Special Topics in Small Claims

Contracts

Module 4: What Are the Terms?

Objectives — By the end of this session, you will be able to:

- Correctly determine whether you are barred from considering particular evidence because of the parol evidence rule
- Identify and apply special rules for determining terms in contracts for the sale of goods
- Reach the correct result in cases involving allegations of breach of warranty in contracts for the sale of goods

Resource Materials — The following resource materials will be used for this section:

- A Basic Introduction to Contract Law (Module 1)
- *Small Claims Law,* pp. 59-67, 73-74
- The Parol Evidence Rule in Contracts for the Sale of Goods
- The Parol Evidence Rule in Other Contracts
- What the UCC Says About Terms in Contracts for the Sale of Goods
- Warranties in Contracts for the Sale of Goods

The Parol Evidence Rule in Contracts for the Sale of Goods

The statute:

§ 25-2-202. Final written expression; parol or extrinsic evidence.

Terms with respect to which the confirmatory memoranda of the parties agree or which are otherwise set forth in a writing intended by the parties as a final expression of their agreement with respect to such terms as are included therein may not be contradicted by evidence of any prior agreement or of a contemporaneous oral agreement but may be explained or supplemented

(a) by course of dealing or usage of trade (G.S. 25-1-205) or by course of performance (G.S. 25-2-208); and

(b) 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.

What the small claims judge must determine:

1. Did the parties intend the writing to be the final expression of their agreement as to this term?
2. When did the oral statements at issue occur relative to the writing?
3. Do the oral statements <u>contradict</u> the writing?

Practice pointers:

~ If the written contract contains a “merger clause” stating that the written agreement is the complete and final agreement of the parties, that clause will generally be given effect, absent some clear indication to the contrary.

~ Remember that the parol evidence rule has no application to the admissibility of oral statements made subsequent to the writing.

~ Even when a written contract is final and complete, evidence of course of dealing, course of performance, and usage of trade may be considered by the court in determining the terms of the contract.

~When a contract omits a term altogether, the court will consider evidence of oral statements relevant to that term in preference to implying a “reasonable” term. Example: A written contract for the purchase of a piano does not address time of delivery. The UCC “gap-filler” provision would normally be applied so as to imply that delivery be accomplished within a “reasonable” period of time. If the evidence demonstrates that the parties orally agreed to delivery the same day as sale, however, that term will be enforced by the court.

The Parol Evidence Rule in Other Contracts

"Any or all parts of a transaction prior to or contemporaneous with a writing intended to record them finally are superceded and made legally ineffective by the writing."

Rowe v. Rowe, 305 N.C. 177 (1972).

The purpose of this traditional rule is to "prevent the overthrow of written contracts by fabricated extrinsic negotiations." Chadbourne & McCormick, *The Parol Evidence Rule in North Carolina*, 9 N.C.L.Rev. 151 (1931).

The parol evidence rule set out in the Uniform Commercial Code for contracts for the sale of goods is considerably more liberal than the traditional North Carolina rule applicable to other contracts. That rule prohibits admission of oral or written terms serving to vary, add to, or contradict the final written contract. The language used by the cases sometimes refers to all prior communications as having been "subsumed" into the ultimate written document. That document is thereafter treated as the exclusive source for determining the parties' rights and obligations.

When a small claims magistrate is considering a contract case involving a written agreement and one party seeks to introduce evidence of oral or written terms agreed to by the parties prior to or contemporaneous with the written contract, the magistrate must make an initial determination: Does the written contract set out the parties' agreement as to those terms? If so, the parol evidence rule must be considered.

This determination is sometimes more difficult than it first appears. Clearly, if a contract requires the monthly payment of rent in the amount of $700, evidence of an oral agreement for $500 is barred by the parol evidence rule. The parties have agreed to an amount and have specified that agreement in the lease, Imagine, however, that the challenged evidence is that the parties orally agreed to a lease for one year, and that the written lease is silent as to the term of the lease. Some courts would allow this evidence, reasoning that the written lease does not, in fact, reflect the parties' final agreement as to term. Other courts might reason that a lease providing for monthly payment of rent which specifies no specific term accurately reflects the parties' intention to avoid a fixed term. Under this view, evidence of an oral agreement for a one-year lease is barred as an impermissible attempt to "add to" the final written contract. As a general rule, this determination will be greatly influenced by two factors: First, does the written document specifically address the particular topic at issue? If so, a court is much more likely to bar testimony based on a finding that the written contract is the final word on the matter. Second, courts sometimes consider whether the term is one likely to have

been considered by the parties. In the example above, lease duration is a significant aspect of a rental agreement, and omission of a specific term may reasonably be interpreted as reflective of the parties' actual intention. Failure to address a trivial or unlikely event in the written contract, however, does not so readily lend itself to this interpretation.

Perhaps the most useful understanding of the law related to the parol evidence rule is reflected in knowing when it need NOT be considered. The rule has no application to the following circumstances:

- Evidence offered to show that no contract exists, or that the contract should not be enforced. Evidence indicating lack of consent, for example, would not fall within the scope of the parol evidence rule. Statements indicating that a signature was obtained by fraud or duress, or testimony relevant to unconscionability are examples.

- Evidence tending to show that no contract was formed because of failure of a condition precedent. For example, statements by an agent that his authority to enter into a contract on behalf of the principal is conditioned on prior written approval by the principal might or might not be a defense to contract formation, but are certainly not barred by the parol evidence rule.

- The parol evidence rule does not bar evidence contradicting recitals of facts contained in the written contract. A contract provision stating that a used car has 75,000 miles on the odometer does not bar evidence that the actual mileage is closer to 200,000.

- The parol evidence rule has no application to evidence related to subsequent agreements between the parties.

What the UCC Says About Terms in Contracts for the Sale of Goods

Article 2 of the Uniform Commercial Code was enacted by North Carolina's General Assembly in 1965. This detailed set of statutes regulates contracts for the sale of goods by establishing rules "to more effectively respond to the realistic needs of modern commerce." Hutson & Miskimon, North Carolina Contract Law §6-3 (2015). Many other states have adopted their own versions of Art. 2, and law schools throughout the country offer courses about its provisions. (The same is true of Art. 9, which governs secured transactions.) UCC law differs from traditional contract law in a number of significant ways, requiring small claims magistrates to begin any contracts case by making an immediate determination: does this case involve a contract for the sale of goods?

What if it does?

Determining that a contract case is governed by GS 25, Art. 2, has a number of important consequences. For example, the statute of limitations for these contracts is 4 years, rather than the 3-year period applicable to most other contracts. There are other distinctions, but the most sweeping changes implemented by Art. 2 relate to the terms of covered contracts.

Art. 2 provisions establishing implied warranties are among the most important for magistrates to know about, but there are other significant rules about how courts are to deal with determining terms in contracts for the sale of goods. In particular, the UCC differs from common law in its preference for determining and enforcing contracts in a manner consistent with the intentions of the parties—even when those contracts are vague, incomplete, informal, or inconsistently expressed. The parol evidence rule is applied in a more relaxed manner, and courts are called upon to take into account surrounding circumstances and other evidence of intent in addition to the formal written agreement of the parties. **In particular, three additional sources of contract interpretation are specifically authorized:**

1. Course of dealing: When a buyer and seller have been involved in previous transactions, the court may look to those transactions "as establishing a common basis of understanding for interpreting their expressions and conduct." GS 25-1-303(b).

2. Usage of trade: A court may consider common trade practices proven to "justify an expectation that it will be observed with respect to the transaction in question." Whether and to what degree the court relies on trade usage is

determined by the court based upon the evidence presented. GS 25-1-303(c).

3. Course of performance: A court may consider conduct by the parties in carrying out their agreement if that conduct by one party is known and accepted by the other party. GS 25-1-303(a)

These three things are identified by the law as **potentially relevant to**:

- The meaning of their agreement;
- The particular meaning of specific terms of their agreement;
- A supplement or qualification o the terms of their agreement.

The law requires that, as much as is reasonable, the express terms of the agreement and the evidence of terms arising from these three considerations should be construed together as being consistent with each other. When there is conflict, the following rules apply:

- Express terms prevail over the other three;
- Course of performance prevails over course of dealing and trade usage;
- Course of dealing prevails over trade usage;
- Course of performance is relevant to determining whether a term has been modified or waived.

Warranties in Contracts for the Sale of Goods

In contracts for the sale of goods, one or more of three types of warranties may be involved. The first is an EXPRESS WARRANTY under G.S. 25-2-313.

Requirements for express warranty:

- Seller makes promise, or statement of fact, about goods sold, and this representation is one of reasons buyer decides to buy goods.

- Instead of making verbal statement, seller may make express warranty by showing buyer a sample or model.

- Not necessary that seller use words like “guarantee” or “warranty” in order for express warranty to arise, but statement must amount to more than mere “sales talk” (i.e., statement of opinion, rather than fact, about goods).

- Determination of terms of express warranty, if any, is really determination of terms of contract itself: what kind and quality of good did seller agree to sell?

- Buyer has burden of showing that seller made express warranty, that goods did not comply with warranty, and that buyer was injured as result. Evidence that goods were sold “as is” is strong evidence that seller made no express warranty.

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A second type of warranty often involved in a contract for the sale of goods is the IMPLIED WARRANTY OF MERCHANTABILITY.

This term simply means that a seller promises that goods will be fit for the purpose for which they are ordinarily used. If a consumer buys an oven, for example, the oven must work well enough to permit the consumer to use it to bake.

This warranty is implied; no statement or behavior by the seller is necessary for it to attach. It is implied only in sales by MERCHANTS regularly selling the particular type
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of goods involved, however. A person who is not a merchant who sells his used car does not make an implied warranty of merchantability.

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The third type of warranty sometimes involved in a contract for the sale of goods is the <u>IMPLIED WARRANTY OF FITNESS FOR A PARTICULAR PURPOSE.</u>

This warranty arises if, at the time of sale, the seller had reason to know that goods were required for particular purpose, and that buyer was relying on seller's skill or judgment to select the appropriate item.

This warranty is also <u>implied,</u> but it differs from the warranty of merchantability in that it attaches even when the seller is not a merchant.

<u>EXCLUSION OF WARRANTY:</u>

Exclusion of an express warranty doesn't come up often, since the only thing a seller has to do to keep from being bound by an express warranty is to avoid making it in the first place. Often written contracts will contain a broad exclusion clause that specifies **<u>no</u>** warranty, express or implied, attaches to a particular sale. If consumer credit sale under Retail Installment Sales Act, seller may not exclude express warranty made a part of the basis of the bargain.

A merchant may exclude the implied warranty of merchantability if:

- he makes specific reference to the warranty by name in his statement of exclusion.
- If the exclusion is in writing, it must also be "conspicuous." The reason for this rule is to prohibit "fine print" exclusions of this basic warranty.

A seller may exclude the implied warranty of fitness for a particular purpose only in writing which is conspicuous. It is not necessary for the exclusion to refer to the warranty by name, however; it may simply refer to "implied warranties."
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Both the implied warranty of merchantability and the implied warranty of fitness for a particular purpose are waived by the buyer if:

He purchases goods sold “as is,” “with all faults,” or otherwise clearly identified as goods not subject to any guarantee or warranty.

He either inspects the goods, or refuses to inspect when seller demands that he do so. In this case, however, the buyer waives the implied warranties only as to defects that are discoverable upon inspection.

A prior course of dealing between the parties suggests that exclusion or waiver of warranty is assumed by both to be part of the contract.

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REMEDIES IN ACTION FOR BREACH OF WARRANTY:

Damages in these actions are usually based on difference between fair market value of goods as warranted and fair market value of goods received. G.S. 25-2-714.

Buyer has burden of proof on value of goods warranted and received.

Owner’s testimony about what property is worth is some evidence of value.

Contract price is often good evidence of value of goods as warranted.

In addition to regular damages, described in Section 1 above, the buyer may also be entitled to incidental and consequential damages. These damages compensate the buyer for injury or loss caused indirectly by a breach of contract. The damages must be reasonably foreseeable by the seller, however; the buyer cannot recover for remote damages connected only tenuously to the original breach.

A buyer may return defective goods and demand his money back if he does so within a reasonable time. In order to be entitled to any damages for breach of warranty, the buyer must show that he notified the seller of the breach within a reasonable time after he discovered it. G.S. 25-2-607(3). A buyer may not return defective goods under this law if he doesn’t identify the specific defect, and his failure to do so deprives the seller of an opportunity to fix the defect. The policy behind these requirements is to give sellers an opportunity to correct their mistakes before bringing them into court.
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Warranty Case Studies

Case Study # 1

Ms. Brown went to Fast Eddie's Used Cars to buy a car for her 18 year-old son, James.

Ms. Brown went to Fast Eddie, the owner of the store, and said:

> "I want a car that has a very good safety record. And it must never have been in a wreck. Also, my son will be driving the car to college in the mountains of North Carolina, so it's important that it doesn't have trouble going up and down the mountain roads. And I want it to have enough pick up so he can get around pretty good up there. I don't know much about cars, so what would you recommend?"

Fast Eddie said he would recommend a Yugo and showed Ms. Brown a red one.

Fast Eddie told Ms. Brown:

"This is a great car--your son will love it! It has an excellent record for safety, and even better—it's never been in a wreck."

Ms. Brown bought the car for James. The first week James drove it to school, the car wouldn't go up the mountain at more than 35 miles per hour and after driving about 30 minutes it started making a grating noise. He took it to a mechanic who indicated that no one would ever drive a Yugo in the mountains because it did not have a powerful enough engine to handle the steep inclines and would never do better than it was performing now. In addition, the mechanic discovered that the car had been in a wreck before Ms. Brown bought it (that's what caused the noise) and would require major repairs to fix the problems. The cost of repairs was $1500. Ms. Brown also checked the annual car issue for Consumer Reports and found that the Yugo had the lowest safety rating in a 1999 US government test.

Ms. Brown is disgusted. She calls Fast Eddie, who says:

"Tough. You bought the car, and it's yours now."

Ms. Brown returns the car to the Fast Eddie and says:

"Here it is; you deal with it."

Ms. Brown sues to recover the $3800 she has already paid on the car, plus the $250 it cost her to have the car towed from the mountains to her home.

Who wins, why, and if you rule for Ms. Brown, how much does she get?

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Variation A: What if Ms. Brown is going to pay cash for the car and signs a contract that states that the car is being sold "as is"?

Variation B: After making all of those promises, Fast Eddie handed Ms. Brown a contract calling for the payment of $3000 down and $250 per month paid to Fast Eddie's Used Cars. The contract provided in large, bold letters that the car is being **SOLD WITHOUT ANY EXPRESS OR IMPLIED WARRANTIES.**

Variation C: Would it make a difference if after negotiating for the sale of the car, Fast Eddie said to Ms. Brown, "why don't you drive the car around the block to see how it does?" and Ms. Brown replied, "No, I won't be driving the car."

Case Study # 2

Bob's neighbor Jill is having a yard sale. Bob has wanted to take up tennis and sees that Jill is selling a tennis racket. Bob asks Jill about the racket and she tells him it was her former husband's and hasn't been used in several years but her husband always said it was a winning racket. Bob buys the racket for $50. He goes to his first tennis lesson; he does very poorly–clearly the racket is not a winning racket. After playing about an hour, he takes a swing at a ball and the ball goes right through the racket, creating a nice hole in the middle of it. It cost Bob $50 to have the racket restrung. Bob sues Jill for $50.

Was there a warranty term, express or implied, in this contract for sale?

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Variation: Would your answer differ if Bob bought the racket from Play It Again Sports?

Case Study # 3

Beth read an advertisement in the newspaper about the Hammond Electric Barbecue Grill. It stated that the grill was “safe,” “would heat up to 350° in 5 minutes,” and was easy to use. Beth went to her local hardware store and bought a Hammond Grill for $350. She used it for about a year and then it wouldn’t heat. She took it back to the store. They said they wouldn’t take it back. Beth sues the hardware store for breach of warranties, asking for $350 -- the difference between the fair market value as warranted and the value as it is ($0 since it doesn’t work). The manager of Hammond said he never told her the goods were warranted.

Was there a warranty term, express or implied, in this contract for sale?

If so, was there evidence of breach?

Case Study #1: Answers and Explanations

Ms. Brown is alleging, of course, that Fast Eddie breached a term of the contract pertaining to warranty—the car, she is saying, is not of the type and quality that she had a contractual right to. Accordingly, the first question must be whether this contract contained a warranty term. In determining the answer to that question, you should have considered the following factors:

Express warranty?

"This is a great car." "Your son will love it." Most judges would quickly conclude this is "puffing"–mere sales talk.

"It has an excellent record for safety"– closer question, but probably opinion and not affirmation of fact–might be warranty if said it was ranked number 1 for safety on the 1999 Federal Safety Study conducted by the US Dep't of Transportation.

"It has never been in a wreck."–This statement is affirmation of fact or promise. Relates to the goods; basis of the bargain. Warranty is breached.

Implied warranty of merchantability?

Yes, sale of goods by merchant, who warrants that the car may be used for ordinary purpose for which intended. No breach of that warranty, though.

Implied warranty of fitness for particular purpose?

Yes. Fast Eddie knew particular purpose (go up mountains and maneuver easily) and knew Ms. Brown was relying on his skill and judgment to pick the proper car; Ms. Brown did rely on Fast Eddie's skill. Breach.

The next question you must determine is what remedy Ms. Brown is entitled to. She may be requesting one of several things:

First, can she return the car and demand her money back?

Yes, provided that she acts within a reasonable time. Fast Eddie's breach allows her to choose to cancel the contract and be returned to the position she was in before the sale. In that case, Ms. Brown is entitled to her money back plus the cost of the towing that was necessary as a result of Fast Eddie's breach.

Can she decide to keep the car for her own use?

Yes, in which case her damages will be the difference between the FMV of the car as it is, and the FMV of a car that complies with the warranties.

Can she return the car, buy a car that fits the bill, and recover the difference in price from Fast Eddie?

Yes—Ms. Brown may recover the difference between contract price and cost of a substitute purchase made without unreasonable delay plus incidental damages (towing).

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Variation A: What if Ms. Brown is going to pay cash for the car and signs a contract that states that the car is being sold "as is"?

"As is" waives all implied warranties. Look at other language in the contract to see if it waives express warranties. Can't introduce parol evidence (before or contemporaneous with signing contract) to vary, add to, or contradict the express terms of the written contract so can't introduce evidence of oral express warranty.

But note an interesting case, Torrance v. AS&L Motors, Ltd., 119 N.C. App. 552 (1995), in which purchaser claimed unfair trade practice as well as breach of warranty. The Court of Appeals said the plaintiff couldn't introduce oral earlier express warranty for purposes of overriding "as is" disclaimer, but could introduce it as part of claim of unfair trade practice. Trade practice "is unfair when it offends established public policy as well as when the practice is immoral, unethical, oppressive, unscrupulous, or substantially injurious to consumers. A practice is deceptive if it has the capacity or tendency to deceive; proof of actual deception is not required.... A purchaser does not have to prove fraud, bad faith or intentional deception. ...Plaintiff must only show that defendant's statements had the capacity or tendency to deceive and that plaintiff suffered injury as a proximate result of defendant's statements."

[Unfair and deceptive trade practice, sometimes abbreviated as UTP or UDTP, is a tort, but is quite frequently asserted in contract cases.]

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Variation B: After making all of those promises, Fast Eddie handed Ms. Brown a contract calling for the payment of $3000 down and $250 per month paid to Fast

Eddie's Used Cars. The contract provided in large, bold letters that the car is being **SOLD WITHOUT ANY EXPRESS OR IMPLIED WARRANTIES.**

In a consumer credit sale, the law does not allow the sales contract to limit, exclude or modify terms of express warranty. Here, where Fast Eddie expressly stated that the car "had never been in a wreck," there was a breach of the express warranty, and Ms. Brown is entitled to difference in fair market value if as warranted (not in a wreck) and "as is" (previously wrecked).

Effective disclaimer of warranty of fitness for a particular purpose, though–written and conspicuous.

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Variation C: Would it make a difference if after negotiating for the sale of the car, Fast Eddie said to Ms. Brown, why don't you drive the car around the block to see how it does? Ms. Brown said, "No, I won't be driving the car."

This question points out that a buyer may not rely on implied warranties if the seller offers an opportunity to examine goods and buyer refuses to do so. This is true, however, only for defects that the buyer would have discovered upon inspection. Here, driving around block would not have revealed that car had been in a wreck or how it would drive in the mountains.
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