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# The Public Meaning Rule: Reconciling Meaning, Intent, and Contract Interpretation

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**THE PUBLIC MEANING RULE:  
RECONCILING MEANING, INTENT, AND  
CONTRACT INTERPRETATION**

**Aaron D. Goldstein\***

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#### INTRODUCTION

When and what kinds of extrinsic evidence should courts admit in order to interpret the meaning of a contract? Courts must answer this question before they can begin the process of interpretation, and the answer has profound implications for whether courts achieve the goals of predictability and fairness that motivate the law of contracts.<sup>1</sup>

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1. See Eric A. Posner, *The Parol Evidence Rule, the Plain Meaning Rule, and the Principles of Contract Interpretation*, 146 U. PA. L. REV. 533, 542–46 (1998) (discussing the costs and benefits of strict and lenient rules regarding the admission of extrinsic evidence); Alan Schwartz & Robert E. Scott, *Contract*

In answer to this question, courts generally follow one of two rules.<sup>2</sup> Under the plain meaning rule, evidence outside the four corners of a contract is not admissible to interpret a contract that appears unambiguous on its face.<sup>3</sup> Under the context rule, however, courts must consider extrinsic evidence to interpret the language of a contract, even where the contract appears facially unambiguous.<sup>4</sup>

Each of these rules is problematic, albeit in very different ways. The plain meaning rule allows more sophisticated parties to hide behind carefully worded contracts of adhesion without fear that the circumstances surrounding the contract might intrude.<sup>5</sup> The plain meaning rule also ties the interpretation of contract terms to a judge's subjective notions of what words mean in language and prevents parties from submitting evidence of alternate meanings that may be publically used and acknowledged, but not set forth in a standard dictionary.<sup>6</sup> Furthermore, the plain meaning rule (or at least unsophisticated versions of it) relies upon the notion that words and phrases can, standing alone, have a single unequivocal meaning—a notion that has been thoroughly debunked by modern scholars who study language.<sup>7</sup>

While the context rule responds to the issues associated with interpreting language in a vacuum, it relies upon unreliable evidence in order to give meaning to contract language.<sup>8</sup> Parties lie and misremember, especially

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*Theory and the Limits of Contract Law*, 113 YALE L.J. 541, 618 (2003) [hereinafter Schwartz & Scott, *Contract Theory*]; Eyal Zamir, *The Inverted Hierarchy of Contract Interpretation and Supplementation*, 97 COLUM. L. REV. 1710, 1722–23 (1997). See also E. ALLAN FARNSWORTH, CONTRACTS §§ 7.7–7.14 (1982).

2. This statement is a bit of an oversimplification. As explained below, there are variants of the context rule that differ in the order of preference with which courts treat various forms of extrinsic evidence. There are also variants of the plain meaning rule that differ in the strictness with which courts limit themselves to the text of the contract alone. But generally speaking, courts either look first to the language of the contract itself to determine whether it bears only a single interpretation, or instead look to extrinsic evidence to determine whether the contract is ambiguous in the first place.

3. See *infra* Part II.

4. See *infra* Part III.

5. See *infra* Part II.A.2.

6. See *infra* Part II.A.3.

7. See *infra* Part II.A.

8. See *infra* Part III.A.2.

regarding extrinsic evidence such as prior negotiations, course of performance, and course of dealing. Also, extrinsic evidence of parties' prior acts is often compatible with numerous contradictory accounts of what the parties intended, and thus fails to shed light on the parties' actual bargain. In many cases, it is questionable whether a court can determine contracting parties' intent at all (as opposed to a contract's textual meaning), even when extrinsic evidence is not restricted. Most problematically, by looking to evidence of the parties' subjective intent, rather than the shared and public meaning of terms, the context rule undermines the usefulness of contracts as tools to predictably constrain another party's behavior. And it is this ability to predictably constrain another party's behavior that, in large part, makes coordinated human activity possible.

Taking into account the criticisms levied against both the *plain meaning rule* and the *context rule*, this Article proposes a third rule for interpreting negotiated commercial contracts, the *public meaning rule*, which looks to extrinsic evidence of the public and conventional meaning of words and phrases in language, as opposed to evidence of what words meant in the head of the speaker.<sup>9</sup> Under the public meaning rule, the court applies the public conventional meaning of the words and phrases in the contract in order to interpret the contract, and then from that interpretation, resolves the parties' dispute. This rule would admit evidence of a word or phrase's public and conventional meaning within language, including evidence outside of dictionary meaning such as trade usage, to interpret even what appears to be a facially unambiguous contract. This rule would exclude, however, evidence that does not relate to what words mean publically in language, such as evidence of the parties' course of performance or course of dealing, when interpreting an otherwise facially unambiguous contract.

The epistemological basis for this rule is the fact that people must employ public and shared conventions regarding what words mean in order to communicate. The public and conventional meaning of words can shed light on the intentions of the speaker, but the intention of the speaker cannot be what gives words their meaning. This is so

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9. See *infra* Part IV.

because, in order for people to communicate, both the speaker and the hearer must reflexively apply the same public and shared conventions for using words.<sup>10</sup>

In this Article, I argue that courts should abandon extrinsic evidence typically associated with the subjective intent of the parties, such as evidence of the parties' course of performance or course of dealing, as a basis for interpreting negotiated commercial contracts, unless the contract is intractably ambiguous.<sup>11</sup> Courts have increasingly seen this notion of the intent of the parties as a basis for interpreting contracts as problematic. As early as the nineteenth century, legal scholars and jurists began moving away from the concept of a subjective meeting of the minds towards the so-called objective theory of contract where a party's intent is discerned from the objective manifestations of that intent, such as the party's acts. However, as explained below, even so-called objective manifestations cannot tell us what the parties to a contract subjectively intended. A given set of objective manifestations is often compatible with numerous contradictory accounts of what a party actually intended.<sup>12</sup>

Paradoxically, the courts' search for the intent of the parties ends up leading courts away from the function that parties intend their contracts to perform, that is, to mutually constrain each other's behavior in a way that is certain and predictable. When courts look to evidence of subjective intent, they untie contract adjudication from the public conventions of meaning that allows parties to set their agreements in writing in a way that can be predictably enforced. And even though parties do not always have a shared intent as to those details of a contract which they ultimately decide to litigate, the very act of entering into a contract implies a shared intent that the words of the contract set the limits within which the process of contract interpretation must be carried out.

Rather than looking to evidence that is commonly associated with the parties' subjective intent to give meaning to contract language, courts should limit the application of such evidence to equitable claims and defenses—i.e., where

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10. *See infra* Part IV.

11. *See infra* Part IV.

12. *See infra* Part IV.A.

courts are concerned about fairness, not about what a contract actually means. Where courts allow extrinsic evidence in service of such equitable principles, it reflects not an attempt to determine the meaning of language in a contract, but quite the opposite, a willingness to sacrifice some certainty of meaning and predictability of effect in the name of fairness. When courts apply equitable claims and defenses, they in effect throw out the rules that the parties agreed to because those rules, in their substance or in their application, are just too unfair. This trade off should be made explicitly through equity and not under the guise of interpretation.

One might argue that allowing unlimited extrinsic evidence in cases of equitable claims and defenses, as a practical matter, opens the floodgates to the same kinds of extrinsic evidence as the context rule, rendering the proposal in this Article a distinction without a difference. But as argued below, different and usually tougher standards apply to equitable claims and defenses, and a jurisprudence that looks to evidence of the parties' course of performance and course of dealing only when applying equitable claims and defenses will be different as a practical matter and not just in theory.

While the rule proposed in this Article makes sense in the context of negotiated commercial contracts, it could lead to abuses outside of this context. This proposed rule could have very negative consequences if applied to consumer contracts, especially contracts of adhesion, where evidence of public and conventional meaning is less relevant and where the terms are set by commercial entities that enjoy a position of superior power and sophistication.

In the context of negotiated commercial contracts, however, restricting parties to evidence of usage will protect contracting parties from the uncertainties of extrinsic evidence associated with subjective intent and the legal gamesmanship it engenders. And it will still allow parties to supplement judges' preconceptions regarding what words mean with evidence that is harder to fabricate or game for purposes of litigation.

Part I of this Article describes the current state of the law regarding the admission of extrinsic evidence.<sup>13</sup> Part II describes the plain meaning rule, the primary motivations behind it, and various criticisms that can be made against it.<sup>14</sup> Part III describes the context rule, which has more recently been adopted in several jurisdictions, and argues that it is problematic in its own way, especially when applied to negotiated commercial contracts.<sup>15</sup> Specifically, the contextualist endeavor of discerning the parties' intent through extrinsic evidence is problematic (e.g., through evidence of course of dealing, course of performance, or testimony from the parties themselves regarding what they meant).

Drawing upon the criticisms levied against both the plain meaning rule and the context rule, Part IV proposes a new rule for interpreting negotiated commercial contracts that abandons the subjective intent of the parties as the touchstone for contract interpretation. Part IV proposes that, for negotiated commercial contracts, courts should determine the meaning of contract terms by looking to the public, shared, and conventional meaning of those terms (and as explained below, limited biographical information regarding the parties, if necessary, to decide between multiple public meanings).<sup>16</sup> If a court cannot resolve the meaning of the contract through evidence of what the contract's words and phrases mean in language and limited biographical evidence, then the contract is ambiguous and courts should resort to extrinsic evidence of the facts and circumstances surrounding the parties' contract, not to interpret the contract, but to apply equitable principles.

Part IV goes on to argue that the rule proposed in this Article better reflects and supports the reason why parties enter into contracts, that is, to predictably constrain another party's future behavior.<sup>17</sup> Part IV also argues that equitable claims and defenses, which were created for the very purpose of achieving fairness, are a better mechanism for implementing our notions of fairness than shoehorning such

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13. See *infra* Part I.

14. See *infra* Part II.

15. See *infra* Part III.

16. See *infra* Part IV.

17. See *infra* Part IV.

consideration into the rules for contract interpretation. Finally, Part IV addresses how issues of ambiguity would be resolved under the public meaning rule proposed in this Article.<sup>18</sup>

#### I. THE CURRENT STATE OF THE LAW REGARDING EXTRINSIC EVIDENCE

Contract interpretation is a multistage process in which, at each juncture, the court must decide what evidence it will consider.<sup>19</sup> There is universal agreement that, at the outset, courts must consider the language of the contract. The various jurisdictions then diverge as to what additional evidence courts should consider to determine whether the contract is ambiguous. Where courts look to various categories of extrinsic evidence in this first stage, these same courts take different positions regarding the order of precedence of each type of extrinsic evidence. Under the Uniform Commercial Code, for example, courts look to the text of the contract, along with evidence of the parties' course of performance, course of dealing, and trade practice and usage at this initial stage, resorting to each of these categories of extrinsic evidence in order with the former trumping the latter.<sup>20</sup>

The rules regarding when and what kind of extrinsic evidence is admissible at the initial phase of contract interpretation vary greatly from jurisdiction to jurisdiction.<sup>21</sup>

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18. See *infra* Part IV.D.

19. See Zamir, *supra* note 1, at 1710.

20. *Id.* at 1712–13. As explained in Part IV below, this Article is not concerned with the order of preference courts apply to various types of extrinsic evidence, *per se*. Rather, this Article argues that certain types of extrinsic evidence should not be considered at all at the initial stage where the court determines whether a contract is ambiguous. See *infra* Part IV.

21. There is a good amount of confusion regarding what exactly the parol evidence rule is and the parol evidence rule is often conflated with the plain meaning rule. Likewise, the term “parol evidence” is often conflated with the term “extrinsic evidence.” The parol evidence rule prohibits parties from admitting extrinsic evidence of prior or contemporaneous oral agreements to interpret an integrated contract, while the plain meaning rule prohibits a party from admitting extrinsic evidence to interpret a facially unambiguous term. See Margaret N. Kniffin, *Conflating And Confusing Contract Interpretation and the Parol Evidence Rule: Is the Emperor Wearing Someone Else's Clothes?*, 62 RUTGERS L. REV. 75, 81 (2009) (quoting *Sunoco, Inc. v. Makol*, 372 F.3d 31, 36 n.1 (1st Cir. 2004)). Many of the sources referenced in this Article incorrectly use the terms “parol evidence” and “extrinsic evidence” synonymously. Where

Certain jurisdictions continue to cleave to a strict plain meaning rule, refusing to admit extrinsic evidence to interpret a facially unambiguous contract.<sup>22</sup> In *Savik v. Entech, Inc.*, the Supreme Court of Montana held that “there can be no evidence of the terms of the agreement other than the contents of the writing except when a mistake or imperfection in the writing is claimed or when the validity of the agreement is the fact in dispute.”<sup>23</sup> Likewise, in *Tallmadge Bros., Inc. v. Iroquois Gas Transmission System, L.P.*, the Supreme Court of Connecticut declared:

We decline to abandon the basic principal of contract law that we construe contract language by reference to the words chosen by the parties. *Especially in the context of commercial contracts*, we assume that definite contract language is the best indication of the result anticipated by the parties in their contractual arrangements.<sup>24</sup>

Other jurisdictions, however, have abandoned the plain meaning rule, holding that extrinsic evidence is admissible to interpret a contract regardless of any facial ambiguity.<sup>25</sup> The Supreme Court of Alaska applied such a rule in *Municipality of Anchorage v. Gentile*:

In determining the intent of the parties the court looks to the written contract as well as extrinsic evidence regarding the parties’ intent at the time the contract was made. The parties’ expectations are assessed by examining the language used in the contract, case law interpreting similar language, and relevant extrinsic evidence, including the subsequent conduct of the parties.<sup>26</sup>

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this Article quotes such sources, the term “parol evidence rule” is being used to mean a rule for when extrinsic evidence is admissible to interpret the language of a contract.

22. See Peter Linzer, *The Comfort of Certainty: Plain Meaning and the Parol Evidence Rule*, 71 *FORDHAM L. REV.* 799, 805 n.28 (2002).

23. *Savik v. Entech, Inc.*, 923 P.2d 1091, 1094 (Mont. 1996).

24. *Tallmadge Bros., Inc. v. Iroquois Gas Transmission Sys., L.P.*, 746 A.2d 1277, 1289 (Conn. 2000) (emphasis added). As discussed throughout this Article, stricter rules for the admission of extrinsic evidence are more appropriately applied to negotiated commercial contracts as opposed to consumer contracts of adhesion.

25. See, e.g., *Municipality of Anchorage v. Gentile*, 922 P.2d 248, 256 (Alaska 1996).

26. *Id.* (citations omitted).

These jurisdictions often apply the caveat that such extrinsic evidence cannot be used to vary or contradict the contract.<sup>27</sup> For example, the court in *Admiral Builders Savings & Loan Ass'n v. South River Landing, Inc.*, held that extrinsic evidence is admissible to determine whether a contract is ambiguous in the first instance, but that such extrinsic evidence cannot be used to vary, alter, or contradict the plain meaning of the writing.<sup>28</sup>

[I]n the initial determination of ambiguity, *vel non*, extrinsic evidence need not be excluded from the trial court's consideration (so long as that evidence does not vary, alter, or contradict the plain meaning of the writing) because, until the evidence is heard, ambiguity or the lack thereof cannot be fully appreciated.<sup>29</sup>

Still other courts apply various hybrids of the two. For example in *Mellon Bank, N.A. v. Aetna Business Credit, Inc.*,<sup>30</sup> the Third Circuit held that courts ought to consider extrinsic evidence of the facts and circumstances surrounding a contract before determining whether the contract is ambiguous,<sup>31</sup> but further held that there are limits on the range of meanings that words can bear. As the court explained:

[O]ur approach does not authorize a trial judge to demote the written word to a reduced status in contract interpretation. Although extrinsic evidence may be considered under proper circumstances, the parties remain bound by the appropriate objective definition of the words they use to express their intent. Generally parties will be held to definitions given to words in specialized commercial and trade areas in which they deal. Similarly, certain words attain binding definition as legal terms of art.<sup>32</sup>

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27. As discussed below, this idea that extrinsic evidence gives contract language its meaning but cannot be used to contradict the contract is problematic. See *infra* Part III.A.3.

28. *Admiral Builders Sav. & Loan Ass'n v. S. River Landing, Inc.*, 502 A.2d 1096, 1099 (Md. Ct. Spec. App. 1986).

29. *Id.*

30. *Mellon Bank, N.A. v. Aetna Bus. Credit, Inc.*, 619 F.2d 1001 (3d Cir. 1980).

31. *Id.* at 1010–11.

32. *Id.* at 1013.

In *Mellon Bank*, the court analyzed whether the term “insolvent” should be interpreted according to its standard commercial definition, i.e., a business is insolvent where “[it is] unable to pay [its] debts as they come due,” or “[its] liabilities exceed its assets.”<sup>33</sup> The trial court looked to extrinsic evidence showing that Aetna had not considered Mellon Bank’s assets and liabilities when the parties entered into their contract.<sup>34</sup> Accordingly, (so the argument went) the parties had not intended the term “insolvent” to mean “liabilities exceeding assets.”<sup>35</sup> The Third Circuit reversed, holding that the term “insolvent” was too well established to be contradicted by extrinsic evidence.<sup>36</sup>

Even within a particular jurisdiction, the rules regarding extrinsic evidence are not always uniformly applied. As Professor Linzer observed in his scholarship regarding plain meaning and extrinsic evidence, “[o]ften lower courts stick to older, more rigid rules and ignore, or at least do not follow, liberalizing cases from their state’s supreme court.”<sup>37</sup>

## II. THE PLAIN MEANING RULE

Courts that strictly apply the plain meaning rule generally follow the following procedure for interpreting a contract: First, the court looks to the text of the contract alone and determines whether the contract is ambiguous on its face.<sup>38</sup> If the contract is ambiguous on its face, the court will admit extrinsic evidence in order to determine the contract’s meaning.<sup>39</sup> Courts applying the plain meaning rule, however,

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33. *Id.* at 1008.

34. *Id.* at 1008–09.

35. *Id.* at 1009.

36. *Id.* at 1013–14.

37. Linzer, *supra* note 22, at 806 (citing *Student Loan Guarantee Found. of Ark. v. Barnes, Quinn, Flake & Anderson, Inc.*, 806 S.W.2d 628 (Ark. Ct. App. 1991)). See Harry G. Prince, *Contract Interpretation In California: Plain Meaning, Parol Evidence and Use of the “Just Result” Principle*, 31 LOY. L.A. L. REV. 557, 577–78 (1998).

38. *W.W.W. Assocs., Inc. v. Giancontieri*, 566 N.E.2d 639, 642 (N.Y. 1990) (“[E]xtrinsic and parol evidence is not admissible to create an ambiguity in a written agreement which is complete and clear and unambiguous upon its face.” (quoting *Intercontinental Planning, Ltd. v. Daystrom, Inc.*, 248 N.E.2d 576, 580 (N.Y. 1969))).

39. *Connors v. Tanoma Mining Co.*, 953 F.2d 682, 685 (D.C. Cir. 1992) (“A contract’s meaning is to be determined by its language, without resort to extrinsic considerations, unless the language is ambiguous.” (quoting *Eatmon v. Bristol Steel & Iron Works, Inc.*, 769 F.2d 1503, 1518 (11th Cir. 1985))).

will allow in extrinsic evidence, regardless of any facial ambiguity, to establish equitable claims (such as unjust enrichment)<sup>40</sup> or equitable defenses to the contract (such as fraud).<sup>41</sup>

Early courts adopted the plain meaning rule as a bulwark against faulty memory and dishonesty.<sup>42</sup> As the court in *The Countess of Rutland's Case* declared, "it would be inconvenient, that matters in writing made by advice and on consideration, and which finally import the certain truth of the agreement of the parties should be controlled by averment of the parties to be proved by the uncertain testimony of slippery memory."<sup>43</sup>

The plain meaning rule arguably grew out of pre-nineteenth century common law conventions that privileged sealed instruments over all other forms of evidence of a legal obligation.<sup>44</sup> Under this pre-nineteenth century rule, a writing under seal could not be controverted or varied by written or oral evidence because sealed documents were presumed to be the best evidence of a party's intent to be bound.<sup>45</sup> Other commentators have suggested that the plain meaning rule arose not as a natural evolution of prior common law notions of what was necessary to "seal a deal," but instead out of a concerted effort by jurists such as Langdell, Williston, and Holmes, to remake the common law

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40. See, e.g., *Midwest Indus. Funding, Div. of Rivera Lend Lease, Inc. v. First Nat'l Bank of Lockport*, 973 F.2d 534, 539 (7th Cir. 1992) ("The parties should be allowed to admit extrinsic evidence relevant to the Bank's unjust enrichment defense.")

41. See *Happy Dack Trading Co. v. Agro-Industries, Inc.*, 602 F. Supp. 986, 992 (S.D.N.Y. 1984) ("[P]arol evidence is admissible to show that a contract is not a contract but a sham . . ."). See also *Callanan v. Powers*, 92 N.E. 747, 753 (N.Y. 1910) ("It is claimed that these conversations were incompetent, because they were merged in the written contract, according to the familiar rule. The plaintiff, however, had alleged fraud as a ground of rescission, and he had a right to prove the existence of fraud if he could. On that issue the contemporary and preceding conversations, both those involving representations and those tending to show that the directors relied upon them were competent, and, although the plaintiff did not succeed on the issue of fraud, still the receipt of that evidence was not error.")

42. See, e.g., *The Countess of Rutland's Case*, 77 Eng. Rep. 89, 90 (K.B. 1604), 5 Co. Rep. 25b.

43. *Id.*

44. See Joseph M. Perillo, *The Origins of the Objective Theory of Contract Formation and Interpretation*, 69 *FORDHAM L. REV.* 427, 434 (2000) (citing WM. L. CLARK, JR., *HANDBOOK OF THE LAW OF CONTRACTS* § 262 (1894)).

45. *Id.*

for purposes of a grand theory of contract, which would accommodate free-market capitalism during the industrial revolution.<sup>46</sup>

Regardless of its origins, the plain meaning rule came to be embraced by formalists as a curative to the vagaries of the subjective intent of the parties. Rather than attempt to divine the parties' actual subjective intent through the parties' testimony and other extrinsic evidence, courts would limit themselves to the plain meaning of the contract language itself.<sup>47</sup> As commentators from as early as 1810 explained, "[t]o admit a party to a contract to support it by his own testimony in an action brought upon it, would destroy all security for our property . . . ."<sup>48</sup> As jurists from across the Atlantic simultaneously explained, "[i]t would, indeed, be highly mischievous, and tend to the endangering all property . . . if such parol testimony should be admitted . . . . It would tend greatly to introduce perjuries . . . to the great hazard of the titles of all property."<sup>49</sup>

As described more recently by the high court in New York, the plain meaning rule brings "stability to commercial transactions by safeguarding against fraudulent claims, perjury, death of witnesses . . . infirmity of memory . . . [and] the fear that the jury will improperly evaluate the extrinsic evidence."<sup>50</sup> As one author put it, "[t]he conceptual move that launched the rule seems quite natural today: the written agreement is not merely a memorandum that summarizes understandings between people. Rather, the document

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46. *See id.* at 428 ("Grant Gilmore's account holds that Christopher Columbus Langdell invented the generalized notion of contract in 1871, which was brilliantly reformulated by Oliver Wendell Holmes, Jr., and then propagated by a diligent scrivener named Williston. Gilmore credits Holmes with the invention of the objective theory. Like Horwitz and Friedman, Gilmore attributes the creation of late nineteenth century classical contract doctrine to a response to the same stimuli that gave rise to laissez-faire economics." (footnotes omitted)).

47. *See id.* at 443–44.

48. *Id.* (quoting ZEPHANIA SWIFT, A DIGEST OF THE LAW OF EVIDENCE IN CIVIL AND CRIMINAL CASES AND A TREATISE ON BILLS OF EXCHANGE 99 (1810)).

49. *Id.* at 445 (quoting *Holmes v. Simons*, 20 S.C. Eq. (3 Des.) 149, 152 (1810)).

50. *W.W.W. Assocs., Inc. v. Giancontieri*, 566 N.E.2d 639, 642 (N.Y. 1990) (citation omitted). *See also* Robert E. Scott, *The Case for Formalism in Relational Contract*, 94 NW. U. L. REV. 847, 848 (2000) (arguing that a "rigorous application of the common-law plain meaning and parol evidence rules preserve the value of predictable interpretation . . . .")

constitutes the agreement itself.”<sup>51</sup>

Under the plain meaning rule, a court will only look beyond the text of the contract itself when the contract, standing alone, cannot be given a single clear meaning.<sup>52</sup> And thus the traditional plain meaning rule takes for granted that words and properly constructed phrases are capable of having a single unambiguous meaning.

#### A. *Problems with the Plain Meaning Rule*

##### 1. *The Problem with Plain Meaning in Principal*

As many critics of the plain meaning rule have opined, it is very difficult to attribute a singular plain meaning to a word and it is even more difficult to do so to an entire contractual provision.<sup>53</sup> As one critic put it:

A judge who believes that contract terms can have a single, reasonable meaning that is apparent without reference to extrinsic evidence of the parties' intentions “retires into that lawyer’s Paradise where all words have a fixed, precisely ascertained meaning; where [people] may express their purposes, not only with accuracy, but with fulness [sic]; and where, if the writer has been careful, a lawyer . . . may sit in [a] chair, inspect the text, and answer all questions . . . .” Such a belief is unrealistic, for “the fatal necessity of looking outside the text in order to identify persons and things, tends steadily to destroy such illusions and to reveal the essential imperfection of language, whether spoken or written.”<sup>54</sup>

As Arthur Corbin, one of the most famous critics of the plain meaning rule, explained:

It is true that when a judge reads the words of a contract he may jump to the instant and confident opinion that they have but one reasonable meaning and that he knows what it is. A greater familiarity with dictionaries and the

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51. Lawrence M. Solan, *The Written Contract as Safe Harbor for Dishonest Conduct*, 77 CHI.-KENT L. REV. 87, 92 (2001).

52. See Margaret N. Kniffin, *A New Trend In Contract Interpretation: The Search For Reality as Opposed to Virtual Reality*, 74 OR. L. REV. 643, 648 (1995) (“The ambiguity thus required by these courts as prerequisite to admission of extrinsic evidence is often said to exist when the contract language is reasonably susceptible to at least two different meanings.”).

53. See, e.g., *id.* at 644–45 n.3.

54. *Id.* at 648 (alteration in original) (quoting JAMES BRADLEY THAYER, A PRELIMINARY TREATISE ON EVIDENCE AT THE COMMON LAW 428–29 (1898)).

usages of words, a better understanding of the uncertainties of language, and a comparative study of more cases in the field of interpretation, will make one beware of holding such an opinion so recklessly arrived at.<sup>55</sup>

These scholars make the point that a word's meaning is often, if not always, unfixed, and can only be determined in context.

## 2. *The Plain Meaning Rule as a Cover for Exploitive Contracts*

A strict plain meaning rule can enable exploitive business practices at the contract formation stage.<sup>56</sup> A strict plain meaning rule provides companies with a "safe harbor for sharp business practices that results from any version of the rule that permits businesses to promote products and services subject to a subsequent, integrated agreement that the other party did not read or understand when entering into a transaction."<sup>57</sup>

Professor Solan outlines three types of contracts where a strict plain meaning rule allows a sophisticated commercial company to exploit another party's lack of bargaining power and sophistication: consumer credit agreements (e.g., credit card agreements); shrink wrap contracts (i.e., form contracts shipped along with goods); and certain promissory notes.<sup>58</sup>

The plain meaning rule can help sophisticated sellers of commercial credit abuse their superior bargaining position.<sup>59</sup> As many of us have experienced firsthand, purveyors of consumer credit will often send their would-be customers applications for credit that clearly disclose terms which would make the offer enticing, while burying less favorable terms in blocks of "devil in the details" fine print.<sup>60</sup> Now certainly if the print is fine enough or the terms monstrously unfair, courts may not enforce them for equitable reasons such as unconscionability. But if the terms or the manner in which

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55. *Id.* at 644–45 n.3 (quoting 3 ARTHUR L. CORBIN, CORBIN ON CONTRACTS § 535 (1960)).

56. *See* Solan, *supra* note 51, at 90, 106–14.

57. *Id.* at 90.

58. *Id.* at 106–14.

59. *See id.* at 109.

60. *See id.* at 107–08.

they are communicated do not rise to the level of procedural or substantive unconscionability, credit peddlers, under a strict plain meaning rule, can hide behind a contract that is sneaky but not sneaky enough to be torn up by the court. As Professor Solan explains:

Credit card issuers can circulate such applications because they know that ultimately it is the written agreement that will govern, and the written agreement will have no such silly contradictions. The parol evidence rule [in its plain meaning rule form] comes into this picture once the borrower has agreed to abide by the credit agreement by signing the application or by using the credit card.<sup>61</sup>

Professor Solan also points to shrink wrap contracts (also known as box-top contracts), which like the consumer credit transactions discussed above, are both consumer contracts and contracts of adhesion. Shrink wrap contracts are form contracts that are bundled with goods when they are shipped. The terms of such contracts usually state something like “by using this product you agree to be bound by the following terms.”<sup>62</sup> Again, a plain meaning rule in this context makes it easier for companies to bind consumers to one sided terms, which the consumer is less likely to read or understand.

Professor Solan also points to a particular kind of promissory note transaction where one company convinces another to sign a promissory note for outstanding amounts due, payable on demand, but orally promises to not execute for a particular period of time.<sup>63</sup> The idea being that the debtor will readily agree to such a contract rather than face immediate default. It is unclear, however, whether this type of dishonest conduct is one which, in fact, ends up being protected under the plain meaning rule. In many jurisdictions, equitable doctrines outside of the plain meaning rule are likely to aid the signer of such a promissory note, at least in those cases where a strict plain meaning rule would seem to produce unfair results. Under even a strict plain meaning rule, extrinsic evidence is admissible to prove fraud or other defenses which assert that no contract was formed in the first place.<sup>64</sup>

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61. *Id.* at 109.

62. *Id.*

63. *Id.* at 112–13.

64. Even under a centuries-old formulation of the plain meaning rule, a

Notice that the first two types of contracts discussed by Professor Solan are both consumer contracts and contracts of adhesion. As mentioned in the introduction of this Article, a strict plain meaning rule is far more problematic when applied to consumer contracts, especially contracts of adhesion. Indeed, Professor Solan's analysis is a strong argument for having different rules for interpreting and applying consumer contracts of adhesion. As he recognizes, reliance on the language of the contract itself rather than extrinsic evidence tends to amplify power and sophistication disparities between parties:

Reliance on the written word is a two-edged sword. On the one hand, it reduces the likelihood of dispute about what the agreement (or statute) really says. On the other, it empowers the party with the pen. When only one party to the transaction controls the document, the possibility arises that the drafter will take advantage of this leverage unfairly.<sup>65</sup>

In negotiated commercial contracts, disparities in power, sophistication, and access to legal counsel are less severe. The very fact that a contract is negotiated rather than a contract of adhesion evinces a greater parity of power between the parties. By comparison, consumer contracts are often contracts of adhesion, which do not allow the consumer any opportunity to negotiate contractual terms. The problems associated with restricting extrinsic evidence are thus less pronounced in the context of negotiated commercial contracts—the context in which this Article suggests that a more restrictive rule regarding extrinsic evidence ought to be applied.<sup>66</sup>

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party was allowed to escape liability by showing that they entered into the contract by fraud or mistake. JOHN H. WIGMORE, 9 WIGMORE ON EVIDENCE: EVIDENCE IN TRIALS AT COMMON LAW § 2405, at 15 (James H. Chadbourn ed., 4th ed. 1981) [hereinafter WIGMORE ON EVIDENCE] (“That a man who could not read had sealed a document which had been incorrectly read over to him, was recognized, before the 1400s, as sufficient to relieve him from liability.”); *Staver v. Rogers*, 28 P. 906, 907 (Wash. 1892) (holding that extrinsic evidence is inadmissible “without an allegation in the pleadings that such contract was in fact signed by the party making such allegations by mistake or fraud, or without full knowledge of the conditions thereof.”).

65. Solan, *supra* note 51, at 92.

66. As discussed below, the reason for applying a more strict rule regarding extrinsic evidence is not because meaning somehow arises differently in negotiated commercial contracts as opposed to consumer contracts of adhesion.

3. *Plain Meaning, Ambiguity, and Reasonableness:  
Whose Plain Meaning Should Govern?*

Another problem with the plain meaning rule is that it ties the interpretation of contract language to the subjective understanding of the interpreting judge by excluding extrinsic evidence of the public and conventional meaning of language. Under the plain meaning rule, a court must first determine whether a contract is ambiguous on its face.<sup>67</sup> A contract is considered ambiguous if it is subject to two or more *reasonable* interpretations.<sup>68</sup>

This formulation requires a judge to determine whether each party's proposed interpretation is reasonable, and to do so armed only with the judge's own preconceptions regarding what the particular terms in question mean. As many scholars have recognized in the context of tort law and criminal law (especially in regard to claims of self-defense), when a judge or jury is required to determine whether something is reasonable, without any further guidance, the judge or jury's preconceptions regarding what is reasonable infect the determination.<sup>69</sup> In the context of criminal defendants claiming self-defense, this can lead to, for example, a jury's racial biases excusing violent conduct that was, at least in part, motivated by racial stereotypes regarding the victim.<sup>70</sup>

But reasonableness determinations can and do lead to problems in the commercial contract context as well. The notion that a contract is ambiguous if it is subject to more than one reasonable interpretation injects a judge's subjective notions of meaning into a process that purports to be concerned with objectivity and predictability. If the

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Rather, the possibility of exploitable contracts provides equitable grounds for allowing in a broader range of extrinsic evidence.

67. See *W.W.W. Assocs., Inc. v. Giancontieri*, 566 N.E.2d 639, 642 (N.Y. 1990) (“[E]xtrinsic and parol evidence is not admissible to create an ambiguity in a written agreement which is complete and clear and unambiguous upon its face.” (quoting *Intercontinental Planning, Ltd. v. Daystrom, Inc.*, 248 N.E.2d 576, 580 (N.Y. 1969))).

68. See, e.g., *Cent. Auto Co. v. Reichert*, 273 N.W.2d 360, 364–65 (Wis. Ct. App. 1978) (“Words and phrases in a contract are ambiguous when they are reasonably susceptible to more than one meaning.”).

69. See, e.g., Aaron D. Goldstein, Note, *Race, Reasonableness, and the Rule of Law*, 76 S. CAL. L. REV. 1189, 1190 (2003).

70. See *id.*

preconceptions of the judge determine reasonableness, then the law of contracts is made unpredictable, or perhaps worse, made into a game where litigants intentionally play to such preconceptions. This is especially problematic in contracts involving a highly technical subject matter, where ambiguity may be apparent to someone familiar with relevant trade usage, but not apparent to a judge who is asked to make a reasonableness determination, in the first instance, within the four corners of the contract alone.

As the court in *Metric Constructors, Inc. v. NASA* recognized, the plain meaning rule can fail to account for the parties' reasonable commercial expectations, even where the language of a contract appears facially unambiguous.<sup>71</sup>

In *Metric Constructors*, the Court of Appeals for the Federal Circuit (CAFC) analyzed whether evidence of trade practice is admissible to determine if terms within a contract are ambiguous.<sup>72</sup> Prior to the court's decision in *Metric Constructors*, the CAFC had issued several conflicting opinions regarding when evidence of trade practice and usage are admissible to interpret the meaning of contract terms.<sup>73</sup>

In *Metric Constructors*, the National Aeronautics and Space Administration (NASA) awarded a contract to Metric Constructors, Inc. to build a space station processing facility at the Kennedy Space Center in Florida.<sup>74</sup> A major part of the contract required the contractor to install "new lamps" in fluorescent light fixtures capable of high-intensity lighting "immediately prior to completion of the project."<sup>75</sup> The president of Metric's electrical subcontractor, Meisner Electric, Inc., testified that he interpreted the specification to require "(a) the installation of new lamps in the facility and (b) immediately prior to the contract completion or the provision of beneficial occupancy of specific rooms or areas, the replacement of any defective, burned out, or broken lamps."<sup>76</sup>

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71. *Metric Constructors, Inc. v. NASA*, 169 F.3d 747, 754 (Fed. Cir. 1999).

72. *Id.* at 753.

73. *Id.*

74. *Id.* at 748.

75. *Id.* at 749.

76. *Metric Constructors, Inc. v. NASA*, ASBCA No. 48,852, 98-1 BCA ¶ 29,384, at 146,046.

After NASA inspected the facility towards the end of the project, it created a punch list of items the contractor had to address before the contract would be considered fulfilled.<sup>77</sup> The list included a “request to relamp the facility.”<sup>78</sup> The ASBCA<sup>79</sup> later found that in the electrical industry, the term “relamping” is used to describe the “total replacement of lamps at a particular facility,” and “[i]t is uncommon for specifications for new construction to require relamping.”<sup>80</sup> The board also found that NASA’s estimate for the cost of the project did not include the cost of this relamping work.<sup>81</sup>

After receiving the punch list, Metric sent NASA a letter requesting that NASA put off or eliminate the replacement of working lamps from the specifications of the contract.<sup>82</sup> The Contract Officer responded by deleting the contract requirement to install new lamps from Metric’s scope of work.<sup>83</sup> After about ten months of unsuccessful price negotiation, the Contract Officer unilaterally reduced the contract price by \$132,570 for the work deleted by the modification.<sup>84</sup>

On appeal to the ASBCA, Metric argued that the absence of the trade term “relamping” in the specification “reasonably led to the interpretation that it was required to replace only those lamps which did not work.”<sup>85</sup> The Board refused to consider evidence of trade usage after it determined that the work described in the contract was not ambiguous: “It is

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77. *Id.*

78. *Id.*

79. The Armed Services Board of Contract Appeals is described as follows on the ASBCA’s website:

The ASBCA is a neutral, independent forum which has been in existence for over fifty years. Its primary function is to hear and decide post-award contract disputes between government contractors and the Department of Defense; the National Aeronautics and Space Administration; the Central Intelligence Agency, as appropriate; and other entities with whom the ASBCA has entered into agreements to provide services.

ARMED SERVS. BD. OF CONTRACT APPEALS, <http://www.asbca.mil/> (last visited Sept. 30, 2012).

80. *Metric Constructors, Inc. v. NASA*, ASBCA No. 48,852, 98-1 BCA ¶ 29,384, at 146,045.

81. *Id.*

82. *Id.* at 146,046–47.

83. *Id.* at 146,047.

84. *See id.* at 146,048.

85. *Id.* at 146,051.

difficult to divine a less ambiguous requirement than that for ‘new lamps.’”<sup>86</sup> Thus, according to the ASBCA, because the contract language was unambiguous, Metric could not submit evidence of trade practice or custom to vary the unambiguous terms.<sup>87</sup> The ASBCA held that “NASA was entitled to issue the deductive change,”<sup>88</sup> and that the amount deducted was “reasonable.”<sup>89</sup>

On appeal, the CAFC stated that the case “squarely presents the recurring issue of the role of evidence of trade practice and custom in contract interpretation.”<sup>90</sup>

The court identified two lines of cases that deal with the “role of evidence of trade practice and custom in contract interpretation.”<sup>91</sup> The first line of cases holds that a court “may consult evidence of trade practice and custom to discern the meaning of an ambiguous contract provision, but not to contradict or override an unambiguous contract provision.”<sup>92</sup> The second line of cases holds that a court “may consult evidence of trade practice and custom to show that ‘language which appears on its face to be perfectly clear and ambiguous has, in fact, a meaning different from its ordinary meaning.’”<sup>93</sup> The first approach to contract interpretation assumes that language is capable of having a plain and unambiguous meaning on its face, and that such meaning should govern the interpretation of a contract.<sup>94</sup>

Ultimately, the court adopted a standard closer to the second line of cases. After accepting evidence of industry usage from the plaintiff, the court ruled that by failing to use the term “relamping” to describe the work that it sought, NASA had created ambiguous specifications that had to be construed against NASA—the party that drafted it.<sup>95</sup>

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86. Metric Constructors, Inc. v. NASA, 169 F.3d 747 (Fed. Cir. 1999), ASBCA No. 48,852, 98-1 BCA ¶ 29,384, at 146,050

87. *Id.*

88. *Id.* at 146,051.

89. *Id.* at 146,052.

90. Metric Constructors, Inc., v. NASA, 169 F.3d 747, 751 (Fed. Cir. 1999).

91. *Id.*

92. *Id.*

93. *Id.* (quoting Gholson, Byars & Holmes Const. Co. v. United States, 351 F.2d 987, 999 (Ct. Cl. 1965)).

94. *Id.*

95. *Id.* at 754.

As the court in *Metric Constructors* explained:

Trade practice and custom illuminate the context for the parties' contract negotiations and agreements. Before an interpreting court can conclusively declare a contract ambiguous or unambiguous, it must consult the context in which the parties exchanged promises. Excluding evidence of trade practice and custom because the contract terms are "unambiguous" on their face ignores the reality of the context in which the parties contracted. That context may well reveal that the terms of the contract are not, and never were, clear on their face. On the other hand, that context may well reveal that contract terms are, and have consistently been, unambiguous.<sup>96</sup>

The plaintiff in *Metric Constructors* also raised the point that refusing to consider trade usage to interpret what appears to be an unambiguous contract could lead to absurd results, especially where a contract incorporates language that may seem unambiguous to a person outside the relevant industry, but that has a very different meaning within the industry:

Metric points out that the vast majority of lamps for this project (nearly 12,000 of about 13,000) had a life of six years and eight months. The Board found that most of the lamp installation occurred during the summer of 1993. Metric delivered more than half of the facility in June and October 1993, and ultimately completed the project the following summer. Based on this sequence of events, Metric points to the absurdity and waste of re-lamping recently installed, long-lived lamps.<sup>97</sup>

Thus the plain meaning rule can lead to absurd results where the court is not aware of the usage of a term that is employed by participants within an industry to which the parties belong.

### III. THE CONTEXT RULE: A RESPONSE TO THE PLAIN MEANING RULE

The context rule is the culmination of decades of criticism leveled against the plain meaning rule, which is grounded in the notion that words are capable of possessing a singular

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96. *Id.* at 752.

97. *Id.* at 750.

plain meaning.<sup>98</sup> The impetus behind the context rule lies in the critiques of scholars such as Arthur Corbin discussed above.

Under the context rule, when a court decides whether a contract is ambiguous in the first instance, the court must examine the language of the contract itself along with all extrinsic evidence of the parties' intent.<sup>99</sup> Typically, courts applying the context rule also hold that extrinsic evidence is not admissible to vary or contradict the language of the contract.<sup>100</sup>

Put simply, the context rule states that extrinsic evidence is always admissible to interpret even a facially unambiguous contract. The Washington Supreme Court decision *Berg v. Hudesman*<sup>101</sup> is often cited as an exemplar of the context rule in action. In *Berg*, the Supreme Court of Washington announced that "extrinsic evidence is admissible as to the entire circumstances under which the contract was made, as an aid in ascertaining the parties' intent" even where a contract appears unambiguous on its face.<sup>102</sup> In so holding, the court abandoned the plain meaning rule, which excluded extrinsic evidence in interpreting a fully integrated (i.e. complete) and unambiguous contract.<sup>103</sup> Rather, the court held that "parol evidence is admissible to show the situation of the parties and the circumstances under which a written instrument was executed, for the purpose of ascertaining the intention of the parties and properly construing the writing."<sup>104</sup>

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98. See *supra* Part II.A.1.

99. See *Berg v. Hudesman*, 801 P.2d 222, 229, (Wash. 1990) ("[E]xtrinsic evidence is admissible as to the entire circumstances under which the contract was made, as an aid in ascertaining the parties' intent."). See also *id.* ("[P]arol evidence is admissible to show the situation of the parties and the circumstances under which a written instrument was executed, for the purpose of ascertaining the intention of the parties and properly construing the writing." (quoting *J.W. Seavey Hop Corp. v. Pollock*, 147 P.2d 310, 316 (Wash. 1944))).

100. See *In re Marriage of Schweitzer*, 937 P.2d 1062, 1066 (Wash. 1997).

101. *Berg*, 801 P.2d 222.

102. *Id.* at 229.

103. *Id.* at 230.

104. *Id.* at 229 (quoting *J.W. Seavey Hop*, 147 P.2d at 316). See also *Bort v. Parker*, 42 P.3d 980, 987 (Wash. Ct. App. 2002) ("A trial court may resort to parol evidence for the limited purpose of construing the otherwise clear and unambiguous language of a contract in order to determine the intent of the parties.").

Some jurisdictions, such as Washington, have argued that the context rule will not inject uncertainty into contractual relationships because the plain meaning rule “effectively does the same thing as the context rule.”<sup>105</sup> As the court in *Eagle Insurance Co. v. Albright* explained:

If a context rule is applied, there will be no effective loss in the certainty of writings, since it is submitted that the plain meaning rule is used only where there is no difference over the sense of the words anyway. Where this is so, evidence on the context in which the words were used would produce the same result as a reading of the face of the writing. Where it is not so, the plain meaning rule either gives way to its exception, which allows the consideration of context evidence or it stands as a mechanically applied bar to the most relevant obtainable evidence of the sense of the words which the parties desired to employ.<sup>106</sup>

But as discussed below, there are fundamental problems with applying extrinsic evidence of the parties’ subjective intent to determine the meaning of the terms by which the parties agreed to be bound. Contrary to the reassurances of the court in *Eagle Insurance*, the context rule can and does lead to uncertainty in contract interpretation. By letting in all extrinsic evidence of the intent of the parties, the context rule unmoors the courts from shared and public standards of meaning and thereby invites gamesmanship and creates uncertainty.

#### A. *Problems with the Context Rule*

##### 1. *Hunt Foods & Industries, Inc. v. Doliner, Illustrating the Problem*

The case of *Hunt Foods & Industries, Inc. v. Doliner*<sup>107</sup> shows how the context rule can completely unmoor the process of contract interpretation from the language that the parties chose to govern any future dispute between them.<sup>108</sup>

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105. *Eagle Ins. Co. v. Albright*, 474 P.2d 920, 929 (Wash. Ct. App. 1970).

106. *Id.* (citing 3 ARTHUR L. CORBIN, CORBIN ON CONTRACTS, § 536 (1960); 4 SAMUEL WILLISTON, WILLISTON ON CONTRACTS §§ 609, 618, 629 (3d ed. 1961); RESTATEMENT OF CONTRACTS § 230 (1932)).

107. *Hunt Foods & Indus., Inc. v. Doliner*, 270 N.Y.S.2d 937 (N.Y. App. Div. 1966).

108. See Jody S. Kraus & Robert E. Scott, *Contract Design and the Structure*

In *Hunt Foods*, the court considered whether a facially *unconditional* option to purchase stock could be treated as a *conditional* option based upon communications between the parties outside of the contract itself.<sup>109</sup>

The parties in this case had been negotiating the sale of the defendant's shares in a corporation.<sup>110</sup> When negotiations stalled, the parties entered into an option contract, under which the plaintiff had the right to purchase all of the defendant's shares for \$5.50 a share.<sup>111</sup> The plaintiff paid \$1000 in exchange for the option to purchase the shares.<sup>112</sup>

The defendant admitted that, during the negotiations, his counsel had "called attention to the fact that the option was unconditional in its terms . . . ."<sup>113</sup> However, the defendant's attorney said "he obtained an understanding that [the option] was only to be used in the event that [the defendant] solicited an outside offer . . . ."<sup>114</sup> The defendant further admitted that the "plaintiff insisted that unless the option was signed in unconditional form negotiations would terminate."<sup>115</sup>

The Court of Appeals, nonetheless, held that the alleged oral agreement that the option would only be exercisable if the defendant entertained outside offers raised a sufficient question of fact for the defendant to survive summary judgment.<sup>116</sup> While the defendant recognized that the option term was facially *unconditional*, the court ruled that evidence that the option term was, in fact, *conditional* did not contradict the parties' written contract and was admissible.<sup>117</sup>

*Hunt Foods* is an excellent example of a case where the resort to extrinsic evidence undermined any certainty that the parties had in relying upon the written terms of their contract.<sup>118</sup> The defendant's own attorney recognized and

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of *Contractual Intent*, 84 N.Y.U. L. REV. 1023, 1048–53 (2009).

109. *Hunt Foods*, 270 N.Y.S.2d at 939.

110. *Id.*

111. *Id.*

112. *Id.*

113. *Id.*

114. *Id.*

115. *Id.*

116. *Id.* at 940.

117. *Id.* at 939–40. "The conversations in this case, some of which are not disputed, and the expectation of all the parties for further negotiations, suggest that the alleged oral condition precedent cannot be precluded as a matter of law . . . ." *Id.* at 940.

118. Case reports illustrating the problems with the context rule are, by

reported to the defendant that the option term was unconditional.<sup>119</sup> What is more, the plaintiff refused the defendant's request to include language making the plaintiff's option conditional.<sup>120</sup> It is hard to see how the plaintiff in this case could have expressed his intent to obtain an unconditional option more clearly. As Professors Kraus and Scott recognized, the defendant "could not reasonably have believed both that [the plaintiff] was content to receive a legally conditional option and that [the plaintiff] had good reason to insist that the condition not be stated in the writing."<sup>121</sup>

By looking to extrinsic evidence contrary to the written contractual terms the parties knowingly chose, the court undermined the parties' ability to firmly and effectively set their agreement into writing in a manner that would be predictably enforced by the court.

## 2. *Memory and Veracity*

Just as Professor Solan explains that the plain meaning rule can lead to dishonest conduct (especially in consumer contracts), Professor Solan also explains that the context rule invites its own variety of gamesmanship and dishonesty.<sup>122</sup> "A frequent justification for the parol evidence rule . . . is the desire to improve the resolution of business disputes by creating a process that is relatively free from unreliable types of evidence, from the whims of jurors, and from dishonesty."<sup>123</sup> "Privileging the written contract serves a useful function precisely because people do forget what was said, and because people really do testify dishonestly, or at least consistently with a self-serving reality that they have

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nature, difficult to come by. An opinion is not simply a recounting of the facts and legal conclusions of the case. An opinion is also a justification of the legal conclusions reached by the court. As such, courts will naturally report facts that make their legal conclusions appear reasonable and correct, while excluding facts that undermine their conclusions.

119. *Id.* at 939.

120. *Id.*

121. Kraus & Scott, *supra* note 108, at 1053. The court did not attempt to analyze the parties' alleged oral understanding under equitable doctrines such as estoppel. Such a claim would likely have failed. It is hard to see how one could reasonably rely upon an agreement that another party is explicitly refusing to make part of the written contract.

122. See Solan, *supra* note 51, at 87-90.

123. *Id.* at 95 (footnote omitted).

created in their own minds about events underlying a litigation.”<sup>124</sup>

Professor Solan backs this point with several studies that demonstrate just how fallible human memory is, especially where a party has an incentive to remember things a certain way. “Basically, we remember two seconds of verbatim speech. What happens with the information after the actual words cannot be recalled is still a matter of active research and debate among psychologists of language. But the fact that the actual words remain with us only briefly is uncontroversial.”<sup>125</sup> He then describes several studies that have shown that while we are capable of remembering the gist of what we hear and read, we are very bad at remembering the details.<sup>126</sup>

To make matters worse, these studies show that our recollections are very suggestible. Specifically, how we recall past events is greatly influenced by the way in which we are asked about them.<sup>127</sup> This problem is greatly magnified in litigation, where parties are under tremendous economic and peer pressure to recall events in a manner that is helpful to their claims:

Imagine, then, what happens when a corporate executive is interviewed by lawyers about the circumstances surrounding the execution of a contract that is now in litigation. Assume that the executive is basically an honest person, but has only sketchy memory of the events. The lawyers brief their client on how the case seems to be coming together and ask—quite in earnest—whether the executive recalls facts relating to the negotiation that can be helpful. Much of the time, I submit, that executive’s memory will be appropriately jogged, and he will testify at the deposition to the events the lawyers want to hear as though they had just happened yesterday. This is not

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124. *Id.* at 89–90.

125. *Id.* at 95.

126. *Id.* at 96–97 (citing Jacqueline Strunk Sachs, *Recognition Memory for Syntactic and Semantic Aspects of Connected Discourse*, 2 PERCEPTION & PSYCHOPHYSICS 437 (1967); Amina Memon & A. Daniel Yarmey, *Earwitness Recall and Identification: Comparison of the Cognitive Interview and the Structured Interview*, 88 PERCEPTUAL AND MOTOR SKILLS 797 (1999)).

127. See Solan, *supra* note 51 at 97 (citing Elizabeth F. Loftus & John C. Palmer, *Reconstruction of Automobile Destruction: An Example of the Interaction Between Language and Memory*, 13 J. VERBAL LEARNING & VERBAL BEHAV. 585 (1974)).

because he is a liar. It is because he has reconstructed the story in such a way as to integrate helpful scenarios into the parts of the story that he actually remembers. I recall such experiences from my own practice as a litigator, and I have interviewed corporate lawyers in connection with this project whose recollections also accord with this view.<sup>128</sup>

Of course, there is also the problem of lying, especially where such economic and peer pressure is brought to bear. Professor Solan also points to a growing body of social science literature suggesting that our system of commercial exchange, especially in the context of corporate structures, creates strong incentives for dishonest behavior:

Social psychologists have, over the past decade, identified incentive systems within the corporate structure that appear to encourage sharp practices and dishonesty. Recently, various anthologies of studies about corporate ethics have been published. Serious acts of wrongdoing committed by business executives are seen not as the isolated acts of bad people, but rather as the predictable consequences of pressures and incentives in today's corporate culture.<sup>129</sup>

This incentive towards dishonesty in corporate structures is yet further support for a more restrictive rules regarding extrinsic evidence in disputes over negotiated commercial contracts. This is, in essence, the flip side of Professor Solan's earlier point that restrictive rules for extrinsic evidence tend to magnify the power disparities attendant to consumer contracts of adhesion. A restrictive rule for extrinsic evidence can restrain a party's ability to gain advantage through dishonesty since it is much more difficult to lie about the language of a written contract than it is to lie about what was said and done outside of the four corners of the contract.

### 3. *The Context Rule and Extrinsic Evidence at Odds with Apparent Plain Meaning*

Jurisdictions that have adopted the context rule often also hold that while extrinsic evidence is admissible to shed light on the intent of the parties—and therefore the meaning of contract language—it is not admissible to vary or

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128. *Id.*

129. *Id.* at 98.

contradict the written terms of a contract.<sup>130</sup> This construction of the context rule, however, is problematic and fails to address the problems associated with the context rule discussed above. Specifically, the “no varying or contradicting” rule entails one of two problematic consequences. Either a) the judge must first determine the plain meaning of the contract so as to determine whether certain extrinsic evidence varies or contradicts it, or b) the rule requires extrinsic evidence to establish what the contract means in the first place, and accordingly, such extrinsic evidence could never contradict the meaning of a word or phrase that it itself has given.

This first notion is but the plain meaning rule in contextualist clothing, and is not how courts that have adopted the context rule apply it.<sup>131</sup> If the court can already determine the plain meaning of a contract such that it can determine whether extrinsic evidence contradicts the plain meaning, why consider extrinsic evidence at all? In such a case, the court already *has* the contract’s plain meaning.

The second notion creates a problem of circularity. How can extrinsic evidence, which is used to give the contract meaning in the first place, ever contradict the very meaning that the extrinsic evidence has given the contract? For this to happen, the extrinsic evidence would have to mean both X and not X, i.e., it would have to vary or contradict *itself*. In practice, this second way of applying the “no varying or contradicting” version of the context rule boils down to an appeal to the judge’s common sense or gut feeling that certain language really can only support a certain range of meaning—a kind of plain meaning light.

As shown in the *Hunt Foods* case, the context rule can lead courts to engage in rather violent contortions in order to show that the extrinsic evidence the court is relying upon supplements rather than contradicts the language of the contract. In *Hunt Foods*, the court explained that its

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130. *In re Marriage of Schweitzer*, 937 P.2d 1062, 1066 (Wash. 1997) (explaining that a court cannot “‘add[ ] to, modify[ ], or contradict[ ] the terms of a written contract, in the absence of fraud, accident, or mistake.’” (quoting *Berg v. Hudesman*, 801 P.2d 222, 229 (Wash. 1990))).

131. *See Berg*, 801 P.2d at 230 (“We thus reject the theory that ambiguity in the meaning of contract language must exist before evidence of the surrounding circumstances is admissible. Cases to the contrary are overruled.”).

interpretation that an unconditional option was in fact conditional was not a contradiction because the condition merely “lessened” the effect of the option and did not “negate” it.<sup>132</sup> It is hard to see the terms “conditional” and “unconditional” as compatible with one another. At the very least, the tensions within the court’s interpretation of the option language (especially when the defendant admitted that the written option was facially unconditional) illustrates a problem with requiring courts to determine whether extrinsic evidence contradicts or merely supplements the terms of a contract.<sup>133</sup>

One initially appealing retort to this criticism is that the no varying or contradicting rule only comes into play where the court is choosing between the various *possible* meanings of a word or phrase. But this cannot be what is meant in jurisdictions that apply the context rule. In such jurisdictions, extrinsic evidence is admissible to determine in the first place the various possible meanings that a word or phrase might bear—i.e., extrinsic evidence must be considered when determining whether the word or phrase is ambiguous in the first instance.<sup>134</sup> Evidence used to establish that a word or phrase is ambiguous could never contradict the word or phrase in question since that evidence has itself established the range of possible meanings. Put another way, the evidence that defines what a word means logically cannot contradict what a word means.

4. *While the Context Rule Looks to the Parties’ Subjective Intent, Divining the Parties’ Subjective Intent Is Problematic*

Under the context rule, courts look to extrinsic evidence to determine the subjective intent of the parties, but as explained below, determining the parties’ subjective intent is highly problematic for several reasons.<sup>135</sup> Even courts

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132. *Hunt Foods & Indus., Inc. v. Doliner*, 270 N.Y.S.2d 937, 940 (N.Y. App. Div. 1966) (“To be inconsistent the term must contradict or negate a term of the writing. A term or condition which has a lesser effect is provable.”).

133. See Schwartz & Scott, *Contract Theory*, *supra* note 1, at 571 n.58.

134. See *Admiral Builders Sav. & Loan Ass’n v. S. River Landing, Inc.*, 502 A.2d 1096, 1099 (Md. Ct. Spec. App. 1986).

135. FARNSWORTH, *supra* note 1, at § 7.9. While Farnsworth acknowledges that parties usually do not have a shared intent, he nonetheless describes the “court’s task” in such cases as “applying a standard of reasonableness to

applying the context rule have recognized that looking to the subjective intent of the parties is not workable—at least in regard to whether the parties have formed a contract. In complex negotiated commercial contracts, it is difficult to assign a single intent to the language of a contract that was negotiated and drafted by numerous individuals on each side of the contract. If parties are litigating the interpretation of a contract in good faith, then those parties must not have had a single intent, at least in regard to the subject matter of their dispute.

*i. The Context Rule's Focus on Subjective Intent Is Incompatible with the Objective Theory of Contracts*

It is a long held assumption in the law of contracts that what ought to govern the interpretation of a contract is the intent of the parties. As a 1795 case from the Supreme Court of North Carolina held: “The true intent of the parties to be regulated by that contract, shall not be defeated and justice overturned, so long as any evidence remains which throws any glimmering of light on that subject, from which a jury may be enabled to infer the real state of the transaction.”<sup>136</sup>

This is especially true of courts that apply the context rule, which has as its primary justification the notion that extrinsic evidence of the context in which the parties entered into their contract is essential to properly identify the parties' intent.<sup>137</sup>

The second concept that underlies our analysis is this state's so-called “context rule.” . . . We include “the subject matter and objective of the contract, all circumstances surrounding its formation, the subsequent acts and conduct of the parties, statements made by the parties in preliminary negotiations, and usage of trade and course of

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determine which party's intention is to be carried out . . .” *Id.* This Article's critique of the parties' intent goes further by questioning whether the court can determine the parties' subjective intent at all, regardless of whether the parties had the same intent or not.

136. *Ingram v. Hall*, 2 N.C. (1 Hayw.) 193, 207 (N.C. 1795).

137. While courts applying the plain meaning rule recite the same truism that the touchstone of contract interpretation is the intent of the parties, such courts focus on the language of the contract as the best indicator of the parties' intent. See *Tallmadge Bros., Inc. v. Iroquois Gas Transmission Sys., L.P.*, 746 A.2d 1277, 1289 (Conn. 2000).

dealings.” This approach permits us to then “discover the intent of the parties based on their *real meeting of the minds*, as opposed to insufficient written expression of their intent.”<sup>138</sup>

Here, the court is not referring to objective manifestations of intent.<sup>139</sup> The court is looking for the parties’ actual, subjective, and presumably unitary intent (even if it will not allow the parties to testify to their subjective understandings directly). Indeed, courts almost universally invoke the intent of the parties as the touchstone of all contract interpretation. How close courts come to matching their interpretations to what the parties actually *subjectively* intended is the barometer by which courts applying the context rule judge their success or failure in interpreting a contract.

The notion that parties even have a single unified intent at the moment of execution is also not axiomatic. And if parties frequently do not have such a unified intent, even where they both knowingly and fully agree to the language of a particular contract, then the endeavor of determining the parties’ intent would, in such cases, be impossible.

Even while seeking the parties’ subjective intent, courts recognize that determining a shared subjective intent among the parties to a contract is problematic:

Article 2 does not, however, require a “true ‘meeting of the minds.’” Rather, the objective theory of contracts is used. The objective theory stresses an outward manifestation of assent made by one party to the other party. The parties’ objective intent and what a reasonably prudent person would have believed from the actions or words of the parties is analyzed.<sup>140</sup>

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138. *Carpenter v. Remtech, Inc.*, 226 P.3d 159, 161–62 (Wash. Ct. App. 2010) (emphasis added) (citations omitted) (quoting *Berg v. Hudesman*, 801 P.2d 222, 228 (Wash. 1990); *Tjart v. Smith Barney, Inc.*, 28 P.3d 823, 828–29 (Wash. Ct. App. 2001)).

139. See also Michael L. Boyer, *Contract as Text: Interpretive Overlap in Law and Literature*, 12 S. CAL. INTERDISC. L.J. 167, 171 (2003) (“The parol evidence rule is characterized by two schools of thought: the mechanical conception of Professor Williston, emphasizing the agreement and its plain meaning, and the modern approach of Professor Corbin, emphasizing the parties’ intentions and use of extrinsic evidence to reveal these intentions.”) (citing Stephen F. Ross & Daniel Tranen, *The Modern Parol Evidence Rule and Its Implications for New Textualist Statutory Interpretation*, 87 GEO. L.J. 195, 199–207 (1998)).

140. *Dean Mach. Co. v. Union Bank*, 106 S.W.3d 510, 521 (Mo. Ct. App. 2003)

Indeed, at least when it comes to issues of contract formation, courts now universally hold that it is not the parties' actual subjective agreement that matters, but instead it is the parties' outward expressions of agreement to a written document that determines whether the agreement is binding.

Even in jurisdictions that have adopted the context rule, courts have all but done away with the notion that parties must have a subjective meeting of the minds in order to form a contract. As Justice Friendly quoted Justice Holmes in the *Frigalment Importing Co.* case, "the making of a contract depends not on the agreement of two minds in one intention, but on the agreement of two sets of external signs—not on the parties' having meant the same thing but on their having said the same thing."<sup>141</sup> As Justice Posner recognized, "[m]ost contract disputes arise because the parties did not foresee and provide for some contingency that has now materialized—so there was no meeting of minds on the matter at issue—yet such disputes are treated as disputes over contractual meaning, not as grounds for rescinding the contract . . . ."<sup>142</sup> Thus, even jurisdictions that apply the context rule when interpreting contracts tacitly recognize the problems with relying upon the parties' subjective intent when they apply the objective theory of contracts to formation issues.

Courts applying the context rule deal with the contradiction between the objective theory of contracts and the search for the parties' subjective intent by applying the objective theory of contracts to determine whether a contract was *formed*, but then determining what the contract means by reference to the parties' subjective intent.<sup>143</sup> Courts do so by invoking notions like the parties' actual intent or true

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(citations omitted). The apparent conflict between the court's explication of the context rule in *Carpenter* and the court's explication of the context rule in *Dean* illustrates an insoluble conflict between the objective theory of contract and the context rule. The objective theory of contract seeks apparent meaning (based upon what a reasonably prudent person would interpret) while the context rule seeks subjective meaning (i.e., what the parties in fact intended).

141. *Frigalment Importing Co. v. B.N.S. Int'l Sales Corp.*, 190 F. Supp. 116, 117 (S.D.N.Y. 1960) (citation omitted).

142. *Colfax Envelope Corp. v. Local No. 458-3M, Chi. Graphic Commc'n Int'l Union*, 20 F.3d 750, 752 (7th Cir. 1994).

143. *Compare Carpenter*, 226 P.3d at 161–62, with *Argo Welded Prods., Inc. v. J.T. Ryerson Steel & Sons, Inc.*, 528 F. Supp. 583, 592 (E.D. Pa. 1981).

meeting of the minds.<sup>144</sup> While this procedure allows courts to apply these rules consistently, it does not resolve the inherent contradiction between a rule that admits that contracts can be *formed* without a subjective meeting of the minds, and a rule that requires courts to seek out a subjective meeting of the minds when *interpreting* the same contract. Indeed, putting to one side the possibility that either party is lying, the very fact that a dispute has arisen suggests that the parties did not have a shared subjective intent, at least in regard to the subject matter of their dispute.

*ii. The Realities of Negotiating and the Illusion of Unitary Intent*

Given the nature of how complex commercial contracts are negotiated and the incentives of the parties to jockey for advantage, there is good reason to think that parties often do not have a unified intent when they agree to sign a complex commercial contract, at least as to those details that end up being litigated.

First, complex commercial contracts are not simple agreements between two individuals reduced to writing. Such contracts are almost always entered into between corporations controlled by varying numbers of officers, directors, managers, etc. The individual that signs a contract may or may not be among the several individuals who negotiated the contract for one side. Even the individuals on one side of a contract who all agree to its written terms may not all have a single unitary intent regarding exactly what those terms mean. Perhaps different individuals, even on one side of the contract, drafted different portions of it. And perhaps those responsible for agreeing to the contract were not the ones who drafted it. In such cases, contracts begin to look less like expressions of shared underlying intent, and more like agreements to be bound by particular language.

Second, negotiating commercial contracts is not a communal activity, but rather a competitive sport. Such negotiations may not be a truly zero sum game where one party wins, and the other party loses. There are certainly provisions in commercial contracts that both parties want and both will benefit from. However, the goal of any form of

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144. See *Argo Welded*, 528 F. Supp. at 591–92.

commercial negotiation in a competitive capitalist economy is to capture the greatest profit—usually at the expense of the other party to the negotiation. Under such circumstances, each party does not agree to contractual language simply to set into writing their agreement. They agree to language because they believe that it will provide them with an advantage should a dispute arise. As to any given provision, both parties cannot be right.

For example, the parties to a fixed-price construction contract might agree that, should the owner terminate its contract with the contractor at any point prior to final completion, the contractor is entitled to a prorated share of the fixed-price based upon the percentage of completion. The contractor might have agreed to this term believing that it would be interpreted to mean percentage completion based upon the amount spent to date on the project compared to the amount the contractor would have to spend to finish it. The owner, on the other hand, might have agreed to this term believing that percentage of completion is the ratio of the amount the *owner* has paid the contractor to the amount the owner would have to pay to complete the project. The parties might have agreed to this language, not because they actually reached an agreement as to what this term means, but because each party believed it could win a dispute over what this term means. This does not mean that the parties failed to reach an agreement, but rather, that they calculated the effects of their agreement differently.<sup>145</sup>

Parties negotiating a commercial contract are not simply negotiating about the subject matter of the contract. The language of the contract itself is part of what is being bargained for. A party may agree to take a lower payment in return for language that the party believes will advantage it should a dispute arise. Parties will also often horse trade contract language—“I do not like section 2.B. of the contract, but we can keep it if you agree to this new provision in section 3, which we would like.” Here, parties are not concerned simply with setting their intent into writing, but with getting language into the contract that they can rely upon and that

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145. Calling such a contract ambiguous does not save the context rule from its reliance upon the parties' subjective intent. If the parties believed that the term would be interpreted differently, the intent of the parties is of no help and extrinsic evidence of the subjective intent of the parties is irrelevant.

they believe will benefit them should a dispute arise.

5. *For Communication to Occur, the Meaning of Language Cannot be Grounded in the Intent of the Parties*

As discussed above in Part III.A.4, courts applying the context rule see evidence of the parties' subjective intent as necessary to interpret what a contract means. But there are good reasons to be skeptical about whether a contract's meaning must be determined by direct reference to the subjective intent of the parties.<sup>146</sup> As Professor Ricks argues, the contextualist attack upon the plain meaning rule is flawed because it presumes that the meaning of a contract must be the intent of the parties.<sup>147</sup>

First, the judges assert that plain meaning could only be found by reading a document if words had inherent meaning, or absolute and constant referents. But they do not, the argument goes. Second, the opinions claim that the meaning of words is actually the thoughts and intentions of the speaker, or perhaps the speaker and hearer. No written contract could ever adequately reveal these. Plain meaning is therefore impossible. This claim is left irrefuted in the casebooks and contract law literature . . . .<sup>148</sup>

. . . .

But the claim that plain meaning is impossible is false, as are its premises. . . . [W]ords cannot be the thoughts and intentions of the speaker, hearer, or anyone else . . . . [P]lain meaning does not require that words have "inherent meaning" or "absolute and constant referents." Plain meaning is possible and occurs quite apart from reference or another theory of inherent meaning. Plain meaning rests instead on our unreflective, public, conventional practice of language use.<sup>149</sup>

In other words, it is how words are used publically by convention that comes to define their meaning, not what any

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146. Val D. Ricks, *The Possibility of Plain Meaning: Wittgenstein and the Contract Precedents*, 56 CLEV. ST. L. REV. 767, 769 (2008) ("Drawing on the philosophy of Ludwig Wittgenstein, . . . the meaning of words cannot be the thoughts and intentions of the speaker, hearer, or anyone else.").

147. *Id.* at 768.

148. *Id.*

149. *Id.* at 769.

particular user intends. For communication to be possible, meaning must be based upon public and shared conventions.<sup>150</sup> “The thoughts and intents of the speaker and writer, hearer and listener, are irrelevant to the meaning of language. Meaning is not subjective and personal. Instead, the meaning of language is necessarily public and objective. The meaning lies in the consistent, conventional patterns of our usage.”<sup>151</sup>

A language that has meaning by reference only to what the speaker or the hearer intends, in fact, has no meaning at all.<sup>152</sup> Professor Ricks summarizes Wittgenstein’s argument to this effect as follows:

The difficulty with such a language is that no “criterion for correctness” for the use of it exists. Language, to have meaning, must be used consistently. (Wittgenstein’s way to express this consistency was to say that language is used “according to rule” . . . .)[.] Moreover, some way to check the consistency must exist so that users of the language know whether language is being used meaningfully or not. But no method exists to keep a wholly private language consistent, or to check it for consistency.<sup>153</sup>

This observation, that for communication to be possible, the meaning must be based upon public and shared conventions, undermines not only the context rule, but also the plain meaning rule to the extent the plain meaning rule excludes extrinsic evidence of the public and conventional meaning of words or phrases. Context is essential to meaning, but only to the extent that such context is public and shared.<sup>154</sup>

Even when courts apply the plain meaning rule, they are not discerning the meaning outside of any context. Of course, such a thing would be impossible. Even when courts do not utilize extrinsic evidence, judges bring to a text all of their internalized rules for common usage—rules of grammar,

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150. *Id.* at 784.

151. *Id.*

152. *Id.* at 785–86 (citing LUDWIG WITTGENSTEIN, PHILOSOPHICAL INVESTIGATIONS ¶ 202 (G.E.M. Anscombe trans., Basil Blackwell Ltd. 3d ed. 1986) (1953)).

153. *Id.* at 785 (footnote omitted) (citing WITTGENSTEIN, *supra* note 152, ¶ 258).

154. *See id.*

syntax, etc.—through which they interpret the contract,<sup>155</sup> even when purportedly limited to the four corners of the contract. This phenomenon is best typified by courts' frequent referral to an English dictionary—a document outside the contract itself—even when applying the plain meaning rule.<sup>156</sup>

Take for example the famous case of *Frigaliment Importing Co. v. B.N.S. International Sales Corp.*, where the court, in first determining whether the word “chicken” is ambiguous, looked to the dictionary definition of the term.<sup>157</sup>

The issue is, what is chicken? Plaintiff says “chicken” means a young chicken, suitable for broiling and frying. Defendant says “chicken” means any bird of that genus that meets contract specifications on weight and quality, including what it calls “stewing chicken” and plaintiff pejoratively terms “fowl”. Dictionaries give both meanings, as well as some others not relevant here.<sup>158</sup>

Contrary to the contextualist critique of the plain meaning rule, it is possible to consistently assign meaning to words and phrases in a contract based upon the text of the contract alone and the tools available to courts applying the plain meaning rule. The question is whether the plain meaning rule (or the context rule or the public meaning rule suggested by this Article) will assist courts in interpreting contracts in a way that reflects the purposes for which parties enter into contracts. As explained below in Part IV.B., that purpose must include the ability to predictably constrain another party's behavior. And if this indeed is an essential purpose of contracts, the observation that communication is only possible via public and shared conventions for what words mean entails that contracts must be interpreted according to such shared and public conventions if contracts are to serve their essential function. Put simply, if parties

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155. *Id.* at 801–02 (“The context of the plain meaning rule includes the contract itself, whatever of the commercial context that can be discerned from the contract, the learning and background of the judge, and the arguments that litigants offer regarding whether the language is clear. . . . The grammatical rules by which language has meaning, even plain meaning, can function in this setting, in this context.”).

156. *Frigaliment Importing Co. v. B.N.S. Int'l Sales Corp.*, 190 F. Supp. 116, 117 (S.D.N.Y. 1960).

157. *Id.*

158. *Id.*

cannot rely upon public and shared conventions for meaning they cannot predictably constrain others' behavior, and this undermines the purpose for which parties enter into contracts.

#### IV. A PROPOSED RULE FOR NEGOTIATED COMMERCIAL CONTRACTS

So far, this Article has addressed problems with both the plain meaning rule and the context rule, which govern when and what kinds of extrinsic evidence are admissible to interpret a contract that appears unambiguous on its face. The plain meaning rule is flawed (at least in its claims that words have absolute meaning) because the language of a contract can only have meaning in context. Furthermore, the plain meaning rule relies upon judges' subjective preconceptions regarding what the terms in a contract mean. Looking only to the language of the contract itself, and holding the parties to it, can also allow more sophisticated parties to take advantage of less sophisticated parties. Finally, the language of the contract alone cannot shed light on what the parties to the contract actually intended, and it is the intent of the parties that defines what a contract means (or so contextualists argue).

But the context rule is problematic in its own way. Many kinds of extrinsic evidence are inherently unreliable. Parties misremember and parties lie, and it is much easier to fake or misrepresent extrinsic evidence than it is to fake or misrepresent the language of the contract itself. Furthermore, there are good reasons to doubt that divining the intent of the parties, especially in complex commercial contracts, is possible. Parties often do not have a shared intent regarding the matters or factual circumstances that end up being litigated, but instead only agree to be bound to the particular language of their contract. This is especially true in contracts between commercial entities, where various individuals negotiate, approve, and sign contracts even on behalf of a single party—thus making a unitary intent even more problematic. More fundamentally, in order for communication to occur, the meaning of words or phrases cannot be based upon the intent of the party stating them, but instead derives from the way the terms of the contract are publically and conventionally used within language.

The notion that meaning, in communication generally and in contracts in particular, must be based upon shared and public conventions of usage provides the basis for a rule that addresses the problems with the strong forms of both the plain meaning rule and the context rule. If the meaning of a word, phrase, or text must be based upon shared and public conventions, then evidence aimed at the subjective intent of one or both of the parties should not be what courts look to in order to interpret contract language. Rather, evidence of the shared and public conventions for how a word or phrase is used in language ought to govern how a court interprets a word or phrase. The public meaning rule allows parties to submit evidence of such shared and public conventions at the initial stage of contract interpretation, while excluding evidence offered to show the subjective intent of one or more of the parties, evidence that, as discussed above, is highly problematic.

This Article's response to the contextualist critique of the plain meaning rule is to untie meaning from both the subjective notions of a judge (under a strict plain meaning rule) *and* from extrinsic evidence of the subjective intent of the parties (under the context rule). Instead, meaning must be fastened to the public and shared conventions for the usage of words and phrases within language, which courts can determine through evidence of how a word or phrase in a contract is, in fact, publically and conventionally used.

The rule proposed in this Article would be applied by a court as follows: When interpreting the meaning of a contract, the court would first look to whether the contract has a single, unambiguous meaning in light of the language of the contract itself. In addition, the court would also look to evidence of how the words or phrases in the contract are publically and conventionally used in language, such as trade usage. The court would also require each party to produce limited biographical extrinsic evidence that the parties are members of a group that employs the usage of the term or phrase, which the party advocates. Put another way, the parties, at this initial stage, must submit extrinsic evidence to prove that their proposed usage is relevant, and/or that the other parties' proposed usage is not relevant. Courts at this stage would not admit evidence of what one or both of the parties subjectively understood the words or phrases in the

contract to mean. If the contract is still ambiguous, the court would resort to equitable principles to determine a fair outcome, and allow any extrinsic evidence relevant to that endeavor.

The result of the public meaning rule proposed by this Article is that after the initial stage of contract interpretation, courts will be left with a definite list of the possible meanings that the word or phrase at issue may bear, i.e., those interpretations that are supported by evidence of what the word or phrase in fact means in language. Words and phrases can only have a certain range of conventional meanings within a particular group of speakers, otherwise communication would be impossible. Under the public meaning rule, parties will not be able to present evidence that the word or phrase at issue has a meaning outside of the boundaries of usage relevant to the parties.<sup>159</sup>

This Article is not concerned with the order of preference courts apply to the various types of extrinsic evidence, *per se*. Rather, this Article argues that courts should not consider certain types of extrinsic evidence at the initial stage where the court determines whether a contract is ambiguous. The hierarchy of extrinsic evidence is important under any interpretive theory that looks to multiple categories of extrinsic evidence at any particular phase. However, the thesis of this Article is that only one category of extrinsic evidence—evidence of the public and shared meaning of a word or phrase—should be admitted during the first phase of contract interpretation where the court determines whether the contract is ambiguous. The practical effect of the rule proposed in this Article is that evidence of usage will be privileged over other forms of extrinsic evidence. But the order in which courts apply categories of extrinsic evidence other than usage (only after determining that a contract is ambiguous) is beyond the scope of this Article.

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159. While, as discussed above, courts that apply the context rule generally also hold that extrinsic evidence cannot be used to vary or contradict the terms of the contract, the public meaning rule provides a procedure for putting this notion into practice that is far more concrete and less reflexive. *See infra* Part IV.A. The public meaning rule is grounded in more than the court's reflexive notions of whether a purported definition is simply "beyond the pale."

*A. Example Categories: Trade Usage Versus Course of Performance and Course of Dealing*

There are numerous categories of extrinsic evidence that parties can submit in contract litigation. They include evidence of the parties' course of dealing, evidence of the parties' course of performance, evidence of the parties' pre-contract negotiations, evidence of the parties' communications post-contract, evidence of internal communications by one of the parties to the contract, evidence of trade usage, and so on. Rather than address each of these categories, this Section addresses a few in particular as examples of extrinsic evidence that are relevant to the public and conventional meaning of words in language and examples that are not.

*1. Evidence of Public and Conventional Usage*

Unlike course of dealing and course of performance, evidence of public and conventional usage (such as trade usage as described in Article 1 of the Uniform Commercial Code<sup>160</sup> and the Restatement of Contracts (Second)<sup>161</sup>) is evidence of the very conventions that make communication possible. Courts frequently refer to dictionary definitions when attempting to determine the meaning of contract terms<sup>162</sup> and reliance upon a dictionary is appropriate given the dictionary's functions as a guide to common usage.

But the dictionary is not the final word on the proper usage of terms. A dictionary is an attempt to catalogue public usage. It does not itself define public usage.

A dictionary, it is vital to observe, never says what meaning a word must bear in a particular context. Nor does it ever purport to say this. An unabridged dictionary is simply an historical record, not necessarily all-inclusive, of the meanings which words in fact have borne . . . . The editors make up this record by collecting examples of uses of the word to be defined, studying each use in context, and then forming a judgment about the meaning in that context.<sup>163</sup>

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160. U.C.C. § 1-205(2) (1978).

161. RESTATEMENT (SECOND) OF CONTRACTS § 202(5) (1979).

162. See, e.g., *Frigalimint Importing Co.*, 190 F. Supp. at 117.

163. HENRY M. HART, JR. & ALBERT M. SACKS, *THE LEGAL PROCESS: BASIC PROBLEMS IN THE MAKING AND APPLICATION OF LAW* 1190 (William N. Eskridge, Jr. & Phillip P. Frickey eds., 1994).

The dictionary is a starting point, not an end point, in the court's search for what a word or phrase means. Evidence of trade usage, usage within a particular region, usage among speakers of a particular dialect, etc. allows parties to supplement dictionary definitions and the judge's understanding of common usage with evidence of other particular public usages of a term among particular groups, specifically groups to which one or more of the parties belong.<sup>164</sup>

For example, the common usage of the term "hacker" among computer programmers is "an expert at programming and solving problems with a computer."<sup>165</sup> The common usage of the term "hacker" outside of this subgroup of computer programmers, however, is a person who uses a computer to gain unauthorized access to data.<sup>166</sup> It is impossible for a court to determine which meaning is appropriate for a given contract unless the court is a) aware of both usages of the term, and b) can determine whether the contract is properly situated within the particular subgroup of computer programmers or is properly situated within the subgroup of non-computer programmers.

To solve the first problem, parties must be able to submit evidence of common usages of the term. For example, an English dictionary lists both of the above definitions. But what if an American-English dictionary only listed the second

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164. In response to this notion that meaning derives from the common usage of a terms as employed by a group (as opposed to the intent of the parties), one might ask: why can't the parties be considered a "group" with its own conventions of usage?

First, parties enter into contracts, not just to communicate with each other, but to communicate with a third-party arbiter should a dispute between the parties arise. For this reason, as discussed in Part IV.2, it would be irrational for parties to use language in an idiosyncratic way, such as attempting to create a private language and then drafting a contract in that private language.

Second, for language to communicate, there must be public and shared conventions of usage. Without such an outside point of reference, it is impossible to give meaning to the language they hear or read. Ricks, *supra* note 146, at 785 (citing WITGENSTEIN, *supra* note 152, ¶ 258).

Where two parties have a dispute over the proper usage of a term, there is no way to decide between the two parties' positions without some reference to an outside independent standard of usage. Without some independent "criterion for correctness," there is no basis for preferring one party's usage over another's.

165. *Hacker Definition*, MERRIAM-WEBSTER.COM, <http://www.merriam-webster.com/dictionary/hacker> (last visited Sept. 28, 2012).

166. *See id.*

meaning and the parties are both companies in the computer programming industry? In order to educate the judge regarding the additional common convention for usage, each of the parties should be allowed to submit evidence of a public usage outside the definition set forth in the dictionary. This is where extrinsic evidence of usage, such as trade usage, comes in.

Once the judge establishes the range of public usages, the judge can then determine which public usage is appropriate to the particular contract in question. Often, this is quite easy within the four corners of the contract itself. If a computer programming company enters into a contract with a temp agency that specializes in computer programmers, it is clear that the appropriate custom of usage is that common to computer programmers. The definition of “hacker” as “a person who uses a computer to gain unauthorized access to data” would not be a public usage among computer programmers and thus would not be the basis for that term’s meaning.

This example raises an important issue that would require courts to expand evidence of public usage to include evidence that a party belongs to a particular group that employs the particular usage when the contract itself does not suggest the appropriate usage group. Using the above example, a party relying upon trade usage to define a term would have to show not just that an alternative public usage exists, but also that the party is part of a group that employs the particular trade usage. For the extrinsic evidence of usage to be relevant, the party would have to show that the particular usage purported is a common usage in the group to which that party belongs. It would make little sense for a court to consider extrinsic evidence of what a word means in British English if neither party is British or resides in Britain. Such biographical information regarding the parties is not evidence of the parties’ intent, but instead is evidence that the usage purported by a party is relevant.

## 2. *Course of Dealing and Course of Performance*

Unlike evidence of public meaning, which is grounded in the very conventions that give words their ability to communicate meaning, evidence of parties’ prior conduct is very difficult to associate with a limited range of meanings or

intentions. As discussed below, any particular act or series of actions is very frequently compatible with numerous contradictory purported intentions on the part of the actor. The meaning of a phrase that parties agree to be bound by, put into writing, and sign their names to, can be bounded in a way that the meaning underlying a party's actions cannot.

*i. Course of Dealing and Course of Performance Are Not Determinative of Meaning*

Evidence of the parties' course of performance and course of dealing is problematic, not only because it is evidence of subjective intent, which cannot be what gives words their meaning when people communicate, but also because such evidence is frequently compatible with multiple subjective intentions. Courts that rely upon such evidence look at parties' course of dealing and course of performance in order to determine what the parties intended, and by this determination of what the parties intended, such courts define what the contract means.

But a party's actions in performing a contract are often compatible with numerous contradictory intentions, and thus cannot provide a basis for meaning. Take the following simplified example: If I order halibut, but the waiter instead returns with beef, and neither I nor the waiter object, and then I pay the amount listed next to the word "halibut" (or the amount next to the word "beef" for that matter), it is by no means clear that the waiter and I meant or understood the terms "halibut" and/or "beef" in the same way. I could have simply had in mind that by uttering the word "halibut" I would receive something to eat, or I could have understood that I would receive a dark sanguineous meat as opposed to a white flaky meat—and so also for the waiter's understanding. This same transaction could happen a dozen times in exactly the same way, and there still would be no way of knowing what exactly either of us meant or understood.

But let us say that the thirteenth time I order halibut, and the waiter returns with the same dark sanguineous meat as the last twelve times, I object and say "this is not halibut, this is beef and I will not pay for it." On what basis could I say that I am right or I am wrong other than by virtue of conventions of public meaning outside of the course of dealing between me and the waiter? As described above, there is no

way to tell what I meant each of the twelve previous times I ordered halibut, or even that I meant to distinguish between light flaky meat and a dark sanguineous meat each time I ordered. Nor is there any way to tell what the waiter understood me to mean. The only way to make such a judgment is by reference to some outside standard of public meaning, which cannot be logically derived from the parties' course of dealing. As discussed above, one cannot assume that the waiter and I have merely swapped the general usage of the term "halibut" with the general usage of the term "beef" since our conduct is consistent with numerous other intentions.

One might think "well this is silly, clearly you meant 'beef' when you said 'halibut.' Sure, it is *possible* that you meant 'something to eat,' but that certainly is not what any reasonable observer would possibly think you meant." The problem with this criticism is that one's intuition that I must have simply meant "beef" when I said "halibut" is itself based upon common conventions of usage. In this case, the convention is: "when one orders from a menu one is asking for a particular thing, not just something to eat." This is not something that is baked into the word "halibut" but is something that is imported into the word based upon conventions of use. One cannot save the notion that meaning is grounded in the intent of the speaker (or the hearer) without reference to public customs and conventions for how words are used.

*ii. Course of Dealing, Course of Performance, and Accidental Terms*

When parties enter into a contract, they agree to be bound by the terms set forth in the contract. But when parties act a certain way, either over the course of several contracts or in the course of performing a single contract, parties are not necessarily intending to create the terms of the contract to which they agreed to be bound. For example, say I enter into a contract with a tenant that calls for \$1000 rent at the beginning of each month. But say that for eight months, those payments are made anywhere from the first of the month through the fourteenth of the month. In such a case, under the context rule, evidence of the parties' course of performance could be used to show that what the parties

really meant, and therefore what the contract means, is that payments could be made up to two weeks into the month.

This is problematic because, as discussed above, the fact that the payments were up to two weeks late and nobody objected is consistent with multiple intentions regarding the language of the contract. I might accept these payments, which I consider late, not because I in fact intended the contract to mean that payment must be made within two weeks of the first of every month, but merely because I do not yet wish to go to the trouble of litigating the issue. I might also merely be cutting the other party slack because I understand that they are in financial difficulty, but have no intention of waiving my right to declare a breach at any point (a right I have always maintained I have).

If the court entertains evidence of my accepting late payments (course of performance) as an objective manifestation of my intent, the court is very possibly reading an intent that I never in fact had into the meaning of the language of the contract. If evidence of course of performance is admissible in the first instance to determine the meaning of a contract, and if I am not careful, I could end up inadvertently altering the meaning that courts will assign to the contract.

Not only does this seem to undermine the very endeavor that courts claim to be pursuing—discerning the intent of the parties—but it can also lead to increased transaction costs as parties are forced to carefully monitor their conduct so as not to create extrinsic evidence that will be used to give contracts meaning that the acting party may never have intended.

As discussed below, there is certainly a place for evidence of the parties' course of performance and course of dealing, but there is not a place for that in the interpretation of what the parties' contract means. Rather, there are circumstances where our legal system privileges notions of fairness over what contracts actually say. And it is in those types of cases that evidence of the parties' course of performance and course of dealing should be admitted.

By tying meaning to public conventions of usage, rather than some notion of absolute meaning, the proposal in this Article takes the notion of plain meaning off its platonic pedestal and puts it back into the earthly realm of convention. Many of the problems with formalist concepts

such as plain meaning stem from the fact that those formalist concepts claim to be describing some objective underlying reality, when in fact, they are vehicles for incorporating conventions. Those conventions may have within them notions that, upon reflection, appear to be unjust or unfair. Examples of this include the concerns raised by Professor Solan and the discussion above regarding consumer contracts of adhesion.<sup>167</sup> But a view of contract meaning that treats meaning not as absolute but as conventional, will allow courts to more readily put conventions regarding meaning aside and focus on equity where our moral intuitions call for it. Or at least, the proposal in this Article will force courts to make a choice between the ideals of predictability and fairness explicit.

*iii. An Alternative Explanation for the Intuitive Appeal of Course of Dealing and Course of Performance*

There is something intuitively appealing about evidence of what the parties have done in prior agreements and how they have carried out the contract over which they currently have a dispute. One explanation for this intuitive appeal is that such evidence reflects what the parties actually meant by the words of their contract, as compared to what they merely said or wrote. Actions speak louder than words. But as discussed above, there are numerous situations where parties' course of dealing or course of performance may not reflect their intent regarding what their contract means.

I suspect, rather, that the intuitive appeal of such extrinsic evidence is bound up with commonly held notions of fairness, more particularly embodied in equitable concepts such as detrimental reliance. The application of such concepts has little to do with enforcing the commercial expectations of the parties based upon the words they put into writing, and thus has little to do with making the law of contracts more predictable. Rather, such equitable concepts are intuitively appealing because we as a society are willing to give up a certain degree of certainty that our contract will be enforced as written in return for a degree of fairness. For example, parties who lead others to believe that there will be

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167. Solan, *supra* note 51, at 90, 106–14.

no consequences for a breach should not be allowed to claim a breach and collect damages, regardless of what the contract says.

Indeed, many jurisdictions explicitly look to course of performance as evidence supporting a claim for estoppel or waiver, as opposed to evidence of what contract terms mean. This use of course of performance evidence in support of a defense *against* the terms of a contract illustrates the point that course of performance and course of dealing are intuitively appealing as a basis for disregarding a contract, not for interpreting it. As the court in *PC Com, Inc. v. Proteon, Inc.* explained, “parties can generally *change* a contract by a modifying agreement, by a course of performance, or by estoppel.”<sup>168</sup> Here, the court all but makes explicit the notion that course of performance is not evidence of what the parties’ contract means, but is evidence that the court should *disregard* the contract’s meaning on equitable grounds.<sup>169</sup> The court also addresses the doctrine of waiver by course of performance, which is an even more explicit use of course of performance to nullify a contractual provision on equitable grounds.<sup>170</sup> Waiver, by definition, is a claim that a party has *abandoned* a contractual right.<sup>171</sup> A waiver defense asserts that evidence of course of performance should be used to directly contradict the language of the contract, not to interpret it.<sup>172</sup>

Similar equitable notions also explain the intuitive appeal of other forms of extrinsic evidence typically associated with the intent of the parties, such as evidence of a prior or collateral agreement. As discussed above, Professor Solan gives the example of a particular kind of promissory note transaction where one company convinces another to sign a promissory note for outstanding amounts due, payable on demand, but orally promises not to execute for a particular

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168. *PC Com, Inc. v. Proteon, Inc.*, 946 F. Supp. 1125, 1130 (S.D.N.Y. 1996) (emphasis added) (citation omitted).

169. *See id.*

170. *Id.* at 1133.

171. BLACK’S LAW DICTIONARY 1717 (9th ed. 2009).

172. *See, e.g., Cent. Ill. Pub. Serv. Co. v. Atlas Minerals, Inc.*, 965 F. Supp. 1162, 1175 (C.D. Ill. 1997) (“As far as the termination date is concerned, the contract was neither ambiguous nor incomplete. Thus, course of performance is only relevant to the extent it is evidence of a waiver.” (citation omitted)), *aff’d*, 146 F.3d 448 (7th Cir. 1998).

period of time.<sup>173</sup> Professor Solan notes that under a strict plain meaning rule, the prior oral promise is not enforceable.<sup>174</sup> But again, this has little to do with what the terms of a promissory note “payable upon demand” mean. Common English usage is not equivocal that such language means that the creditor can foreclose the debt any time she chooses. The extrinsic evidence of a prior agreement has nothing to do with what the parties’ contract means but instead has everything to do with fairness. It would be unfair to allow a party to induce another to sign an agreement based upon a promise and then renege on that promise.

*B. Why the Public Meaning Rule Better Reflects the Purpose of Contracts*

People use language for a multitude of reasons. They use language to state facts and inform (“You have a stain on your shirt.”). They use language to perform actions (“I declare war.” “The meeting is adjourned.” “I offer. . . . I accept.”). They use metaphors to convey subtle abstract notions (“Juliet is the sun.”<sup>175</sup> “Now is the winter of our discontent.”<sup>176</sup>).

Why do people use language to enter into contracts? While there may be numerous ancillary reasons, the primary purpose of a contract is to control a future state of affairs by invoking the coercive power of the state. Put another way, people enter into contracts to ensure that other people will do particular things at or by a particular time. The explanation for why this must be so has to do with the role that promises backed by coercive force play in coordinating human activity.

Take, for example, the project of building a home. Now it is theoretically *possible* for me to build a structure without relying upon promises backed by coercive force. I could go to a Home Depot and buy the lumber, nails, drywall, plumbing materials, electrical materials, etc., paying cash on the spot (for purposes of this example, I will even allow an instant exchange of money for stuff not to count as a contract). I could then buy the required excavating machines and go about building the structure all by myself. This would presuppose a vast amount of construction experience, which I

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173. Solan, *supra* note 51, at 112–13.

174. *Id.* at 113.

175. WILLIAM SHAKESPEARE, *ROMEO AND JULIET* act 2, sc. 2.

176. WILLIAM SHAKESPEARE, *RICHARD III* act 1, sc.1.

would have somehow obtained without any promise to pay for it. The house I could so construct would certainly be a meager affair, and even this meager affair would rely upon a background of contractual interactions that allow for storefronts such as a Home Depot to exist in the first place.

But compare this to what I can do with access to a mechanism for guarantying (or at least making it very likely) that others will perform some of these tasks for me at a certain time. I could ensure that materials will be delivered to the construction site at or by a particular date so they will not be exposed to the elements, or at the very least, so I would not have to make constant trips to a building supply store. I can have teams of individuals perform coordinated tasks simultaneously, motivated by my legally enforceable promise to pay them. Each of these individuals could be a specialist in a particular or field of construction, such as a plumber, an electrician, or a roofer—each of whom could perform greater and more complicated tasks than a generalist ever could. Thus, through the power of contracts, I could build a mansion rather than the shack discussed above. All of this is based upon my ability to enter into an agreement backed by the coercive power of the state, which will predictably influence the actions of others.<sup>177</sup>

Without contracts backed by the coercive power of the state, or some other method of predictably controlling the future actions of another, coordinated human activity is impossible. Thus, the purpose of contracts—their *raison d'être*—is at a minimum the ability to control another party's future activities, and thereby control a future state of affairs. People might use the form of a contract for other purposes, but such other purposes are not the primary purpose that contracts serve in society.

The role that contracts play in society is a contextual fact that governs the meaning of the language of a contract, and that militates against the interpretation of contracts in

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177. Of course, contracts are not the only kinds of promises backed by coercive force. I could take out a high interest loan from a well-organized family business that might be backed by other types of coercive force involving the future application of a baseball bat to my kneecaps. Even social pressures may act as a form of coercive force. The moral notion that lying or reneging on one's promises is wrong is another type of coercive force attended with consequences ranging from social ostracization to my inability to enter into such agreements in the future.

idiosyncratic ways, i.e., based upon the subjective understanding of a party. A contract is not merely a communication between the parties since it must, at the end of the day, be capable of being implemented by a court. It is a fair assumption that the parties to contracts know this; that their audience—the parties to whom they are communicating—must ultimately include the court if a contract is to serve its function. This fact rules out the idiosyncratic use of language by a rational party. It would be irrational to use a word or phrase in a non-standard, private way. A rational party will not knowingly say one thing and mean another because a court will have much more direct access to public and shared conventions regarding the meaning of what was said or written, as opposed to what the speaker or writer subjectively meant. A rational party will not jest in a contract given the risk that the court will not get the joke. This presumption makes the possibility that parties will use words or phrases in idiosyncratic or novel ways far less of a concern.

The purpose that contracts serve—creating a predictable future state of affairs—is an essential part of the context by which the language in a contract must be interpreted. The notion that the words in a contract cannot be understood outside of the context of all the extrinsic evidence is highly questionable given the reasons that parties enter into contracts in the first place. Parties to contracts are attempting to reduce their agreement to writing in a manner that can be effectively implemented by a court, and parties will therefore write their contracts so as to achieve that goal. More importantly, as discussed above, if courts look to sources of meaning that are not public and shared, and/or not within the parties' control, courts undermine this critical ability to utilize contracts to predictably constrain another party's behavior, and undermine society's ability to engage in coordinated activity generally. When courts interpret contract language outside of the public, shared, and conventional usage of language, they unmoor language from the very shared conventions that make communication possible, and thereby make it impossible for parties to rely upon those shared conventions to predictably bind each other's behavior. As discussed above, parties have far less control over the kinds of extrinsic evidence that courts look to

in order to determine the parties' subjective intent.

C. *The Public Meaning Rule and Procedural Legitimacy*

The rules governing the admissibility of extrinsic evidence, as with the rules governing contract interpretation generally, should be judged not only by the extent to which they foster predictability and fairness, but also to the extent they foster a sense of legitimacy among those subject to such rules. While it is certainly true that a system of rules that fosters predictability and fair outcomes is more likely to be seen as legitimate, there is something to be said about whether a system of contract interpretation itself appears logical and reasonable rather than strained and legalistic. The perceived reasonableness of the process itself matters, not just the outcomes.

As Professors Schwartz and Scott have argued, how contracting parties expect the court to interpret their contracts matters. "[T]he issue is not what interpretive style is best calculated to yield the correct answer. Rather, the issue is what interpretive style would typical parties want courts to use when attempting to find the correct answer."<sup>178</sup> Schwartz and Scott argue that business parties will prefer judicial interpretations based upon the text of the contract alone because the costs of drafting and litigating such contracts will be lower, even if a textualist interpretive scheme is less effective at determining the intent of the parties.<sup>179</sup>

But it is not just the cost of litigation that drives parties to prefer the language they have chosen. Parties are likely to prefer the language they have chosen *because* they have chosen it (as opposed to extrinsic evidence of the parties' words or acts, which the parties have not chosen to be part of their contract). Rules of a game seem inherently fairer when those rules are agreed to by the players rather than imposed by the arbiter after the fact.<sup>180</sup> As discussed in Part IV.A.2.ii,

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178. Schwartz & Scott, *Contract Theory*, *supra* note 1, at 569.

179. Alan Schwartz & Robert E. Scott, *Contract Interpretation Redux*, 119 YALE L.J. 926, 930 (2010) [hereinafter Schwartz & Scott, *Interpretation Redux*].

180. This point is illustrated by the court's reasoning in *Hunt Foods*, discussed above. See *supra* Part IV.A.1. In that case, the court's search for the parties' subjective intent ignored the parties' explicit and intentional decision to put the option to purchase in writing *without condition*. The parties in *Hunt*

parties do not choose their course of performance or their course of dealing in the same way that they choose the language of their contracts. Choosing the language of a contract is an explicit choice regarding the thing that will be used to decide a future dispute. A party's actions outside of the contract do not necessarily represent decisions about how a potential dispute ought to be resolved. The written terms of a negotiated contract<sup>181</sup> are far less likely to be accidental than terms implied through conduct, which as discussed in Part IV, is very frequently compatible with multiple intentions.

Furthermore, when courts apply canons of interpretation or rules for the consideration of extrinsic evidence that lead to interpretations that greatly diverge from common sense and typical experience, courts lose their legitimacy as reasoned arbiters. Aside from the purely consequentialist arguments in this Article, the public meaning rule is better tied to contracting parties' legitimate expectations of both how courts will view their contracts and how they will determine what the words in the contract mean. Restricting parties to evidence of public usage bounds the interpretation of words to those meanings that words in fact have borne, and prevents courts from considering and applying extrinsic evidence that would give words purely idiosyncratic meanings.

#### *D. The Public Meaning Rule and Other Problems: Fairness and Ambiguity*

##### *1. Evidence of Intent and Equitable Claims and Defenses*

This Article posits that courts should *only* consider extrinsic evidence of public conventions of usage, *not* extrinsic

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*Foods* did not accidentally exclude the condition at issue. Rather, they each knowingly agreed to be bound by an option contract that did not contain a condition on the exercise of the option. Thus courts applying the context rule often ignore or at least undervalue the most relevant evidence of what exactly the parties agreed to be bound by—i.e., the language that the parties have chosen to include in (and chosen to exclude from) their written contract.

181. Again, this concept of a contract as rules for dispute resolution which the parties have agreed to does not apply well, if at all, to consumer contracts of adhesion, where it is questionable whether the consumer can be said to have chosen the terms at all. This is yet another reason for limiting the public meaning rule to negotiated contracts.

evidence of subjective intent, when determining the meaning of terms within a contract. However, courts *should* consider other types of extrinsic evidence when considering equitable claims and defenses. In these situations, extrinsic evidence of what we would normally consider the parties' intent may be highly relevant to such considerations of fairness. But courts should be clear that what they are doing in such cases is determining what would be a fair resolution of the parties' dispute based upon various notions of equity—not enforcing the parties contract. In such cases, courts are *not* determining what the language in a contract means, and by allowing such equitable defenses, our legal system trades some predictability for fairness.

As discussed above, contracts give a party the private right to constrain both her and another's behavior.<sup>182</sup> It is this ability to constrain another's behavior that makes contracts a useful tool for creating predictability. You and I agree that if I do X, you will do Y. We set that agreement down in writing using terms that a third party will be able to understand and enforce. When a court decides what is *fair* as opposed to what the words of the contract mean, the courts are no longer enforcing the constraints the parties agreed to, and the predictability creating function of the contract is undermined. Parties also have far less access to where, when, and how courts will apply principles of fairness in determining how a contract ought to be enforced or not. One need only briefly consult the formulations of such equitable doctrines to see that such doctrines undermine predictability. For example, a defense based upon unconscionability is available essentially where contract terms are “really unfair.”<sup>183</sup>

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182. See *supra* Part IV.B.

183. See *Zuver v. Airtouch Commc'ns, Inc.*, 103 P.3d 753, 759 (Wash. 2004) (en banc) (“‘Shocking to the conscience’, ‘monstrously harsh’, and ‘exceedingly calloused’ are terms sometimes used to define substantive unconscionability.” (quoting *Nelson v. McGoldrick*, 896 P.2d 1258, 1262 (Wash. 1995) (en banc))); *Vasquez-Lopez v. Beneficial Or., Inc.*, 152 P.3d 940, 948 (Or. Ct. App. 2007) (“The primary focus . . . appears to be relatively clear: substantial disparity in bargaining power, combined with terms that are unreasonably favorable to the party with the greater power may result in a contract or contractual provision being unconscionable. Unconscionability may involve deception, compulsion, or lack of genuine consent, although usually not to the extent that would justify rescission under the principles applicable to that remedy. The substantive fairness of the challenged terms is always an essential issue.” (quoting *Carey v.*

This is by no means a bad thing. But it is a tradeoff between predictability and fairness that courts and jurists should recognize and make explicit. Just as formalism trades equity in the individual case for predictability from case to case, equitable claims and defenses trade some predictability from case to case for fairness in each particular case. When courts look to extrinsic evidence other than public usage, they trade predictability for fairness.

Even courts that apply a strict plain meaning rule regarding extrinsic evidence are willing to make this trade and allow parties to submit extrinsic evidence to show that no contract was formed in the first place—even where the contract appears facially unambiguous. Courts applying the plain meaning rule allow extrinsic evidence to prove defenses such as unconscionability or fraud. Even under a centuries-old formulation of the plain meaning rule, a party was allowed to escape liability by showing that she entered into the contract by fraud or mistake. As early as the 14th century, an illiterate party who placed his seal upon a document could escape liability by testifying that the document was incorrectly read to him.<sup>184</sup> By 1892, courts were applying the caveat that extrinsic evidence, while generally inadmissible, may be considered if a party alleges fraud or mistake.<sup>185</sup>

Equitable claims and defenses provide a judicial safety valve for cases where it would be simply too unfair to enforce the terms of a contract. For example, because the terms are just too one sided, because one party was tricked into the agreement, because one of the parties made an understandable error, or any of the other numerous bases for claims in equity. While this Article does not provide an argument for exactly what equitable claims and defenses the courts ought to recognize, or what the contours of those claims and defenses ought to be, the existence of equitable claims and defenses addresses one of the most frequent

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Lincoln Loan Co., 125 P.3d 814, 828 (Or. Ct. App. 2005)).

184. WIGMORE, *supra* note 64, § 2405, at 15 (“That a man who could not read had sealed a document which had been incorrectly read over to him, was recognized, before the 1400s, as sufficient to relieve him from liability.”).

185. *E.g.*, *Staver v. Rogers*, 28 P. 906, 907 (1892) (holding that extrinsic evidence is inadmissible “without an allegation in the pleadings that such contract was in fact signed by the party making such allegations by mistake or fraud, or without full knowledge of the conditions thereof.”).

criticisms of contract rules that limit extrinsic evidence—that such formalist rules produce legalistic and unfair results.

*i. Equitable Doctrines Are a Better Fit for  
Equitable/Normative Concerns*

Courts should apply equitable doctrines, rather than interpretive doctrines, to address issues of fairness not only because it is more judicially honest, but also because equitable doctrines were created and have developed for the very purpose of addressing our notions of what is fair. In contrast, the canons of contract interpretation must necessarily be concerned with other considerations, such as predictability and enforcing the constraints the parties bargained for, and are thus less effective tools for implementing our notions of fairness.

As discussed above in Part IV, evidence of a party's course of performance can be used to give a contract term meaning which that party never intended. This flies in the face of what contract interpretation is purportedly about—enforcing the deal that the parties actually made. But the equitable defense of estoppel, as compared to contract interpretation, is not concerned at all with the agreement the parties reached. Quite the opposite, estoppel (reasonable reliance) is grounds for disregarding the parties' agreement because it would be unfair to enforce it. Estoppel has as its primary element, the very thing that makes it unfair to enforce such a contract—that is reasonable reliance upon the other party's words or acts. Estoppel, in other words, is grounded in the very notions of fairness that give evidence of course of performance and course of dealing its intuitive appeal.

Similarly, equitable claims for unjust enrichment and quantum meruit are a much better fit for our intuitions of fairness than are the rules of contract interpretation. Courts have described the elements of unjust enrichment as: (1) whether the plaintiff conferred a benefit upon the defendant, (2) whether the defendant was aware of the benefit, and (3) whether it would be unjust for the defendant to retain the benefit.<sup>186</sup> Again, baked into the elements of such an

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186. *Volt Servs. Grp v. Adecco Emp't Servs. Inc.*, 35 P.3d 329, 337 (Or. Ct. App. 2001).

equitable claim are the very notions of fairness that often cause extrinsic evidence of the parties' actions to tug our sense of fairness. Rather than using extrinsic evidence as a shoehorn to make the language of a contract fit within society's sense of fairness, equitable doctrines such as unjust enrichment allow the court to simply decide what is fair based upon elements of proof that track our criteria for fairness.

*ii. Equitable Doctrines as a Back Door to Evidence of Subjective Intent?*

Does the existence of equitable claims and defenses amount to a simple back door which will effectively allow in extrinsic evidence regardless of the rigor with which the public meaning rule is enforced? There is good reason to think not. With all respect to Professor Gilmore, the equitable exceptions have not killed contracts. These equitable exceptions do not, in fact, swallow the rule. Fraud and mistake must be proven by clear and convincing evidence.<sup>187</sup> Waiver must be shown by words or conduct unequivocally evincing an intent to waive a known right.<sup>188</sup> A party claiming estoppel must prove reasonable reliance upon the words or conduct of the party.<sup>189</sup> A party claiming unconscionability must show that the terms of the contract "shock the conscience."<sup>190</sup> These are not easy standards to meet. Nor do these equitable doctrines merely raise the bar.

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187. *Vasquez-Lopez*, 152 P.3d at 955 ("[A] party asserting fraud must prove by clear and convincing evidence not only that it relied on the other party's misrepresentation, but that the reliance was reasonable under the circumstances."); *Moyer v. Ramseyer*, 359 P.2d 407, 411 (Or. 1961) ("If the contract had been entered into by mutual mistake, reformation to accommodate the true understanding of the parties might have been available."); *id.* at 412 ("[E]vidence of equities which justify such extraordinary relief as well as evidence to prove the agreement really intended must be clear and unequivocal.").

188. *See, e.g., Schmeck v. Bogatay*, 485 P.2d 1095, 1099 (Or. 1971) ("[S]ince waiver must be manifested in some unequivocal manner and requires an *intent* to relinquish a known right. In this case, on the contrary, plaintiffs' conduct was not an "unequivocal" construction of the lease to the effect claimed by defendant . . ." (citation omitted)).

189. *See Puziss v. Geddes*, 771 P.2d 1028, 1030 (Or. Ct. App. 1989) ("Detrimental reliance is a required element of estoppel." (citation omitted)).

190. *Fransmart, L.L.C. v. Freshii Dev., L.L.C.*, 768 F.Supp.2d 851, 870–71 (E.D. Va. 2011) ("The substantive terms of the contract must be so grossly inequitable that it 'shocks the conscience.'" (citation omitted)).

Rather, they change the very nature of what a party must prove.

These heightened standards within these equitable doctrines also provide a firewall against the types of extrinsic evidence that can mislead courts.<sup>191</sup> By requiring parties to prove fraud and mistake by clear and convincing evidence, these equitable defenses counterbalance the unreliability of memory and the incentive to lie with a higher threshold of evidence.

The public meaning rule proposed by this Article thus has practical consequences and is not simply a way of reconceptualizing existing rules of contract interpretation. As an example, evidence of internal communications (such as board meeting minutes) relating to what one party understands a term to mean would be admissible under the context rule, but not admissible under the proposed public meaning rule, even if a party raised an equitable defense such as estoppel or waiver.

For example, in *Denny's Restaurants, Inc. v. Security Union Title Insurance Co.*, a Washington court applying the context rule looked to an internal memorandum of one of the parties when interpreting the language of the parties' contract.<sup>192</sup> The proponent of this evidence argued that, under the context rule that had recently been adopted in Washington,<sup>193</sup> an internal memorandum may be admissible as evidence of that party's intent regarding what the terms of the contract mean.<sup>194</sup> The court agreed, holding that the memorandum was clear evidence of what the parties intended.<sup>195</sup>

Under the rule proposed in this Article, such evidence would not have been admissible, either as evidence of the

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191. See *supra* Part III.A.

192. *Denny's Rests., Inc. v. Sec. Union Title Ins. Co.*, 859 P.2d 619, 630 (Wash. Ct. App. 1993).

193. *Id.* at 623 ("In order to interpret the original meaning of a contract term, extrinsic evidence is admissible, even if the term appears unambiguous.") (citing *Berg v. Hudesman*, 801 P.2d 222, 230 (Wash. 1990)).

194. *Id.* ("Denny's argues that under *Berg*, evidence of industry practice and Security Union's own internal memoranda should be admissible to demonstrate the parties' true intent that the policy was purchased to cover questions of off-record encroachment and boundary.").

195. *Id.* at 627 ("Security Union's own internal memoranda clearly suggest that extended policies are intended to insure questions of off-record encroachment and boundary.").

parties' intent, or as evidence in support of an equitable claim such as estoppel or waiver. Because the memorandum was not communicated to the other party, it could not give rise to detrimental reliance, nor could it evince an intent to waive a known right.<sup>196</sup>

*iii. The Canons of Interpretation and Equity  
Masquerading as Interpretation*

This Article argues for a strict separation between contract interpretation and equitable/normative considerations. Courts should be clear and keep separate when they are determining what the words in a contract mean and when they are deciding what is fair between the parties. One place where equitable/normative considerations can creep into a court's contract interpretation is through the canons of contract construction.

For example, the restatement exhorts courts to give contracts "an interpretation which gives a reasonable, lawful, and effective meaning" to its terms.<sup>197</sup> As scholars have recognized, one possible explanation for this canon is that parties would not waste their time making a contract that is unlawful and invalid.<sup>198</sup> However, this explanation is incomplete at best.<sup>199</sup> As Professor Zamir notes, this canon is not a sincere attempt to affect the parties' intentions, rather it is an attempt to "'push' contracts away from the domain of unenforceability".<sup>200</sup> Likewise, the notion of reasonableness in this canon of interpretation is intimately connected with equitable notions such as "good faith, fairness, and justice."<sup>201</sup>

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196. If an internal memorandum shows that one party was in fact trying to dupe the other, it could give rise to a fraud claim, in which case the internal memorandum would be admissible. *See, e.g.,* McEvoy Travel Bureau, Inc. v. Norton Co., 563 N.E.2d 188, 193 (Mass. 1990) (explaining that the statement by a party to contract that it did not intend to enforce contractual termination provision could form basis for fraud claim, to extent that statement misrepresented actual intent of the speaker as evidenced by internal memoranda). But internal memoranda that merely suggest how one party interpreted the contract would not be admissible under the rule proposed in this article.

197. RESTATEMENT (SECOND) OF CONTRACTS § 203(a) (1979).

198. Zamir, *supra* note 1, at 1722.

199. *Id.*

200. *Id.*

201. *Id.* at 1722–23 (footnotes omitted).

Professor Zamir argues that the plain meaning rule does not reflect what courts actually do, which is look to equitable principles when deciding what contracts mean in the first instance—i.e., they manipulate the canons of construction to interpret the contract in a manner that is fair rather than in a manner that reflects the conventional meaning of the language in the contract.<sup>202</sup>

This Article, however, argues that equitable principles (such as reasonableness) should not be conflated with interpretation. As argued above, a scheme of contract interpretation that replaces the common and public meaning of language with notions of reasonableness/equity both undermines parties' expectations regarding how courts will interpret their agreements and undermines the very reason why parties enter into contracts—that is to bind each other's future behavior in a manner that is predictable and commercially useful. Furthermore, as argued in Part IV in particular, equitable doctrines are better vehicles for achieving equity than are maxims of contract interpretation.

*iv. Limiting the Proposed Rule to Negotiated Commercial Contracts*

As discussed above, rules that exclude extrinsic evidence tend to be problematic in consumer contracts of adhesion, but less so in regard to negotiated commercial contracts. Contracts that are created by a party in a position of superior sophistication and power and offered to a less sophisticated, less powerful party on a take it or leave it basis tend to favor the abuse of superior power and sophistication. In such cases, the plain meaning of the contract can become a fig leaf for self-conscious attempts to get parties to agree to terms that, if properly explained, they never would have agreed to. Indeed, Professor Zamir makes this very point in arguing for an inverted hierarchy of contract interpretation, which begins with notions of fairness at the initial phase of contract interpretation, explaining that “[i]n the case of detailed standard-form contracts, customers frequently do not bother to read most of the provisions of the form. . . .”<sup>203</sup>

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202. *Id.* at 1722.

203. *Id.* at 1771. Professor Zamir goes much further and argues that in *most* contracts parties *generally* fail to say what they mean and that a rule that looks to notions of reasonableness over the language of the contract is more likely to

The problem with consumer contracts of adhesion, however, is one of equity and not one of meaning. As such, fine print is problematic because people do not read it, not because it lacks meaning. But the dangers associated with excluding extrinsic evidence associated with fairness is so great in cases involving consumer contracts of adhesion, that it may be best to allow in all such extrinsic evidence at the outset.

Implementing this distinction between negotiated commercial contracts and other types of contracts is less problematic than it might first appear. There are already specialized bodies of law that apply to various types of contracts, such as secured transactions, negotiable instruments, and sales of goods.<sup>204</sup> In particular, Article 2 of the Uniform Commercial Code includes special provisions that apply to contracts involving merchants:

‘Merchant’ means a person that deals in goods of the kind or otherwise holds itself out by occupation as having knowledge or skill peculiar to the practices or goods involved in the transaction or to which the knowledge or skill may be attributed by the person’s employment of an agent or broker or other intermediary that holds itself out by occupation as having the knowledge or skill.<sup>205</sup>

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conform to the parties’ actual intent. (“[I]f it is true that typically there is a gap between the words of the formal contract and the actual understandings and intentions of the parties—a claim sustained by empirical findings—then the interpreter’s concentration on the formal contract may actually frustrate the goal of realizing these intentions and understandings. . . . It should be stressed that, although this conclusion is particularly applicable to standard-form contracts and consumer transactions, it is by no means restricted to these categories.”). *Id.* at 1773. The frequency with which parties fail to say what they mean, however, is not necessarily a basis for imbuing the process of contract interpretation with notions of reasonableness and fairness. First, as discussed elsewhere in this Article, the existence of equitable claims and defenses allows courts to apply notions of fairness and justice without bending the words that parties have chosen to fit that goal. And, as discussed in Part IV.D.1.i., these equitable doctrines are a better fit for our notions of fairness since these equitable doctrines were created to track commonly held notions of fairness. Second, even if only a minority of parties actually make the effort to say what they mean (which is itself a controversial proposition), the law should not disadvantage parties that do, in fact, attempt to say what they mean when concerns over equity can be dealt with separately through equitable doctrines tailor made to address such concerns.

204. *See, e.g.*, U.C.C. Arts. 2, 3, 9.

205. U.C.C. § 2-104(1) (2003).

A very similar provision could be used to determine when the rule proposed in this Article ought to be applied. Specifically, negotiated commercial contracts could be defined as “negotiated contracts between persons or entities that deal in goods or services of the kind, as either buyers or sellers.” Such a broad, abstract rule certainly has much play in its joints, but courts have managed to apply the definition of “merchant” under the U.C.C. in an intelligible way.

In fact, courts have applied the concept of contracts between merchants in a manner that is similar to that which is suggested in this Article. In *K & M Joint Venture v. Smith International, Inc.*, the court applied the notion of a contract between merchants to include not only parties with “specialized knowledge as to the goods” being transacted, but also parties with “specialized knowledge as to business practices” within the relevant industry.<sup>206</sup> The contract at issue in *K & M* was between a company that sold machines for boring tunnels and a joint venture that was formed for the purpose of bidding on a sewer project for the City of Cleveland.<sup>207</sup> The court noted that while the joint venture was not a merchant in the sense of one who sells the particular goods in question, “one of the joint venturers, had excavated eight tunnels using boring machines before the joint venture was formed.”<sup>208</sup> Accordingly, the court held that the joint venture should be held to the stricter standards applied to merchants under the U.C.C.<sup>209</sup>

One might argue that a less restrictive rule for extrinsic evidence regarding consumer contracts of adhesion will undermine predictability for such contracts. But for such contracts, *stare decisis* will provide the predictability that is otherwise missing under the context rule. Commercial contracts of adhesion almost always involve boiler plate language that is reused in numerous form contracts that are entered into again and again. When the same paragraph is entered into over and over again between a commercial entity and its customers, and a court renders a judgment regarding that paragraph, the court’s ruling will apply broadly to all of

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206. *K & M Joint Venture v. Smith Int’l, Inc.*, 669 F.2d 1106, 1115 (6th Cir. 1982).

207. *Id.* at 1108.

208. *Id.* at 1115.

209. *Id.*

the contracts containing that paragraph. Thus, where a court decides the effect of a form contract, even in equity, its ruling will have force in later cases involving the same language.<sup>210</sup> This simply is not possible for non-standard contracts, which differ from case to case.

## 2. *Conflicting Usage and Ambiguity*

As explained above, the rule proposed in this Article would allow extrinsic evidence where there are two or more common usages of a term. This extrinsic evidence would be limited to biographical evidence submitted by each party to show that the common usage it propounds is relevant to the parties, e.g., evidence that a term has a particular usage among computer programmers and evidence that the party propounding that usage is a computer programmer. In fact, courts may be able to determine the relevant usage from biographical information within the contract itself, such as the fact that the parties are computer programmers.

But there will be cases where courts cannot determine a single relevant usage based upon the text of the contract and evidence of how the words of the text are properly used in language.

Such ambiguity can arise in at least two ways. First, the parties may have no relevant public usages in common. Second, a term may have two conflicting public usages, each of which is relevant to both of the parties. In the first case, parties would be limited to equitable remedies under the rule proposed in this Article since there would be no way to assign a single meaning to the contract. In the second case, the court would have to look to extrinsic evidence of the activity the parties were engaged in at the time of contracting to determine which of multiple relevant public usages applies.

### *i. Irreconcilable Conflicting Usages*

There will be cases where there is no common usage applicable to both contracting parties. In such a case, the language of the contract is irreconcilably ambiguous and cannot be assigned a single meaning, much as if the parties

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210. See Michael Klausner, *The Contractarian Theory of Corporate Law: A Generation Later*, 31 J. CORP. L. 779, 793 (2006) (“As a legal rule or charter term is interpreted and applied in a variety of settings, however, the term acquires more content, and uncertainty regarding its application declines.”).

agreed to a word that has one meaning in German and one meaning in English, and neither party spoke the other's language. Both parties are right in the sense that both have properly used the language. But the parties literally did not say the same thing.

A good example of this would be in contracts between speakers of the same language but from different countries where the same word has two different common usages. For example, if an American company enters into a contract with a British company to purchase 100 beakers, the American company will almost certainly expect to get 100 flat-bottomed vessels with a lip commonly used as a laboratory container,<sup>211</sup> while the British company will likely provide the American company with 100 handle-less drinking cups.<sup>212</sup> In such a case, the term "beaker" as used in this example has no single meaning applicable to both of the parties and the contract is irreconcilably ambiguous.

As explained above, courts ought to (and often do) settle such cases based upon equitable notions, such as whether one party had reason to know the common usage employed by the other. Even if neither party has such reason to know, courts should (and often do) apply remedies to equitably distribute the burden of the ambiguity.

The famous case *Raffles v. Wichelhaus* typifies yet another form of ambiguity that courts need to address.<sup>213</sup> In this case, two parties entered into a contract for the sale of cotton arriving by ship from India.<sup>214</sup> According to the contract, the cotton was to be delivered by the ship "Peerless," however two ships of that name sailed from Bombay roughly one month apart.<sup>215</sup> The seller and the promised cotton were aboard the second "Peerless" and after the first ship arrived without the promised cotton, the buyer filed for breach of contract.<sup>216</sup>

While the majority ruled that the existence of two ships named "Peerless" was not a defense to liability, courts have

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211. WEBSTER'S THIRD NEW INTERNATIONAL DICTIONARY 190 (Philip Babcock Gove et al. eds., Merriam-Webster, Inc. 1993).

212. THE OXFORD ENGLISH DICTIONARY 726 (James A.H. Murray et al., eds., Oxford University Press 1933).

213. *Raffles v. Wichelhaus* (1864) 159 Eng. Rep. 375.

214. *Id.*

215. *Id.*

216. *Id.*

subsequently adopted the dissent's view that a party may present extrinsic evidence of a latent ambiguity to show that the parties differed in their understanding of the contract.<sup>217</sup>

The *Raffles* case and others like it, however, are better understood as mutual mistakes of fact rather than true ambiguity. Such supposed "latent ambiguity" cases involve terms that unambiguously indicate that the world is one way, when in fact the world is another way. In the *Raffles* case, the parties' contract indicated that there would be one ship named "Peerless" sailing from Bombay, when in fact, there were two.<sup>218</sup> In this way, the notion of latent ambiguity is really a mutual mistake of fact by the parties.

The court's role in such a case is to determine a fair resolution, not to determine what the word "Peerless" means. In such a case, the court cannot determine who ought to suffer the consequences of the parties' mistake based upon the meaning of the language within the contract, but the court still has to pick a winner and a loser, or at least divide the costs associated with the parties' mistake. A ruling that the parties failed to reach an agreement and, that the contract is therefore not enforceable, merely declares that the parties' contractual duties of performance are excused by default.

*ii. Multiple Relevant Usages*

In other cases, there may be two or more meanings relevant to *both* parties. In such cases, the court should admit further evidence regarding the activity the parties were engaged in when they drafted the contract. This is not evidence of the public and conventional meaning of language, but neither is it evidence of the parties' intent.

This concept is demonstrated by the following hypothetical. Imagine that two parties enter into a written contract where "Party A agrees to deliver the bag marked X to the bank in return for \$10." Both of these parties speak English where the word "bank" can be used to mean "a place

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217. *Id.* ("There is nothing on the face of the contract to show that any particular ship called the 'Peerless' was meant; but the moment it appears that two ships called the Peerless were about to sail from Bombay there is a latent ambiguity, and parol evidence may be given for the purpose of showing that the defendant meant one 'Peerless' and the plaintiff another.")

218. *Id.*

where money is stored” or “the side of a river.” Based upon the language of the contract alone, this contract could call for Party A to deliver the bag to a place that stores money, or to the side of a river. Extrinsic evidence of the activity the parties were engaged in, such as evidence that the bag was obviously full of money (as opposed to say fishing tackle) would be necessary to resolve the ambiguity. Such evidence is not evidence of intent, nor is it evidence of the possible relevant usages of the text of the contract.

This resort to such extrinsic evidence to resolve such an ambiguity is no different from what courts do under both the plain meaning rule and the context rule, where the full range of extrinsic evidence is relevant to resolve a facial ambiguity, so long as it does not contradict the language of a contract. Translated into the language of the public meaning rule, even in the case of an ambiguity, such extrinsic evidence could not be used to support a usage that is not relevant to either party. In the above example, the parties could not submit extrinsic evidence that they understood the word “bank” to mean a restaurant if there is no evidence that either party belongs to a language group that uses the word “bank” in that way.

#### SUMMARY, CONCLUSION, AND AREAS FOR FURTHER SCHOLARSHIP

Both the plain meaning rule and the context rule are problematic, albeit in different ways.

The observations in this Article regarding the problems with both the plain meaning and the context rule suggest a new rule for when and what kinds of extrinsic evidence courts ought to consider. Courts should admit extrinsic evidence regarding how a term is publically and conventionally used in language, but exclude extrinsic evidence of the parties’ subjective intent, when determining what the terms in a contract mean. Evidence typically associated with the parties’ intent may be relevant to various equitable defenses and equitable claims. But here, courts are not interpreting the contract, they are doing equity. Courts should make this attendant tradeoff between predictability and fairness explicit.

As discussed above, parties enter into contracts in order to predictably control other parties’ behavior—i.e., to ensure that another party will perform (or not perform) a certain act

at a certain time. This ability to control, or at least predictably influence, another party's behavior is what makes a contract a useful tool for coordinating human activity. When courts fail to interpret a contract in a manner consistent with the public and conventional meaning of words and phrases, courts undermine this crucial ability to predictably influence another party's behavior, and thus undermine an essential purpose that contracts serve.

While this Article has focused primarily upon the categories of extrinsic evidence that courts should or should not consider, it also reflects a broader rehabilitation of formalist conventions within the law of contracts. This Article is a microcosm of the larger notion that while formal legal doctrines may not constitute absolute objective truths, the law cannot operate without shared and commonly obeyed formal doctrines that give the law structure and foster predictability. Our particular legal conventions may be historically contingent, but a system of laws cannot operate without a coherent system of publically shared conventions, even if they are cobbled together through trial and error. Formal rules, in both contract law and in communication, are necessary for either endeavor to succeed.<sup>219</sup>

As any second year law student will attest, strict formalism is dead. Law schools no longer teach the law as a series of objectively true legal principles that can be deduced from the case law and then applied mechanically to any particular set of facts to arrive at the proper result. That war is over and the legal realists have won. This is particularly true for the law of contracts where the notion that words in a contract can have an absolute and objective plain meaning has been thoroughly debunked.<sup>220</sup>

But even in this demystified world that the legal realists have made, the bones of legal formalism still stand as the structure upon which the law clings and grows. The various fact-intensive and fuzzy equitable doctrines that choked the life from the formalist enterprises of Langdell and Williston are still applied within a framework of formalist concepts. It

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219. See Scott, *supra* note 50, at 851 n.11 (“[T]he ‘new formalism’ rejects the categorical imperative to deduce rules from first principles that characterized classical formalism as practiced by the late-19th-century Langdellians.”).

220. See Ricks, *supra* note 146, at 768 (“The fashion in American law schools is to teach that contract language cannot have a plain meaning.”).

is impossible to discuss the law of contracts without such formalist concepts as offer, acceptance, and consideration, and these formal doctrines are still applied alongside their equitable counterparts. These formalist concepts are not true in some platonic sense. But whether or not “Contract, like God, is dead,”<sup>221</sup> we all continue to quote its formalist scripture. Courts continue to invoke the preexisting duty rule and the doctrine of illusory promises, even as they recognize claims for unjust enrichment and promissory estoppel.

Simply because we realize that our legal rules are conventions rather than absolute truths does not mean that we should, or even can, discard them completely. Our common law and the society it serves needs these formalist conventions in order to function lest the jurisprudence of commercial exchange collapse into an unpredictable tangle of pure equity. The rule of law entails the existence of laws and rules for their application. To rid the law of all its formality would reduce our legal system to unstructured pleas at the foot of a monarch—whose notions of justice and fairness might change from case to case. Laws, by definition, are meant to apply to a range of factual situations across time. Inevitably, rules have Procrustean consequences. But the stretching and chopping of facts to fit within a finite number of legal principles is a necessary sacrifice if our legal system is to have any uniformity and predictability and if we at all care about the notion of consistent treatment before the law.

People need conventions in order to communicate, regardless of whether those conventions reflect some sort of absolute meaning, or merely an implicit and reflexive agreement within a society to use language in a certain way. Contract interpretation is simply a special case of this same principle. We cannot do away with formalist conventions, such as rules limiting extrinsic evidence, without reducing the law of contracts to pure questions of equity, the outcomes of which are difficult to predict, and therefore, not conducive to stable commerce. The way courts go about interpreting contracts should reflect this need for conventions while at the same time recognizing that such conventions are not

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221. GRANT GILMORE, *THE DEATH OF CONTRACT* 1 (Ronald K.L. Collins ed., Ohio State University Press 1995) (1974).

necessarily true in an absolute sense. Shared conventions of one sort or another are required for language to have meaning, for commerce to occur, and for the law of contracts to function.

While this Article provides a framework for the types of extrinsic evidence that courts ought to consider when interpreting a facially unambiguous contract, and then goes through several examples, it does not provide an exhaustive analysis of exactly what sorts of extrinsic evidence constitute evidence of the conventional and public use of words and phrases as opposed to extrinsic evidence of the parties' subjective intent. While this Article argues that the line between interpretation and equity should be clearly drawn, it does not propose an argument for exactly where that line should fall. In future articles, I intend to provide an exhaustive analysis of where various other particular kinds of extrinsic evidence would fall under the public meaning rule. In addition, I intend to argue for where exactly the line between interpretation and equity should be drawn, in particular, by critically assessing the elements of the various equitable claims and defenses in light of the particular notions of fairness that animate them.