⁴

The first important point to note is that although the rule refers to ‘parol’ evidence,⁴⁵ it does not apply solely to evidence of spoken exchanges. It applies generally to any evidence of prior or contemporaneous agreements or negotiations offered to challenge the authority of the written document.⁴⁶ A justification for the contemporary parol evidence rule, then, cannot succeed solely on the basis of unreliability of memory, or the untrustworthiness of verbal testimony.⁴⁷

Under the standard American parol evidence rule, the determination of whether proffered evidence can be admitted proceeds through a series of discrete steps. First, the court determines whether or not the written agreement was ‘integrated’. That is, whether it was intended to be a final representation of the specific terms covered in the document.⁴⁸ If the court finds that it was not,⁴⁹ the parol evidence rule is inapplicable, as the document does not represent the agreement between the parties. Notably, at this point nothing in the method is inconsistent with an objective approach to contracting, as under an objective theory this question would represent an inquiry into whether the document itself was actually agreed upon by the parties.

It is at the second step of the procedure that the inconsistency of the American parol evidence rule with an objective theory of contracting becomes clear. Once

42 See above n 1.

43 As in fact there are many parol evidence rules across the US, see James Mooney, *The New Conceptualism in Contract Law* (1995) 74 *Oregon Law Review* 1131; Posner, above n 1, 534. Posner states, ‘[t]wo stylized, polar positions can be distinguished. Under what I will call the ‘hard-PER’, the court generally excludes extrinsic evidence and relies entirely on the writing. Under the ‘soft-PER’, the court gives weight both to the writing and to the extrinsic evidence’.

44 See generally Edward A Farnsworth, *Farnsworth on Contracts* (2nd ed, 2001) vol II, pt 3, ch 7, sub-pt B.

45 Interestingly, France is the only major civil law country that has a version of the parol evidence rule: see John E Murray Jr, ‘An Essay on the Formation of Contracts and Related Matters Under the United Nations Convention on Contracts for the International Sale of Goods’ [1998] *Journal of Law and Commerce* 8, fn 154.

46 See Farnsworth, above n 44, § 7.2. Farnsworth states ‘[a] host of cases have applied the so-called parol evidence rule to exclude such writings as letters, telegrams, memoranda, and preliminary drafts exchanged by the parties before execution of a final written agreement’.

47 See Albert G Marquis, ‘The Parol Evidence Rule’ (2002) 10 *Nevada Law Journal* 12, ‘[d]eveloped to prevent fraud and perjury, the parol evidence rule is based on the principle that a written contract is more reliable than oral testimony when determining the terms of an agreement’.

48 Whether the agreement is integrated ‘turns on whether the parties intended the writing as a final expression of the terms it contains, even if the writing was not intended as a complete and exclusive statement of all terms on which agreement was reached’: Farnsworth, above n 44, § 7.3. Whether the agreement is fully or only partially integrated ‘depends on whether the parties intended the writing as a complete and exclusive expression of all terms on which agreement was reached, as distinguished from merely a final expression of the terms that it contains’: at § 7.3.

49 For example, it may have been written up during negotiations to reflect the then existing status of discussions, but with the recognition by the parties that no final agreement had yet been reached.

the court has determined that the written agreement in question is indeed 'integrated', it must determine whether the agreement is 'completely' or only 'partially' integrated. That is, the court must decide whether the written agreement is intended to be a complete representation of all aspects of the agreement between the parties, or whether it only represents some things on which the parties agreed, while other points of agreement were reached and simply omitted from the document in question.⁵⁰

This second step is not itself incompatible with an objective theory of contracting. It is, in effect, utilised in 'objective' jurisdictions in the form of the 'two contract' theory, which allows proof of the existence of additional agreements.⁵¹ However, where the standard American parol evidence rule's departure from the objective theory of contracting becomes clear is in the way the examination is conducted. As the court is still in the process of determining whether the parol evidence rule is applicable to the written document in question, the rule is not yet applicable.⁵² Consequently, evidence of negotiations and prior agreements is admissible, to the extent that they may be used to determine the intention of the parties in writing the document.⁵³ Of course, if the agreement is found to be a complete integration, then evidence of any other agreements will be excluded, as the court has found that the document in question represents the complete agreement between the parties.⁵⁴ However, if the agreement is found to be only partially integrated, then evidence of prior negotiations or agreements will be allowed as long as such evidence does not actually contradict the written document.⁵⁵

This stands in stark contrast to the 'two contracts' approach which operates in some 'objective' jurisdictions. According to this theory, the parol evidence rule should be applied automatically, and the court should not attempt to discern the intentions of the parties in writing the document. Rather, the court simply accepts the document as written, but may then admit the parol evidence in question on the separate issue of whether another agreement also existed.⁵⁶

50 'If an agreement is integrated, it is considered 'partially integrated' or 'completely integrated' according to the degree to which the parties intended the writing to express their agreement': Farnsworth, above 44, § 7.3.

51 According to this approach, even if the written document in question is accepted by the court as the relevant agreement, and hence parol evidence of other agreements is excluded, such evidence may, nonetheless, be used to prove other agreements, even if those agreements were reached prior to the one in question. Moreover, it has been argued that such prior agreements can control the interpretation of the written agreement, if they were a condition of signing the written agreement: *City and Westminster Properties (1934) Ltd v Mudd* [1959] 1 Ch 129.

52 See Farnsworth, above n 44, § 7.3: 'the prevailing view that other evidence, including evidence of prior negotiations, is still admissible to show that the writing was not intended as a final expression of the terms it contains'.

53 The purpose of the American parol evidence rule is 'to give legal effect to whatever intention the parties may have had to make their writing at least a final and perhaps also a complete expression of their agreement': *ibid* § 7.3.

54 See *Restatement (Second) of Contracts*, § 216(1), '[i]f the agreement is completely integrated, not even evidence of 'a consistent additional term' is admissible to explain the writing'.

55 *Ibid* §§ 210(2), 215–6.

56 See Farnsworth, above n 44, § 7.3

Although it may be difficult to see why a ‘subjective’ jurisdiction would apply any form of parol evidence rule,⁵⁷ since it seems explicitly designed to preclude evidence of the true intentions of the contracting parties,⁵⁸ arguments have been made that the existence of the rule does, in fact, help the court to better ascertain the intentions of the contracting parties. For example, it may be argued that ‘[a]ny contract ... can be discharged or modified by subsequent agreement of the parties’.⁵⁹ Consequently, evidence of prior negotiations and agreements should be excluded from the court’s consideration simply because any points of agreement that were *intended* to form part of the complete agreement, would have been reduced to written form.⁶⁰ According to this argument, the parol evidence rule can actually help ensure that the true intentions of the contracting parties are discerned, by excluding evidence that can only serve to obscure their true intentions.

However, this argument is fundamentally flawed in so far as it simply directs the court to determine whether or not the agreement was ‘completely’ or ‘partially’ integrated. Yet under the American parol evidence rule, a court will already have made this determination in the process of deciding whether and to what extent the parol evidence rule should be applied. The rule itself is only used by the court to interpret the language of what it has established to be the only relevant agreement between the parties. However, this defence of the parol evidence rule is only addressed to what the terms actually are, and has nothing to say about what the terms in question may have meant to the contracting parties.

The difficulty that is being highlighted is that, in a ‘subjective’ system, the court is attempting to determine the true intent of the parties. Once one is committed to such a goal, any document has an uncertain meaning until consideration is given to parol evidence, for the court is not attempting to determine ‘what the words mean’, but rather ‘what did the words mean to these two parties’. Nothing precludes the possibility that the parties may have meant ‘cat’ when they said ‘dog’, even if they knew that, to a third party, the agreement would have been misleading as written.⁶¹ That is, in a regime in which the goal of the court is to ascertain the intentions of the contracting parties, every phrase of the written document is unavoidably ambiguous. The court cannot even appeal to the ‘norms of language’, by which ‘cat’ simply means something quite different

57 The parol evidence rule is even applied where there is no jury; therefore, keeping questionable information from the jury cannot be an adequate justification for the rule as it stands: Perillo, above n 27, 966–7. The parol evidence rule also applies in bench trials, suggesting that the real motivating factor behind the rule is distrust of witnesses.

58 See Arthur L Corbin, *Corbin on Contracts* (2nd ed, 1960) 465.

59 Arthur L Corbin, ‘The Parol Evidence Rule’ (1944) 53 *Yale Law Journal* 603, 607–8. Importantly, Corbin himself was famously opposed to any use of the parol evidence rule. He argued that any application of the rule ran the risk of excluding evidence that would show that the intentions of the parties was in fact other than it seemed on the face of the document; hence, this would frustrate rather than help achieve the intentions of the contracting parties: *ibid*.

60 This does not mean that such evidence is irrelevant in determining whether the document in question was intended to be the sole agreement between the parties, or if it was an agreement at all: see generally Farnsworth, above n 44, § 7.4.

61 For example, they may have wished to keep the contents of their agreement secret, perhaps for commercial reasons.

than ‘dog’, as the court cannot justifiably presume that the parties in question were indeed attempting to conform to the norms of language without some consideration of parol evidence.⁶²

This points to a fundamental incompatibility between the subjective approach to contracting adopted by the American legal system and the existence of a parol evidence rule.⁶³ This, of course, raises the question of whether American jurisdictions should simply abandon the rule altogether. However, as will be argued below, this would be a mistake. There are good reasons underlying the continuing reassertion of the parol evidence rule, even in a system based upon a theory with which it is completely incompatible. However, first it is necessary to address the other side of this issue, and to discuss how ‘objective contracting’ jurisdictions have handled the parol evidence rule, using Australia as a specific example.

IV THE AUSTRALIAN PAROL EVIDENCE RULE: THE ‘OBJECTIVE’ APPROACH

This section addresses the nature of the parol evidence rule as it is applied in Australia. As already noted, Australia has maintained an objective theory of contracting,⁶⁴ although it has also experienced ongoing controversy about the existence of the parol evidence rule. This section aims to illustrate the fact that while Australia’s objective theory of contracting has allowed it to create an approach to the parol evidence rule that fits perfectly with its legal system, even

62 For a brilliant argument for the need for evidence of context even to understand ‘the cat is on the mat’ see John R Searle, ‘Literal Meaning’ (1978) 13 *Erkenntnis* 207. Of course, the court could require that the burden of proof should rest with the party who wishes to assert the ‘alternate’ reading; however, in order to use this attempt at proof it would be necessary to consider parol evidence.

63 This is not to say that there might not be arguments for a parol evidence rule within the American system. For example, Eric Posner has made a strong argument in support of the rule based on efficiency: see Posner, above n 1. However, Posner’s argument is based upon an acceptance that we cannot, as a practical matter, always ascertain the intentions of the contracting parties. Therefore, his argument calls for at least a partial renunciation of the ‘subjective’ approach to contracting. The claim being made in this section of the article is precisely that no argument can be made for the rule without such a renunciation.

64 It should be reasserted here that this ‘objective’ approach involves a complete rejection of the attempt to ascertain the subjective intentions of the contracting parties. It is not merely a claim that an ‘objective’ approach to contract interpretation is actually the best way to ascertain the subjective intentions of the contracting parties. This is made clear in the following statement by Lord Wilberforce in *Reardon Smith Line Ltd v Hansen-Tangen* [1976] All ER 570, 574 (‘*Reardon Smith*’), which was approved by the High Court of Australia in *Codelfa* (1982) 149 CLR 337, 351:

It is often said that, in order to be admissible in aid of construction, these extrinsic facts must be within the knowledge of both parties to the contract, but this requirement should not be stated in too narrow a sense. When one speaks of the intention of the parties to the contract, one is speaking objectively – the parties cannot themselves give direct evidence of what their intention was – and what must be ascertained is what is to be taken as the intention which reasonable people would have had if placed in the situation of the parties. Similarly when one is speaking of aim, or object, or commercial purpose, one is speaking objectively of what reasonable persons would have in mind in the situation of the parties.

supporters of the rule are drawn to the question of whether it should always be applied.

A discussion of the nature of the Australian parol evidence rule benefits from the fact that the rule has been extensively discussed by the High Court of Australia in a 1982 case, *Codelfa Constructions v State Rail Authority of New South Wales* ('*Codelfa*').⁶⁵ In *Codelfa*, the State Rail Authority of New South Wales had contracted with Codelfa Construction to excavate two tunnels in Sydney for a planned expansion of the rail network. Dates were set by which Codelfa had to finish certain parts of the work, as was a final completion date.⁶⁶ Codelfa began the project operating three shifts a day, but when injunctions were granted due to the noise created, it agreed to minimise noise between 10pm and 6am.⁶⁷ Codelfa then sought extra payment from the State Rail Authority to cover the additional costs that had been incurred as a result of this changed work schedule.⁶⁸

Although the actual legal issue in this section of the decision is the implication of a term into a contract, rather than the admission of parol evidence, Mason J undertook a lengthy examination of the Australian parol evidence rule.⁶⁹ This judgment has come to be regarded as a definitive discussion of the nature of the parol evidence rule in contemporary Australian law.⁷⁰

The basic statement of the Australian parol evidence rule might not seem out of place in an American court:

The broad purpose of the parol evidence rule is to exclude extrinsic evidence (except as to surrounding circumstances), including direct statements of intention (except in cases of latent ambiguity) and antecedent negotiations, to subtract from, add to, vary or contradict the language of a written instrument.⁷¹

However, within this formulation is a suggestion of the fundamentally different approach required by the objective theory of contracting, namely the

65 *Codelfa* (1982) 149 CLR 337, 347–353. Although Australia, like the United States, has a federal system, this authoritative High Court decision simplifies the discussion of the parol evidence rule in a way that is not currently available in the United States – due to the lack of a similar decision by the United States Supreme Court.

66 *Ibid* 338.

67 *Ibid* 338–339.

68 *Ibid* 339.

69 The rationale was that the implication of a term and the parol evidence rule both concerned an 'orthodox construction of a contract' and this case, in particular, concerned whether 'it is legitimate to take into account the common beliefs of the parties as developed and manifested during their antecedent negotiations': *ibid* 347. Consequently, the analysis of the parol evidence rule is not properly regarded as dicta, since it is an essential part of the Court's judgment regarding the implication of a contractual term.

70 See, eg, *Roman Catholic Trusts Corporation v Van Driel Ltd* [2001] VSC 310 (Unreported, Hansen J, 28 August 2001). This decision, by the Supreme Court of Victoria, relied upon Justice Mason's opinion in *Codelfa* for the proper statement of the parol evidence rule.

71 *Codelfa* (1982) 149 CLR 337, 347. For a description of the English parol evidence rule see *Schuler* [1974] AC 235, 261 (Lord Wilberforce):

The general rule is that extrinsic evidence is not admissible for the construction of a written contract; the parties' intentions must be ascertained, on legal principles of construction, from the words they have used. It is one and the same principle which excludes evidence of statements, or actions, during negotiations, at the time of the contract, or subsequent to the contract, any of which to the lay mind might at first sight seem to be proper to receive.

fact that the Australian parol evidence rule includes an explicit exception for evidence of ‘surrounding circumstances’.⁷²

In his decision, Mason J clearly endorsed the ‘plain meaning’ approach to contracts,⁷³ according to which further evidence should be excluded if the meaning of the contract is already clear to the court.⁷⁴ However, noting decisions by the House of Lords,⁷⁵ Mason J accepted that even a ‘plain meaning’ approach requires the admission of some evidence of the circumstances surrounding the making of the contract, as necessary to interpret the words of the contract.⁷⁶ This, of course, is an argument that has been repeatedly raised in American jurisprudence as a reason to reject the parol evidence rule, since it acknowledges that the same written document can have more than one meaning, and hence it is impossible for any court to claim to have reached the single, ‘objectively true’ meaning of any of its terms.⁷⁷ However, Australia’s objective theory of contracting makes such a complete rejection of the parol evidence rule unnecessary, as the court is not trying to determine what the contracting parties meant by the words they wrote, but merely what a ‘reasonable person’ would have meant in the situation in which the parties were writing the document.⁷⁸

In the first half of the 20th century, the Australian and English courts had insisted that the court could interpret a contract without even considering the

72 Such evidence would only be rejected by an American court that strictly applies the parol evidence rule. As noted, not all American courts do. See the text to which n 8 refers.

73 *Codelfa* (1982) 149 CLR 337, 347–348, where Mason J stated:

Although the traditional expositions of the rule did not in terms deny resort to extrinsic evidence for the purpose of interpreting the written instrument, it has often been regarded as prohibiting the use of extrinsic evidence for this purpose. No doubt this was due to the theory which came to prevail in English legal thinking in the first half of this century that the words of a contract are ordinarily to be given their plain and ordinary meaning. Recourse to extrinsic evidence is then superfluous. At best it confirms what has been definitely established by other means; at worst it tends ineffectively to modify what has been so established.

74 See generally Harry G Prince, ‘Contract Interpretation in California: Plain Meaning, Parol Evidence and Use of the ‘Just Result’ Principle’ (1998) 31 *Loyola Los Angeles Law Review* 557, 575–96.

75 Australian courts regularly refer to the views of English courts, and sometimes to the New Zealand and Canadian courts, as co-developers of the common law: see Stuart Clark and Ross McInnes, ‘2002: Australia’s Year Zero of Tort Reform: But Federal Government’s Response is Crucial’ (2003) 70 *Defense Counsel Journal* 341, 342, ‘Australia’s laws and legal system have their foundation in the common law of England. However, while the judgments of the House of Lords and English Court of Appeal are of persuasive authority, they are not binding on Australian courts’.

76 See *Codelfa* (1982) 149 CLR 337, 348 where Mason J stated:

On the other hand, it has frequently been acknowledged that there is more to the construction of the words of written instruments than merely assigning to them their plain and ordinary meaning ... This has led to a recognition that evidence of surrounding circumstances is admissible in aid of the construction of a contract.

77 See *Pacific Gas & Electric Co v GW Thomas Drayage & Rigging Co*, 69 Cal 2d 33 (Cal, 1968) (Traynor J). Cf *Trident Center v Connecticut General Life Insurance Company*, 847 F 2d 564 (9th Cir, 1988). See also Susan J Martin-Davidson, ‘Yes, Judge Kozinski, There Is a Parol Evidence Rule in California: The Lessons of a Pyrrhic Victory’ (1995) 25 *Southwestern University Law Review* 1.

78 *Codelfa* (1982) 149 CLR 337, 351 (Mason J); See above n 64.

circumstances surrounding the transaction.⁷⁹ However, in 1971 the House of Lords held that while evidence of the intentions of the parties in entering into a contract was irrelevant to the construction of the contract, and should be excluded, evidence of the general factual background known to the parties at the time of the contract, as well as the objective ‘aim’ of the contract, was relevant, and should be admitted.⁸⁰ That is, although the court will reject any attempt to prove what the agreement actually meant to the contracting parties, the court will nonetheless ask what reasonable parties in the situation of the contracting parties, attempting to achieve the same end as the contracting parties, would have meant when they wrote the words in question. Justice Mason clarified this, insisting that evidence of surrounding facts should be admissible only if those facts were themselves known to the contracting parties.⁸¹

Notably, the evidence that is admissible to show this factual ‘background’⁸² to the agreement can include evidence of prior negotiations, which is precisely the evidence the parol evidence rule is designed to exclude. However, such evidence is only admissible to reveal what facts were and were not known to the parties, and cannot be admitted to demonstrate anything about the intentions or expectations of the parties.⁸³ This is so as, under the objective theory of

79 See, eg, *Great Western Railway and Midland Railway v Bristol Corp* (1918) 87 LJ Ch 414, 418–9 (Lord Atkinson); 424–5 (Lord Shaw); compare 429 ff (Shaw J). Justice Shaw argued that extrinsic evidence should always be admissible to raise an ambiguity.

80 See *Prenn v Simmonds* [1971] 3 All ER 237, 239–241, where Lord Wilberforce said ‘[t]he time has long passed when agreements, even those under seal, were isolated from the matrix of facts in which they were set and interpreted purely on internal linguistic considerations. There is no need to appeal here to any modern, anti-literal, tendencies’: at 239.

81 ‘Generally speaking facts existing when the contract was made will not be receivable as part of the surrounding circumstances as an aid to construction, unless they were known to both parties, although, as we have seen, if the facts are notorious knowledge of them will be presumed’: *Codelfa* (1982) 149 CLR 337, 352. Although this might seem, at first glance, inconsistent with an objective approach to contracting, it still does not commit the court to attempting to discern the intentions of the contracting parties. Instead, it is merely a recognition that contracting parties will rarely know everything that is happening. Hence, in attempting to determine what reasonable parties would have done in a given situation, the situation in question consists solely of those things actually known to the parties. *Contra Reardon Smith* [1976] 3 All ER 570, 575, where Lord Wilberforce said:

what the court must do must be to place itself in thought in the same factual matrix as that in which the parties were ... in the search for the relevant background, there may be facts which form part of the circumstances in which the parties contract, in which one or both may take no particular interest, their minds being addressed to or concentrated on other facts so that if asked they would assert that they did not have these facts in the forefront of their mind, but that will not prevent those facts from forming part of an objective setting in which the contract is to be construed.

82 See generally Searle, above n 62. See also Tony Cole, ‘Scalia and the Institutional Approach to Law’ (2003) 34 *University of Toledo Law Review* 559.

83 See *Codelfa* (1982) 149 CLR 337, 352. Justice Mason stated:

It is here that a difficulty arises with respect to the evidence of prior negotiations. Obviously the prior negotiations will tend to establish objective background facts which were known to both parties and the subject matter of the contract. To the extent to which they have this tendency they are admissible. But in so far as they consist of statements and actions of the parties which are reflective of their actual intentions and expectations they are not receivable.

contracting, the actual intentions of the contracting parties are irrelevant, and all that truly matters is their 'objective' contracting behaviour.⁸⁴

By adopting this approach, Australian courts allow themselves enough background information to the transaction so they can construct 'reasonable' contracting parties and interpret the written agreement as such parties would have understood it,⁸⁵ without the consideration of irrelevant parol evidence.⁸⁶

Nonetheless, even after endorsing an approach that manages to avoid the strongest philosophical objections to the use of a parol evidence rule,⁸⁷ Mason J proceeds to make a comment that appears in stark contrast to Australia's objective approach to contracting:

There may perhaps be one situation in which evidence of the actual intention of the parties should be allowed to prevail over their presumed intention. If it transpires that the parties have refused to include in the contract a provision which would give effect to the presumed intention of persons in their position it may be proper to receive evidence of that refusal. After all, the court is interpreting the contract which the parties have made and in that exercise the court takes into account what reasonable men in that situation would have intended to convey by the words chosen. But is it right to carry that exercise to the point of placing on the words of the contract a meaning which the parties have united in rejecting? It is possible that evidence of mutual intention, if amounting to concurrence, is receivable so as to negative an inference sought to be drawn from surrounding circumstances.⁸⁸

Justice Mason seems to at least partially adopt the 'subjective' theory of contracting, as he suggests it is inappropriate to accept a reading of a contract that can be shown to have been explicitly rejected by the contracting parties,

84 Particularly essential for understanding the Australian approach to the parol evidence rule is the rationale offered by Mason J for this exclusion. He does not suggest that evidence of the negotiations should ordinarily be excluded because it may be misleading, or that the true intentions of the parties are too difficult to discern, and so would be a waste of the court's time. Rather, he argues:

when the issue is which of two or more possible meanings is to be given to a contractual provision we look, not to the actual intentions, aspirations or expectations of the parties before or at the time of the contract, except in so far as they are expressed in the contract, but to the objective framework of facts within which the contract came into existence, and to the parties' presumed intention in this setting. We do not take into account the actual intentions of the parties and for the very good reason that an investigation of those matters would not only be time consuming but it would also be unrewarding as it would tend to give too much weight to these factors at the expense of the actual language of the written contract: *ibid.*

Note the concluding sentence in this quotation, in which Mason J acknowledges that an investigation into the actual intentions of the parties would be both 'time consuming' and 'unrewarding'; however, these are not the reasons he offers for rejecting that inquiry. Rather, what he describes as a 'very good reason' for not undertaking such an inquiry is that 'it would tend to give too much weight to these factors at the expense of the actual language of the written contract.' This is an explicit rejection of the 'subjective' approach to contracts. Justice Mason criticises such an approach because it gives 'too much weight' to the question of what the parties actually intended to do with their agreement, rather than simply trying to determine what they actually did.

85 For this idea of the 'construction' of parties in the process of interpreting a writing, see Cole, above n 82 (applying the idea in the context of statutory interpretation).

86 The qualifier 'irrelevant' recognises the fact that, as already noted, some parol evidence is relevant, where it reveals the background to the transaction: see above n 81.

87 Namely, those relating to interpretation of a contract within a subjective contracting regime: see above n 1.

88 *Codelfa* (1982) 149 CLR 337, 353.

even if it was what ‘reasonable parties’ would have done in the circumstances.⁸⁹ However, in a jurisdiction that truly embraces an objective theory of contracting, there would seem to be nothing wrong with adopting such an interpretation, as the court is not concerned with the actual bargain reached by the parties.⁹⁰

It is possible to understand Justice Mason’s comment in a way which is consistent with the objective theory of contracting if the fact that both parties concurred in rejecting the interpretation in question can be taken as evidence that a reasonable person in their situation attempting to attain the same end would also not have adopted that interpretation. However, this is simply not the rationale that Mason J offers,⁹¹ and does not adequately explain the basis upon which he is working. Rather, it is clear that even in the midst of endorsing the parol evidence rule and an objective approach to contracting, he cannot deny the appeal of the notion that the contract really is, in some way, that of the parties, and that it would be improper for a court to completely ignore their intentions in interpreting it.⁹²

This represents the flipside to the difficulty existing in the American system, in which the parol evidence rule has continued to be reasserted despite its complete inconsistency with the subjective theory of contracting endorsed by the same courts. As has been argued throughout this article, advocates of both subjective and objective approaches to contracting are unable to completely reject the appeal of the other alternative, and recognise at least its partial validity.

The next section of this article is devoted to discussing the inability of both objective and subjective jurisdictions to find a satisfactory approach to the parol evidence rule, and argues that the proper approach is to adopt a ‘tailored’ rule, in which some kinds of contracts would have the parol evidence rule applied to them, while others would not.

89 Unfortunately, Justice Mason’s comment is somewhat ambiguous as to whether it refers solely to the parties’ attempted rejection of the objective approach to contracts, or to a particular interpretation of a particular clause. However, the same inconsistency with the ‘objective’ approach would exist in either case, so it is unnecessary to resolve the ambiguity here.

90 See above n 64.

91 His explanation is simply that it may not be ‘right’: *Codelfa* (1982) 149 CLR 337, 353.

92 There are, of course, also Australian courts that have attempted to reject more completely the parol evidence rule: see, eg, *State Rail Authority of New South Wales v Heath Outdoor Pty Ltd* (1986) 7 NSWLR 170, 191–192. Further evidence for the existence of this problem comes from the recent weakening of the English rule: see, eg, *Bank of Credit and Commerce* [2001] 1 AC 251, 269, where Lord Hoffmann said:

There is no conceptual limit to what can be regarded as background. It is not, for example, confined to the factual background but can include the state of the law (as in cases in which one takes into account that the parties are unlikely to have intended to agree to something unlawful or legally ineffective) or proved common assumptions which were in fact quite mistaken. But the primary source for understanding what the parties meant is their language interpreted in accordance with conventional usage: ‘... we do not easily accept that people have made linguistic mistakes, particularly in formal documents’.

See also Jason Chuah, ‘The Factual Matrix in the Construction of Commercial Contracts: The House of Lords Clarifies’ (2001) 12 *International Co and Co Law Review* 294. Chuah suggests that the current state of the law in England allows companies adequate predictability in the interpretation of their contracts, but also allows judges the flexibility to allow in parol evidence if doing so would avoid an injustice.

V A SOLUTION TO THE PAROL EVIDENCE RULE PROBLEM

This article advances the claim that the reason neither the subjective nor objective theories of contracting is able to be completely consistent in its treatment of parol evidence is that, in fact, both theories draw upon strong intuitions that we all have about the proper nature of contract law.⁹³

The objective approach recognises the idea that, in entering into a contract, two people do something fundamentally different than when they simply agree to work together to achieve some goal. They have formalised their relationship and taken it out of the strictly 'social' realm. On this view, a written contract is not simply a long-lasting and reliable record of an agreement that was previously reached between the parties in question, but rather is a distinct kind of social act. In formalising a contract the parties have performed a specific kind of social action that is by its nature public, and draws upon those social practices that deal with relationships between non-intimates.⁹⁴ These are practices designed to ensure predictability and fairness in such relationships, and are directed towards the resolution of disputes without any particular concern for the ongoing viability of the relationship.⁹⁵ Consequently, on this view a written contract is properly interpreted from an 'objective' perspective, in which the personal relations of the contracting parties are simply irrelevant, and the goal of the interpreter is not to determine the intent of the contracting parties, but to interpret their contracting behaviour, as a public act.⁹⁶

By comparison, the subjective theory of contracting emphasises that the actors in the formation of any contract are people, and the reality of any social interaction is that there is a background of understandings against which any agreement is made. Sometimes these understandings are broadly shared social conventions, and so are easily accessible to an interpretative body such as a court, but sometimes they are personal, and an inquiry is necessary to determine their nature. Moreover, once a subjective theory is adopted, no claim can be made that all of these 'background' aspects of an agreement have been recorded

93 For a philosophical treatment of this notion of conflicting intuitions, see John McDowell, *Mind and World* (1994).

94 For an insightful, if controversial, account of the nature of social practices, see John R Searle, *The Construction of Social Reality* (1995). For a treatment more directly related to the legal world see Neil MacCormick and Ota Weinberger, *An Institutional Theory of Law: New Approaches to Legal Positivism* (1986).

95 That is, on this view a written contract is a way of binding someone to an agreement, in a way that would seem inappropriate within a more intimate relationship. For example, close brothers could be expected to lend one another money without a written agreement, based simply on the relationship they have, and the expectation that the relationship itself will be enough to assure repayment.

96 This notion of signing the contract as a form of behaviour is also recognised by Posner, above n 1, 540:

When parties strike a deal, they usually make some effort to formulate it in a way that publicizes the bargain. Some formality, such as a handshake or a writing, makes clear to the parties involved that obligations have been exchanged. Part of the function of the formality is to signal to possible future adjudicators that the parties intend to be legally bound.

in even the most comprehensive agreement. After all, the details of the backgrounds to our relationships are so complex that it would take an enormously large contract to reflect all of them and, in many cases, we may not even have been aware that we were considering them until they subsequently gave rise to a dispute. Consequently, this 'subjective' approach dictates that a court should consider all available parol evidence as the only way to determine the true agreement reached by the contracting parties.

The claim of this article is that both of these conceptions of contracting have an undeniable appeal, and that this explains the inability of both objective and subjective jurisdictions to reach a satisfactory position on the parol evidence rule. In either case, fidelity to the theory of contracting that guides the system concerned will lead to many cases in which that theory is clearly inappropriate. Consequently, there will always be pressure to introduce modifications to the system that are inconsistent with the underlying theory, as has been evident in both the American and Australian legal systems discussed above.

To illustrate this point it is helpful to consider concrete instances of contracting. For example, when two strangers decide to enter into a business relationship, particularly where there is a significant amount at stake, it is to be expected that a great degree of emphasis will be placed upon the precise wording of the written contract. The two parties may share only the most simple of understandings, and have no particular reason to believe that the other person will ultimately turn out to be trustworthy.⁹⁷ Such a case seems to be a perfect example of a 'legal' rather than 'personal' situation, as the written agreement did not arise from any kind of relationship, but is purely an objective means to an end. In such a case the objective approach to interpreting contracts seems perfectly legitimate, and a parol evidence rule is appropriate. Mutual understandings may have evolved between the parties during the course of negotiations that are, nonetheless, not reflected in the written contract, but the contracting behaviour of the parties is 'at arms length', and the agreement is not properly conceived as being between Bob the seller and Sally the buyer. Rather, both have put on a 'cloak of legality' to establish a legal relationship, abstracted from their personal relations.⁹⁸ As such, any personal understandings that either may have developed are irrelevant.⁹⁹

By comparison, the parol evidence rule seems least applicable to agreements between close acquaintances. It is very likely that there will be many shared understandings and presumptions between the parties, which may form a background without which it would be impossible to understand the agreement reached. However, the decisive factor is not the difficulty the parties would have

97 The concern is not simply that the other person will not perform, but rather that they may later attempt to redescribe the agreement as being something other than it actually was.

98 Recognition of the prevalence of this distinction between personal relations and legal relations can be seen in Posner's article, above n 1, 551: '[i]nterestingly, contracts never, as far as I know, contain clauses that direct courts to rely on extrinsic evidence. The lack of such 'anti-merger' clauses might be a clue that most parties would reject soft-PER'.

99 The parties involved may also have a personal relationship, but this particular act was public, and hence is properly interpreted objectively.

faced in attempting to reflect all of these elements in a written agreement. Rather, it is the personal nature of the contracting relationship itself. Of course, for the parol evidence rule to even be an issue, the parties must clearly have written the agreement down, so it is at least in that sense a ‘public’ rather than a private document. However, the distinctive nature of the relationship at the heart of the agreement dictates a different role for the court in interpreting the agreement. Perhaps the simplest way of describing the divergence is that, in the case at hand, the parties are not both bound by the contract, as might be the case in a business agreement, but rather are binding themselves collectively within the actual (non-written) agreement, which itself is merely represented by the writing. To support this intuition we might consider our differing reactions to a party insisting upon a literal interpretation of a written agreement in such a ‘personal’ situation,¹⁰⁰ compared to a business situation. The latter may seem obnoxious, but it does not feel offensive in the way that the former does. In the ‘personal’ situation, then, the parol evidence rule is completely improper, as the writing simply does not constitute the agreement between the parties, but rather is merely a representation of it. To truly know the nature of the agreement itself would require consideration of any parol evidence that might be helpful.¹⁰¹

Even if the contention of this article is correct, however, and there is indeed an unavoidable ‘oscillation’ between embrace and rejection of the parol evidence rule in both objective and subjective contracting systems, there are two approaches that may be taken towards a solution to this problem. One is to propose a third procedure, which satisfies the desires of both the others.¹⁰² However, it is not clear what form this approach might take. Moreover, such proposals generally end up being truly satisfactory only to a limited intellectual community, and unsatisfying to most people. When dealing with a large-scale practical institution such as the law, that is obviously not an acceptable option. Even if the proposed ‘third way’ were a theoretically perfect solution, it would be unable to prevent the oscillation unless most people could recognise it as satisfactory.

Consequently, the best approach is to adopt a system in which both objective and subjective approaches to contracting can co-exist within properly circumscribed, and properly identified, areas of control. This approach implies that there would be some kinds of contract to which the court would apply an ‘objective’ approach to contracting and a hard parol evidence rule. In other contracts, the court would attempt to discern the ‘agreement’ that the parties had reached, and so consider all parol evidence.

100 For example, a contract between close family members.

101 The parties may, nonetheless, explicitly put on a ‘cloak of legality’ by pronouncing that they see this as a contract, enforceable at court. However, a court should only obey this request after consideration of parol evidence reveals that this was indeed the intention of the parties.

102 The classic representative of this approach to the ‘conflicting intuitions’ problem is GWF Hegel. For a clear although simplified account of Hegel’s views, see Peter Singer, *Hegel* (1983). For the best complete presentation of Hegel, see Charles Taylor, *Hegel* (1975). Notably, this ‘third way’ approach is also that adopted by McDowell as a solution to the oscillation with which he is dealing: see McDowell, above n 93.

Of course, any system that proposes such a division of rules will come across cases that can be seen equally well from both perspectives. However, as long as there is no reason to believe that most cases will fall into this unsatisfactory middle ground, it seems acceptable for that middle ground to exist, for no system that operates in the real world will do so without some degree of uncomfortableness, and this has to be accepted as long as the fit in question is not so bad as to show the approach itself to be unworkable.

A more significant problem might seem to be the question of whether judges are adequately trained to discern between ‘personal’ and ‘legal’ agreements. After all, their training is in law, not social psychology. However, this does not really seem a difficulty, as ultimately the evaluation required is non-technical, and requires no particular expertise. In fact, the main qualification for anyone to undertake such evaluations is that they have significant experience with contracts and the relationships around them, and any experienced judge would seem to fulfill this requirement ideally.

Nonetheless, this is not to say that judges need be left completely to their own devices in making such evaluations, as there do seem to be certain ‘rules of thumb’ which could aid the categorisation of the parties’ relationship.¹⁰³ For example, large-scale business agreements should be approached under an objective theory of contracting, even if the two principals have known each other and dealt with each other for a substantial period of time. Although the personal element is never completely absent from any transaction, there is no real level at which such a transaction can be said to be personal. It is constitutive of the commercial element of society, not the social.¹⁰⁴ Of course, the court could require that the burden of proof should rest with the party who wishes to assert the ‘alternate’ reading; however, to evaluate such an attempt at proof it would be necessary to consider parol evidence.¹⁰⁵

Similarly, collective bargaining agreements should be treated objectively.¹⁰⁶ Although the parties concerned have indeed known each other for a considerable amount of time, and fully expect to deal again in the future, the nature of the contracting behaviour clearly is ‘at arms length’. The written agreement is not a mere memorandum of what was discussed in their bargaining sessions. Rather, it is written explicitly (at least primarily) for the purpose of enabling one party to

103 See also Posner, above n 1, 550. Working from the perspective that the parol evidence rule is designed to assist a court in accurately determining the true nature of the subjective agreement between the parties, Posner argues for a ‘tailored’ rule, in which specific kinds of cases would have parol evidence excluded, while others would not:

Such a rule would divide contract cases into different classes, and courts would apply soft-PER to cases in some of the classes and hard-PER to cases in other classes. The classes could be based on the kind of transaction, such as sales of goods, real estate transactions, and bills and notes; or on the kind of parties, such as sophisticated parties, consumers, and lawyer-assisted parties.

104 Note the importance of the term ‘constitutive’, rather than representative: see John R Searle, *Rationality in Action* (2001) 51–52.

105 There is no reason why this should be unacceptable under an ‘objective’ approach to contracting, as the fact that the parties insisted on such a clause would serve as strong persuasive evidence that it is something that reasonable parties in their situation would have insisted upon.

106 *Contra* Posner, above n 1, 558.

enforce its provisions in a court, or to take it to an arbitrator for the resolution of disputes. The relationship in question may be long term, but it is in no sense personal.¹⁰⁷

By contrast, at the other end of the spectrum, an agreement between close family members is unavoidably predominantly personal, even if it is structured as a formal business arrangement. Parol evidence should be considered by the court regardless of the extent to which the parties agree to finalise their agreement in writing.¹⁰⁸ It is important, however, to understand what it is about the contractual relationship that makes it ‘personal’, and that makes application of the parol evidence rule improper. It is not simply that the parties in question know each other well – rather, the determinative element is the way in which the contract was concluded, that is, whether the parties were attempting to forge an agreement within the context of a personal relationship, or if they were simply binding themselves to a future path of behaviour. Only in the former case is the agreement ‘personal’. It is important to emphasise this point because even though, as just stated, a contract between close family members¹⁰⁹ cannot help but be ‘personal’, the same may also be true of a contract between individuals who were previously complete strangers. The relevant consideration is the nature of the contracting behaviour, not the familiarity of the parties.¹¹⁰

Of course, these are merely examples of such evaluations, and more would be needed for such a system to function in an efficient and predictable way. It is not necessary to undertake a list of explicit examples to make the key point.

VI CONCLUSION

As has been demonstrated throughout this article, the parol evidence rule has been such a contentious issue throughout its long existence because it is the centre of a conflict between two inconsistent understandings of the nature of contract, both of which hold an undeniable appeal. The argument of this article is

107 However, as a practical matter it should be noted that this would be an instance in which the new approach would need to be phased in over time in those jurisdictions in which the reality of contemporary contractual interpretation in collective bargaining agreements is that parol evidence is often considered: see Carlton J Snow, ‘Contract Interpretation: The Plain Meaning Rule in Labor Arbitration’ (1987) 55 *Fordham Law Review* 681. Snow notes that even though parol evidence offered to show agreement beyond the contract, or to interpret the terms of the contract, it will usually not be allowed to contradict a clear term of the agreement. Although this ‘phasing in’ might seem inconsistent with a strict application of the theory argued for here, it is precisely the approach that would be prescribed by the ‘objective’ approach to contracting, as a ‘reasonable person’ who knew that parol evidence was regularly considered in labour disputes would clearly take this into account when negotiating the language of the contract.

108 This would be true even if the parties include a merger clause, designed to preclude consideration of parol evidence. Of course, the existence of a merger clause would still be persuasive evidence that prior understandings were indeed superceded by the written agreement. The important point, however, is that it is only persuasive evidence, and does not preclude an attempt to show that it was not intended to apply to the issue in question, or that it was not itself agreed upon.

109 Emphasising ‘close’, since the mere existence of a familial connection by itself says nothing about the relationship in question.

110 Thanks to Philip Soper for emphasising the need to make this point.

that the ideal solution to this constant oscillation between the extremes of 'subjective' and 'objective' contracting is to adopt a system in which both are given their proper place, and the fit between theory and reality made as close as manageable. Without recognition of the validity of both approaches, the oscillation will continue. Although much work still remains to be done in refining the practical details of the approach proposed, it does seem to present a genuinely workable solution to the problem of the parol evidence rule.