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The Contract Interpretation Policy Debate: A Primer

Joshua M. Silverstein
University of Arkansas at Little Rock William H. Bowen School of Law, jmsilverstei@ualr.edu

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Abstract

Contract interpretation is one of the most significant areas of commercial law. As a result, there is an extensive academic and judicial debate over the optimal method for construing agreements. Throughout this exchange, scholars and courts have advanced a wide array of conceptual, theoretical, and empirical arguments in support of the two primary schools of interpretation—textualism and contextualism—as well as various hybrid positions. This Essay is intended to serve as a primer on those arguments.

* Professor of Law, University of Arkansas at Little Rock, William H. Bowen School of Law. B.A., *summa cum laude*, 1993, Hamilton College. J.D., *magna cum laude*, 1996, New York University School of Law. Completion of this article was made possible by a grant from the University of Arkansas at Little Rock, William H. Bowen School of Law.

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I. Introduction

Contract interpretation is one of the most important topics in commercial law. It lies at the center of contract doctrine, which contains numerous rules that regulate the construction of agreements.[1] Interpretation is the subject addressed most often by contract lawyers, whether they are litigators or transactional attorneys.[2] And interpretive disputes constitute the largest source of contract litigation.[3] In fact, contractual meaning may be the most frequently contested issue in civil cases generally.[4] The significance of contract interpretation explains why the field has received extensive academic attention since the turn of the century.[5] And the subject is now recognized as "the least settled, most contentious area of contemporary contract doctrine and scholarship."[6]

The central policy issue in the field of contract interpretation is the role of extrinsic evidence in the interpretive process.[7] Indeed, that issue is virtually the exclusive focus

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1. Benjamin E. Hermalin et al., *Contract Law*, *in* 1 HANDBOOK OF LAW & ECONOMICS 3, 68 (A. Mitchell Polinsky & Steven Shavell eds., 2007) ("The problem of contract interpretation thus provides a central backdrop for the law of contracts, which contains many rules and principles that are designed to address it."); Shawn Bayern, *Contract Meta-Interpretation*, 49 U.C. DAVIS L. REV. 1097, 1099 (2016) ("Interpretive questions are the core questions of contract law."); Melvin Aron Eisenberg, *Expression Rules in Contract Law and Problems of Offer and Acceptance*, 82 CALIF. L. REV. 1127, 1127 (1994) ("The issue of interpretation is central to contract law, because a major goal of that body of law is to facilitate the power of self-governing parties to further their shared objectives through contracting.").
2. MICHAEL H. SCHWARTZ & DENISE RIEBE, A CONTEXT AND PRACTICE CASEBOOK 463 (2009).
3. Hermalin, *supra* note 1, at 68 ("Probably the most common source of contractual disputes is differences in interpretation . . . ."); Alan Schwartz & Robert E. Scott, *Contract Interpretation Redux*, 119 YALE L.J. 926, 928 & n.3 (2010) ("[C]ontract interpretation remains the largest single source of contract litigation between business firms.") (collecting authorities). For an older source, see John D. Calamari & Joseph M. Perrillo, *A Plea for a Uniform Parol Evidence Rule and Principles of Contract Interpretation*, 42 IND. L.J. 333, 333 (1967) ("Any reader of advance sheets is well aware that most of the contract decisions reported do not involve offer and acceptance or other subjects usually explored in depth in a course in contract but rather involve the parol evidence rule and questions of interpretation . . . .").
4. *See* STEVEN J. BURTON, ELEMENTS OF CONTRACT INTERPRETATION § 1.1, at 1 (2009) ("Issues of contract interpretation are important in American law. They are probably the most frequently litigated issues on the civil side of the judicial docket.").
5. Steven J. Burton, *A Lesson on Some Limits of Economic Analysis: Schwartz and Scott on Contract Interpretation*, 88 IND. L.J. 339, 340 (2013) ("After decades of relative neglect, contract interpretation became a hot topic of scholarly debate after 2003."); *id.* at 340 n.8 (collecting authorities).
6. Ronald J. Gilson et al., *Text and Context: Contract Interpretation as Contract Design*, 100 CORNELL L. REV. 23, 25 (2014); *see* David MacLauchlan, *Contract Interpretation: What Is It About?*, 31 SYDNEY L. REV. 5, 5 (2009) ("In recent times, contract interpretation has become one of the most contentious areas of the law of contract.").
7. Hermalin et al., *supra* note 1, at 88-89 ("The key policy question underlying contract interpretation is how thorough the interpretive process should be; and this question is commonly articulated in terms of the dichotomy of form and substance."); William C. Whitford, *The Role of the Jury (and the Fact/Law Distinction) in the Interpretation of Written Contracts*, 2001 WIS. L. REV. 931, 939 ("The great issue in [parol evidence rule] scholarship, debated endlessly over the years, and with ample case law available to support all points of view, is how a court should determine whether a writing is ambiguous or incomplete."); *see also* PETER A. ALCES, A THEORY OF CONTRACT LAW: EMPIRICAL INSIGHTS AND

of the debate among judges and scholars.[8] The rules regarding extrinsic evidence can influence nearly every aspect of the parties' contractual relationship, including "with regard to decisions to breach, to take advance precautions, to mitigate damages, to gather and communicate information, to allocate risk, to make reliance investments, to behave opportunistically, and to spend resources in litigation."[9] As a result, numerous factors are relevant in deciding what constitutes the optimal interpretive regime.[10]

The adversaries in this dispute are organized into two basic camps. "Textualist" courts and commentators argue that the interpretation of contracts should focus primarily on the language contained within the four corners of written agreements. According to this view, extrinsic evidence is of secondary importance, and many contracts can and should be interpreted without such evidence. "Contextualists," by contrast, believe that courts generally ought to examine both the language of the parties' agreement and extrinsic evidence when determining contractual meaning.[11]

The contract interpretation policy debate has been fierce,[12] with some judges adopting "sky-is-falling" rhetoric when criticizing the opposition.[13] The disputants

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MORAL PSYCHOLOGY 152-53 (2011) ("The parol or extrinsic evidence tension in contract is fundamental; it concerns the very foundations of agreement . . . ."); GERARD MCMEEL, THE CONSTRUCTION OF CONTRACTS: INTERPRETATION, IMPLICATION, AND RECTIFICATION § 5.01, at 162 (2d ed. 2011) ("One of the most controversial areas in the principles governing the interpretation of contracts is the question of what materials are admissible to assist the court in carrying out the task."); *id.* at 162-65 (focusing on contract interpretation in jurisdictions outside the United States, particularly England and other common law nations); Aaron D. Goldstein, *The Public Meaning Rule: Reconciling Meaning, Intent, and Contract Interpretation*, 53 SANTA CLARA L. REV. 73, 74 (2013) ("When and what kinds of extrinsic evidence should courts admit in order to interpret the meaning of a contract? . . . [T]he answer has profound implications for whether courts achieve the goals of predictability and fairness that motivate the law of contracts.").

8. *Cf.* Avery Wiener Katz, *The Economics of Form and Substance in Contract Interpretation*, 104 COLUM. L. REV. 496, 497 (2004) ("This question—how broad and thorough should the interpretive process be?—is commonly articulated in terms of the dichotomy of form versus substance. As such, it has long been a matter of professional and academic debate, and has been widely discussed in both case law and commentary.").
9. Hermalin et al., *supra* note 1, at 90; *accord* Katz, *supra* note 8, at 524 (same); Steven D. Walt, *The State of Debate over the Incorporation Strategy in Contract Law*, 38 UNIF. COM. CODE. L.J. 255, 262 (2006) ("An interpretive and default regime . . . can affect a range of variables, including the choice of contracting partner, type of contract, the cost of performance, the decision to breach, and the cost of administering the regime's rules.").
10. Hermalin et al., *supra* note 1, at 90 ("The considerations that determine the optimal approach to contract interpretation are thus quite broad-ranging."); *see id.* at 90-91 (setting forth a list of some of the relevant considerations, including (1) the level of transaction costs, (2) how biased the parties and the court are when interpreting contracts, (3) the likelihood of an interpretive dispute, and (4) the availability of nonlegal enforcement mechanisms).
11. *See infra* Part II.
12. Juliet P. Kostritsky, *Plain Meaning vs. Broad Interpretation: How the Risk of Opportunism Defeats a Unitary Default Rule for Interpretation*, 96 KY. L.J. 43, 54 (2007) ("Scholars have fiercely debated the proper approach for courts to take in interpreting contracts."); MacLauchlan, *supra* note 6, at 5 ("There are fundamental divisions among commentators, practitioners and judges . . . as to the nature of the task and the permissible aids to interpretation.").
13. For perhaps the best example, see notes 241-244 and accompanying text below.

have advanced a wide array of conceptual, theoretical, and empirical arguments in support of textualism, contextualism, and various hybrid and compromise positions.[14] This Essay is intended to serve as a primer on those arguments. While other sources have presented useful surveys of the interpretation debate (including one of my prior articles),[15] the current piece makes three significant contributions. First, it is broader in scope than existing overviews. Second, the paper provides critical elaboration and clarification regarding many arguments presented in the case law and academic literature. And third, it is written in language that is more accessible to nonspecialist audiences.

Part II of this article summarizes the law of contract interpretation, with a focus on the legal principles that drive the policy controversy. Part III discusses the three primary issues in the debate over textualism and contextualism—namely, which approach is superior across the dimensions of (1) interpretive accuracy, (2) transaction costs, and (3) enforcement costs. Part IV addresses three other important issues that have received extensive attention from commentators: (1) which interpretive system is preferred by contracting parties; (2) hybrid approaches that fall between textualism and contextualism; and (3) whether the rules of contract interpretation should be default rules—i.e., whether contracting parties should be permitted to choose the legal principles that govern the construction of their agreements. Part V explains some of the challenges that scholars face when conducting empirical research designed to address these six issues and other aspects of contract interpretation. Finally, Part VI sets forth a brief conclusion.

II. The Law of Contract Interpretation

Contract interpretation is the process of determining the meaning of the language of a contract.[16] The goal of contract interpretation is to ascertain the intent of the parties at the time the agreement was formed.[17] But accomplishing this task can be difficult.

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14. *See* Burton, *supra* note 5, at 341 ("Among contract scholars, there is no consensus about how an interpreter should accomplish these tasks. Consequently, normative theories of contract interpretation proliferate.").

15. *See, e.g.*, George M. Cohen, *Interpretation and implied terms in contract law*, *in* 6 ENCYCLOPEDIA OF LAW AND ECONOMICS 125 (Gerrit De Geest ed., 2011); Hermalin et al., *supra* note 1, at 68-99; Walt, *supra* note 9. As noted in the body, I also wrote a summary of the debate in a section of a prior article. The summary served as background for an empirical study. *See* Joshua M. Silverstein, *Using the West Key Number System as a Data Collection and Coding Device for Empirical Legal Scholarship: Demonstrating the Method via a Study of Contract Interpretation*, 34 J.L. & COM. 203, 261-84 (2016). The current piece borrows from that summary, but greatly expands it and modifies it in numerous ways.

16. RESTATEMENT (SECOND) OF CONTRACTS § 200 (AM. L. INST. 1981); E. ALLAN FARNSWORTH, CONTRACTS § 7.7, at 439 (2004).

17. BURTON, *supra* note 4, § 1.1, at 1 ("American courts universally say that the primary goal of contract interpretation is to ascertain the parties' intention at the time they made their contract."); *accord* 11 SAMUEL WILLISTON & RICHARD A. LORD, A TREATISE ON THE LAW OF CONTRACTS § 30:2, at 17-18 (4th ed. 2012) [hereinafter WILLISTON AND LORD]; JOSEPH M. PERILLO, CALAMARI AND PERILLO ON CONTRACTS § 3.13, at 136 (6th ed. 2009) [hereinafter CALAMARI AND PERRILLO]. *But see* Val D. Ricks, *The Possibility of Plain Meaning: Wittgenstein and the Contract Precedents*, 56 CLEV. ST. L. REV. 767, 807 (2008) (distinguishing between the intention of the parties and the meaning of words).

Party intent is often unclear and disputed.[18] And contracts frequently contain ambiguous language.

Contractual ambiguities exist for numerous reasons.[19] For example, parties typically lack the knowledge and foresight necessary to anticipate every contingency that might be worth addressing in their agreement.[20] Likewise, the stakes in most transactions do not justify the costly and protracted negotiations that are needed to carefully address all of the issues known to the parties.[21] Finally, and perhaps most fundamentally, language is simply an imperfect medium for expressing ideas.[22]

There are two general approaches to contract interpretation set forth in the caselaw. These approaches have multiple names, but, as I indicated above,[23] the most useful labels are "textualist" and "contextualist."[24] Under textualism, interpretation focuses principally on the text of the parties' agreement.[25] The locus of contextualist interpretation is broader. While adherents of contextualism grant critical weight to the words set forth in the parties' compact,[26] contextualist interpretation emphasizes reading contractual language *in context*.[27] Thus, contextualist authorities focus on both the contract's express terms and extrinsic evidence.[28] Extrinsic evidence is evidence of

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18. *See* Cohen, *supra* note 15, at 130 (discussing the uncertainty of party intent).
19. *See* FARNSWORTH, *supra* note 16, § 7.8, at 443-44 (setting forth a list).
20. BURTON, *supra* note 4, § 1.2.2, at 12-13.
21. *Id.* at 13.
22. CHARLES KNAPP ET AL., PROBLEMS IN CONTRACT LAW 396 (9th ed. 2019).
23. *See supra* text accompanying notes 11-13.
24. For other scholars that employ these two labels, see, for example, Cohen, *supra* note 15, at 131, 137; Schwartz & Scott, *supra* note 3, at 928; Peter M. Gerhart & Juliet P. Kostritsky, *Efficient Contextualism*, 76 UNIV. PITT. L. REV. 509, 513 (2015). For other approaches to labelling the two schools, see FARNSWORTH, *supra* note 16, § 7.12, at 465 ("restrictive" interpretation versus "liberal" interpretation); James W. Bowers, *Murphy's Law and the Elementary Theory of Contract Interpretation: A Response to Schwartz and Scott*, 57 RUTGERS L. REV. 587, 589-90 (2005) ("formalist" interpretation versus "contextualist" interpretation); Katz, *supra* note 8, at 497-98 ("formalist" interpretation versus "substantive" interpretation); *see also* Grumman Allied Indus., Inc. v. Rohr Indus., Inc., 748 F.2d 729, 733-34 (2d Cir. 1984) ("classical" interpretation versus "modern" interpretation).
25. *See Grumman Allied Indus.*, 748 F.2d at 733-34 ("Adherents of the classical approach, animated by a belief that a contractual agreement manifests the intent of the parties in a completely integrated form, favor the construction of contracts by reference to explicit textual language.").
26. Bowers, *supra* note 24, at 592 ("Words the parties expressly use play decisive roles in interpretation questions [for contextualist courts].").
27. *See Grumman Allied Indus.*, 748 F.2d at 734 ("Modern . . . interpretation . . . seems to derive from the premise that a contextual inquiry is a necessary and proper prerequisite to an understanding of the parties' intent.").
28. *See, e.g.*, Casey v. Semco Energy, Inc., 92 P.3d 379, 383 (Alaska 2004) ("[E]xtrinsic evidence is always admissible on the question of the meaning of the words of the contract itself."); RESTATEMENT (SECOND) OF CONTRACTS § 212 cmt. b (AM. L. INST. 1981) ("Any determination of meaning or ambiguity should only be made in the light of the relevant evidence of the situation and relations of the parties, the subject matter of the transaction, preliminary negotiations . . . , usages of trade, and the course of dealing between the parties.").

contractual intent from beyond the four corners of the parties' written agreement.[29] Such evidence includes preliminary negotiations, statements made at the time the contract was executed, the surrounding commercial circumstances (such as market conditions), course of performance, course of dealing, and usages of trade.[30]

Textualist jurisdictions follow what is typically called the "plain meaning rule" or "four corners rule."[31] That rule sets forth a two-stage process.[32] During the first stage, the court assesses whether the contract is ambiguous.[33] An ambiguity exists when the relevant contractual language is "reasonably susceptible" to more than one meaning.[34] The ambiguity determination is a question of law for the judge.[35] And in making that determination, the only evidence the judge may consider is the contract itself; the investigation is restricted to the "four corners" of the document.[36]

Two points of elaboration regarding stage one are in order. First, in assessing ambiguity, textualist courts generally interpret the document "in light of rules of

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29. Nautilus Marine Enters. v. Exxon Mobil Corp., 305 P.3d 309, 316 (Alaska 2013); BURTON, *supra* note 4, § 3.1.1, at 68.

30. CALAMARI AND PERILLO, *supra* note 17, § 3.9, at 128-29. A "course of performance" is essentially the parties' conduct in performing the contract at issue. *See* U.C.C. § 1-303(a) (AM. L. INST. & UNIF. L. COMM'N 2017). A "course of dealing" is the parties' conduct under prior contracts between them. *Id.* § 1-303(b). And a "usage of trade" is a practice or method of dealing in the industry or location where the parties operate that the parties should know about and should expect to be followed with respect to the contract at issue. *Id.* § 1-303(c). For an excellent overview of the types of extrinsic evidence, see BURTON, *supra* note 4, Ch. 2, at 35-62.

31. *See* 5 MARGARET N. KNIFFIN, CORBIN ON CONTRACTS § 24.7, at 33 (Joseph M. Perillo ed., Lexis rev. ed. 1998); Aaron D. Goldstein, *supra* note 7, at 75. Courts often use the descriptions "four-corners rule" and "plain meaning rule" synonymously. *See, e.g.*, *In re* Zecevic, 344 B.R. 572, 578 (Bankr. N.D. Ill. 2006); Gary's Implement, Inc. v. Bridgeport Tractor Parts, Inc., 702 N.W.2d 355, 376 (Neb. 2005); Benz v. Town Ctr. Land, LLC, 314 P.3d 688, 694 (N.M. Ct. App. 2013). *But see* BURTON, *supra* note 4, § 4.2.1, at 111, and § 6.3, at 224-25 (distinguishing the "four corners rule" from the "plain meaning rule"). And sources frequently distinguish between the "plain meaning rule" and the "context rule." *See, e.g.*, Brown v. Scott Paper Worldwide Co., 20 P.3d 921, 929 (Wash. 2001); Goldstein, *supra*, at 75. But some scholars use the phrase "plain meaning rule" more broadly to refer to both textualist authorities and most contextualist authorities. *See, e.g.*, CALAMARI AND PERILLO, *supra* note 17, § 3.10, at 129-30; FARNSWORTH, *supra* note 16, § 7.12, at 466.

32. FARNSWORTH, *supra* note 16, § 7.12, at 463.

33. *Id*.

34. 5 KNIFFIN, CORBIN ON CONTRACTS, *supra* note 31, § 24.7, at 33-34, 41-42 (explaining that both textualist and contextualist courts use this definition of ambiguity); *see, e.g.*, Pioneer Peat, Inc. v. Quality Grassing & Servs., Inc., 653 N.W.2d 469, 473 (Minn. Ct. App. 2002) (textualist decision); Cal. Tchrs.' Ass'n v. Governing Bd. of Hilmar Unified Sch. Dist., 115 Cal. Rptr. 2d 323, 328 (Ct. App. 2002) (contextualist decision).

35. Quake Constr., Inc. v. Am. Airlines, Inc., 565 N.E.2d 990, 994 (Ill. 1990); W.W.W. Assocs., Inc. v. Giancontieri, 566 N.E.2d 639, 642 (N.Y. 1990); Gulf Ins. Co. v. Burns Motor, Inc., 22 S.W.2d 417, 423 (Tex. 2000); CALAMARI AND PERILLO, *supra* note 17, § 3.10, at 131.

36. BURTON, *supra* note 4, § 4.2.2, at 111-12; 5 KNIFFIN, CORBIN ON CONTRACTS, *supra* note 31, § 24.7, at 33.

grammar and the canons of construction."[37] They also use dictionaries.[38] It is only *evidence* from beyond the four corners that is forbidden.[39]

Second, when analyzing whether a contract is ambiguous, the question is not whether the agreement is ambiguous per se. Rather, the question is whether the contract is ambiguous as between the different interpretations presented by the parties in the case. In other words, the ambiguity determination is concerned with whether the language of the agreement is reasonably susceptible to the meanings *proffered by both parties*, not whether it is reasonably susceptible to *any* two (or more) potential meanings.[40] This is helpfully described by Professor Steven Burton as ambiguity "in the contested respect."[41]

If the court concludes that a contract is unambiguous, it simply applies the unambiguous, "plain meaning" of the language to the facts of the case.[42] The judge never reviews any extrinsic evidence.[43] And the case can be disposed of via a motion to dismiss, a motion for summary judgment, or some other pre-trial proceeding.[44]

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37. BURTON, *supra* note 4, § 4.3.2, at 126. For surveys of the canons of construction, see *id.* § 2.4, at 57-60, and FARNSWORTH, *supra* note 16, § 7.10, at 456-61. An example of a canon of construction is the rule that specific language in a contract generally overrides conflicting general language in the same agreement. *See* RESTATEMENT (SECOND) OF CONTRACTS § 203(c) (AM. L. INST. 1981). Note that the terms "interpretation" and "construction" are used interchangeably throughout this Article. *See* FARNSWORTH, *supra*, § 7.17, at 439-40 ("This distinction between interpretation and construction is a difficult one to maintain in practice and will not be stressed here."); KNAPP ET AL., *supra* note 22, at 396 (same). *But see* JOHN EDWARD MURRAY, JR., MURRAY ON CONTRACTS § 87[A], at 447-48 (5th ed. 2011) (attempting to distinguish between interpretation and construction).

38. BURTON, *supra* note 4, § 2.1.2, at 38.

39. *Id.* § 4.3.2, at 126; *see also* Anchor Sav. Bank, F.S.B. v. United States, 121 Fed. Cl. 296, 311 (2015) (explaining that dictionaries "are not considered extrinsic evidence").

40. Agrigenetics, Inc. v. Pioneer Hi-Bred Int'l, Inc., 758 F. Supp. 2d 766, 771 (S.D. Ind. 2010) ("Ambiguity exists only when '*both parties* [sic] interpretive positions [are] reasonable.'" (emphasis added) (quoting Majchrowski v. Norwest Mortg. Inc., 6 F. Supp. 2d 946, 963 (N.D. Ill. 1998))); Allen v. United States, 119 Fed. Cl. 461, 480 (2015) ("In order to demonstrate ambiguity, the interpretations offered by *both parties* 'must fall within a "zone of reasonableness."'" (emphasis added) (quoting NVT Techs., Inc. v. United States, 370 F.3d 1153, 1159 (Fed. Cir. 2004))).

41. BURTON, *supra* note 4, Ch. 4, at 105-06, and § 4.1, at 106; *see also* William Blair & Co. v. FI Liquidation Corp., 830 N.E.2d 760, 771 (Ill. App. Ct. 2005) ("In point of principle, the fact that a term is ambiguous in one context does not necessarily make it ambiguous in another."). Note also that "[a]n ambiguity does not arise simply because the parties advance conflicting interpretations of the contract." Columbia Gas Transmission Corp. v. New Ulm Gas, Ltd., 940 S.W.2d 587, 589 (Tex. 1996); *accord* CALAMARI AND PERILLO, *supra* note 17, § 3.10, at 131. An ambiguity exists only when the language is in fact reasonably susceptible to the meanings asserted by both parties. Finally, "[e]ven if both parties assert that a contract is unambiguous, a court may hold that a contract is ambiguous." Horseshoe Bay Resort, Ltd. v. CRVI CDP Portfolio, L.L.C., 415 S.W.3d 370, 377 (Tex. App. 2013).

42. BURTON, *supra* note 4, § 4.2.3, at 118 ("If the document does not appear to be ambiguous, the analysis ends; the plain meaning rule comes into play to require that the judge give the unambiguous meaning to the contract as a matter of law.").

43. *Id.* ("No extrinsic evidence then is admissible for the purpose of giving meaning to the writing.").

44. Abundance Partners LP v. Quamtel, Inc., 840 F. Supp. 2d 758, 767 (S.D.N.Y. 2012); Seaco

If the judge concludes that the contract is ambiguous, then interpreting the agreement moves to the second stage—resolving the ambiguity. At that stage, extrinsic evidence regarding the contract's meaning may be considered[45] and interpretation is generally described as a question of fact.[46] However, if the parties do not submit any relevant extrinsic evidence, or if the textual and extrinsic evidence presented is so one-sided that there is no genuine issue of material fact regarding the contract's meaning, then the judge resolves the ambiguity as a matter of law, typically via summary judgment. If relevant extrinsic evidence is submitted *and* a reasonable jury could rule for either side, then the jury resolves the ambiguity at trial.[47]

Because textualist courts conduct the initial ambiguity determination without considering materials beyond the four corners of the document, the text of the contract is often the only evidence reviewed in ascertaining the meaning of the agreement. Hence the name of this interpretive school: "*text*ualism."

Contextualism is generally understood as involving the same two-stage process.[48] But the contextualist approach differs in the method used to establish whether a contract is ambiguous. According to this view, both the language of the agreement *and* extrinsic evidence are relevant in deciding if an ambiguity exists.[49] In other words, at stage one, the judge must consider extrinsic evidence proffered by the parties, something prohibited by textualism. However, the ambiguity issue is still a question of law for the judge.[50] And it can be resolved via summary judgment, or at trial by holding an evidentiary hearing or ruling upon a motion for a directed verdict.[51] Note that while extrinsic evidence plays a larger role under contextualism than under textualism, contextualist authorities emphasize that the language of the contract remains the most important evidence in determining contractual meaning.[52]

Both textualist and contextualist courts consider all relevant extrinsic evidence at

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Ins. Co. v. Barbosa, 761 N.E.2d 946, 951 (Mass. 2002); Salewski v. Music, 54 N.Y.S.3d 203, 205 (App. Div. 2017).

45. BURTON, *supra* note 4, § 4.2.3, at 118 ("If the contract is ambiguous on its face, extrinsic evidence is admissible for" the purpose of interpreting the contract.).

46. *See, e.g.*, *Seaco Ins. Co.*, 761 N.E.2d at 951; Archer v. DDK Holdings L.L.C., 463 S.W.3d 597, 606 (Tex. App. 2015).

47. *See* Nycal Corp. v. Inoco PLC, 988 F. Supp. 296, 299-300 (S.D.N.Y. 1997); Zale Constr. Co. v. Hoffman, 494 N.E.2d 830, 834 (Ill. App. Ct. 1986); RESTATEMENT (SECOND) OF CONTRACTS § 212(2) & cmt. e (AM. L. INST. 1981); BURTON, *supra* note 4, § 4.2.3, at 118, and § 5.1.1, at 152-53; CALAMARI AND PERILLO, *supra* note 17, § 3.15, at 141-42.

48. *See* FARNSWORTH, *supra* note 16, § 7.12, at 466-67 (stating that Pac. Gas & Elec. Co. v. G.W. Thomas Drayage & Rigging Co., 442 P.2d 641 (Cal. 1968), the foundational and seminal contextualist case, endorsed the same two-stage process used by textualist authorities); BURTON, *supra* note 4, § 4.2.2, at 112-14; *see generally id.* § 4.1, at 106-20 (outlining both the textualist and contextualist approaches to the ambiguity determination).

49. BURTON, *supra* note 4, § 4.2.2, at 112.

50. *Id.* § 4.2.3, at 118-19.

51. BNC Mortg., Inc. v. Tax Pros, Inc., 46 P.3d 812, 819-20 (Wash. Ct. App. 2002), *overruled on other grounds by* Columbia Cmty. Bank v. Newman Park, L.L.C., 304 P.3d 472 (Wash. 2013); BURTON, *supra* note 4, § 4.2.3, at 118-19.

52. *See, e.g.*, RESTATEMENT (SECOND) OF CONTRACTS § 212 cmt. b. (AM. L INST. 1981) ("[T]he words of an integrated agreement remain the most important evidence of intent.").

stage two once a contract is determined to be ambiguous.[53] The touchstone of their disagreement is whether a judge may review such evidence during stage one in making the ambiguity determination.[54] In sum, under textualism, before extrinsic evidence of the context may be considered, ambiguity must be apparent on the face of the agreement.[55] Such an ambiguity is typically called "patent," "intrinsic," or "facial."[56] Under contextualism, extrinsic evidence of the context may be used to establish the existence of an ambiguity.[57] Such an ambiguity is typically called "latent" or "extrinsic."[58] Put simply, textualism recognizes only patent ambiguities, whereas contextualism recognizes both patent and latent ambiguities.

While most scholars and many courts endorse this basic textualist/contextualist framework,[59] the framework is a considerable oversimplification of the jurisprudence.[60] Consider a few examples.

First, there are actually two distinct types of latent ambiguity, and textualist jurisdictions recognize one of those types.[61] A "subject-matter latent ambiguity" is an ambiguity that results when the language of the contract is applied to the real world—in

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53. BURTON, *supra* note 4, § 1.2.3, at 14 ("Under the prevailing law, all of the elements [of extrinsic evidence] are available after a court has determined that a contract is ambiguous."); *accord id.* Ch. 5, at 151; *id.* § 5.2, at 158; Schwartz & Scott, *supra* note 3, at 963 n.94 ("But what if there is a genuine ambiguity in the written agreement? In such a case, the divide between formalist and anti-formalist positions essentially disappears: a court will consider extrinsic evidence to resolve the ambiguity."); *see, e.g.*, Bank of N. Y. Trust Co. v. Franklin Advisers, Inc., 726 F.3d 269, 276 (2d Cir. 2013) (applying New York law) (textualist decision); Wagner v. Columbia Pictures Indus., Inc., 52 Cal. Rptr. 3d 898, 901 (Ct. App. 2007) (contextualist decision). Note that some scholars support using a narrower range of evidence to resolve ambiguities. *See, e.g.*, BURTON §§ 6.1.2.2, at 209-11, and 6.1.3, at 211-12 (arguing that only "objective" evidence should be considered both in determining whether an ambiguity exists and in resolving ambiguities); *see also infra* note 76 and accompanying text (explaining the difference between objective and subjective evidence).

54. *See* Goldstein, *supra* note 7, at 80 ("The various jurisdictions then diverge as to what additional evidence [beyond the language of the contract] courts should consider to determine whether the contract is ambiguous."); *see also* BURTON, *supra* note 4, § 4.2.2, at 111 ("On the question of ambiguity, there is a significant controversy among the courts.").

55. BURTON, *supra* note 4, § 4.2.2, at 111-12; *see, e.g.*, IDT Corp. v. Tyco Group, 918 N.E.2d 913, 916 (N.Y. 2009).

56. *See* Watkins v. Ford, 304 P.2d 841, 847 (Utah 2013); BURTON, *supra* note 4, § 4.1, at 107; FARNSWORTH, *supra* note 16, § 7.12, at 464.

57. BURTON, *supra* note 4, § 4.2.2, at 112; *see, e.g.*, Shay v. Aldrich, 790 N.W.2d 629, 641 (Mich. 2010).

58. *See* BURTON, *supra* note 4, § 4.1, at 107; FARNSWORTH, *supra* note 16, § 7.12, at 464 & n.16.

59. For several examples, see note 24 above. *But 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, 95 (2009) (dividing the cases into three broad schools rather than two).

60. MCMEEL, *supra* note 7, § 1.31 (explaining that dividing the interpretation caselaw into literalist and purposivist schools is "too simplistic").

61. Joshua M. Silverstein, *Contract Interpretation and the Parol Evidence Rule: Toward Conceptual Clarification*, 24 CHAPMAN L. REV. (forthcoming 2021) (manuscript at 14) (on file with author).

particular, to the subject matter of the agreement.[62] The paradigms of subject-matter latent ambiguity are where words in a contract are intended to identify a single item, but instead (1) two or more items fit the description, or (2) nothing fits the description.[63] Both textualist and contextualist courts recognize subject-matter latent ambiguities.[64] A "non-standard-meaning latent ambiguity" is an ambiguity that results when extrinsic evidence demonstrates that the parties may have used some word or words in their contract in a non-standard or special way rather than employing the standard or ordinary meaning of the language.[65] The archetype of such an ambiguity is where the parties allegedly used special industry terminology in drafting their contract.[66] Only contextualist courts recognize non-standard-meaning latent ambiguities.[67]

Second, because the rules of contextualism allow parties to present evidence that they employed language in a special way,[68] the words in a contract do not impose an absolute limit on the scope of possible constructions under that approach.[69] Instead, contractual language can possess *any* meaning as long as the extrinsic evidence supporting the asserted meaning is strong enough.[70] Accordingly, contextualism is best understood as eliminating the ambiguity determination entirely—as eliminating the requirement that the contractual language be "reasonably susceptible" to a party's proffered interpretation.[71] However, since most contextualist courts describe the first

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62. Silverstein, *supra* note 61 (manuscript at 14); *see also* Midkiff v. Castle & Cooke, Inc., 368 P.2d 887, 894 (Haw. 1962) ("An ambiguity may arise from words which are plain in themselves, but uncertain when applied to the subject matter of the instrument.").

63. Silverstein, *supra* note 61 (manuscript at 14); *see also* 32A C.J.S. *Evidence* § 1454 (2008) ("The most common form of a latent ambiguity arises where an instrument or writing contains a reference to a particular person or thing and is thus apparently clear on its face, but it is shown by extrinsic evidence that there are two or more persons or things to whom or to which the description in the instrument might properly apply. Where a grant is issued to a certain person, but no person of that name ever existed, it is a case of latent ambiguity and evidence is admissible to show who was the person intended . . . ."). A classic example is Raffles v. Wichelhaus (1864) 159 Eng. Rep. 375. In that case, the parties' contract provided that certain cotton would arrive on the ship "Peerless." But there were two ships with that name, creating an ambiguity that only became apparent when the language of the agreement was applied to the subject matter of the contract—the cotton on the ship "Peerless."

64. Silverstein, *supra* note 61 (manuscript at 14, 16).

65. *Id.* (manuscript at 16-17).

66. *Id.* (manuscript at 17-18); *see also* 12 WILLISTON AND LORD, *supra* note 17, § 34:1, at 8-9 ("Indeed, often terms that are unambiguous on their face may be ambiguous or have a different meaning as a matter of fact, as when the terms have both an ordinary meaning and a special trade meaning."). For an example of a specialized industry usage, see Western States Constr. Co. v. United States, 26 Cl. Ct. 818, 820-22 (1992) (holding that it was permissible to consider trade usage evidence that the phrase "metallic pipe" does not include pipe made of cast iron in the parties' industry even though iron is "metallic" according to the standard definition of that word).

67. Silverstein, *supra* note 61 (manuscript at 16).

68. *Id.* (manuscript at 50-51).

69. *Id.* (manuscript at 51-53).

70. *Id.* (manuscript at 53-54).

71. *Id*.

stage of their interpretive framework as constituting an "ambiguity" determination,[72] I will generally use that phrasing throughout this Article.

Third, both contextualism and textualism can be subdivided in various ways. Most importantly, contextualist authorities endorse two general versions of that approach. Some follow what I call "full contextualism," under which the judge considers *all* relevant extrinsic evidence in determining whether an agreement is ambiguous.[73] Others embrace what I call "partial contextualism." According to this system, the judge reviews only a subset of the relevant extrinsic evidence in addressing whether a contract is ambiguous.[74] Partial contextualism takes many forms.[75] For example, a number of courts limit the ambiguity determination to the language of the contract and "objective" extrinsic evidence—i.e., evidence of objectively verifiable aspects of the contract's context and/or evidence that is provided by disinterested third parties. Such evidence typically includes the surrounding commercial circumstances, trade usage, and course of performance. "Subjective" evidence—such as testimony by the parties regarding the preliminary negotiations—is excluded at stage one.[76] This distinction is often defended on the ground that objective evidence is much harder to fabricate than subjective evidence, which makes it more reliable.[77] Similarly, when interpreting contracts governed

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72. *See, e.g.*, RSD AAP, L.L.C. v. Alyeska Ocean, Inc., 358 P.3d 483, 488-89 (Wash. Ct. App. 2015), Chopin v. Chopin, 232 P.3d 99, 101-02 (Ariz. Ct. App. 2010); Hervey v. Mercury Cas. Co., 110 Cal. Rptr. 3d 890, 895 (Ct. App. 2010).

73. *See, e.g.*, Adams v. MHC Colony Park Limited P'ship, 169 Cal. Rptr. 3d 146, 161 (Ct. App. 2014); Ward v. Intermountain Farmers Ass'n, 907 P.2d 264, 268 (Utah 1995); *see also* BURTON, *supra* note 4, § 4.2.2, at 112-14, 117 (explaining this approach and describing it as the "subjective theory"); Silverstein, *supra* note 61 (manuscript at 28-31, 36) (describing full contextualism in detail and collecting authorities).

74. Silverstein, *supra* note 61 (manuscript at 28-29, 31-37) (describing partial contextualism in detail and collecting authorities).

75. *Id.* (manuscript at 28-29, 28 n.188).

76. *See, e.g.*, Stryker Corp. v. Nat'l Union Fire Ins. Co., 842 F.3d 422, 428 (6th Cir. 2016) ("But in the ordinary course, a latent ambiguity must be revealed by objective means—for instance, an admission, uncontested evidence, or the testimony of a disinterested third party."); AM Int'l, Inc. v. Graphic Mgmt. Assocs., Inc., 44 F.3d 572, 575 (7th Cir. 1995) ("By 'objective' evidence we mean evidence of ambiguity that can be supplied by disinterested third parties . . . . By 'subjective' evidence we mean the testimony of the parties themselves as to what they believe the contract means. 'Objective' evidence is admissible to demonstrate that apparently clear contract language means something different from what it seems to mean; 'subjective' evidence is inadmissible for this purpose."); *see also* BURTON, *supra* note 4, § 4.2.2, at 112, 114-15, 117 (explaining this approach and describing it as the "objective" theory); *id.* § 2.2 (identifying the "Objectivist" elements of contract interpretation to include, inter alia, "Objective Circumstances," "Trade Usages and Customs," and "Practical Construction (Course of Performance)"); *id.* § 2.3 (identifying the "Subjectivist" elements of contract interpretation to include, inter alia, "Prior Court of Dealing," "The Course of Negotiations," "A Party's Testimony as to Its Intentions," and "Subjective Circumstances"); Lawrence A. Cunningham, *Toward a Prudential and Credibility-Centered Parol Evidence Rule*, 68 U. CIN. L. REV. 269, 275-76 (2000) (constructing a similar objective/subjective classification scheme but including course of dealing in the objective category).

77. *See, e.g.*, *AM Int'l*, 44 F.3d at 575; CALAMARI AND PERILLO, *supra* note 17, § 3.10, at 130; *see also* Cunningham, *supra* note 76, at 275-76 (explaining that objective evidence "is relatively difficult to fake, and thus, evidence that tends to reduce the risk of judicial error").

by the Uniform Commercial Code ("UCC"), many courts restrict the ambiguity determination to the text of the agreement and the "incorporation tools"—course of performance, course of dealing, and usage of trade.[78]

Fourth, some cases have adopted a hybrid interpretive approach under which the judge may consider extrinsic evidence during the ambiguity determination in certain circumstances, as with contextualism, while in other situations the judge is restricted to the four corners of the agreement, as with textualism.[79] In particular, these decisions allow extrinsic evidence to show a non-standard-meaning latent ambiguity only if the evidence supports a construction that *qualifies* language of the contract. When a party offers evidence to prove a meaning that *completely negates* a term in the agreement, the evidence is barred during stage one of the interpretive process.[80]

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78. *See, e.g.*, Paragon Res., Inc. v. Nat'l Fuel Gas Distrib. Corp., 695 F.2d 991, 995-96 (5th Cir. 1983) (applying New York law); *see also* Joshua M. Silverstein, *Contract Interpretation Enforcement Costs: An Empirical Study of Textualism Versus Contextualism Conducted via the West Key Number System*, 47 HOFSTRA L. REV. 1011, 1065 & n.318, 1075 & nn.364-65 (2019) (describing course of performance, course of dealing, and usage of trade as the "incorporation tools," explaining partial contextualism under the UCC, and collecting authorities).

    Textualist authorities can also be subdivided. In particular, some textualist courts take a narrow view of what constitutes a patent ambiguity, while others are more willing to find that such an ambiguity exists. 6 PETER LINZER, CORBIN ON CONTRACTS § 25.13, at 146 (Joseph M. Perillo ed., Lexis rev. ed. 2010); *see also* Goldstein, *supra* note 7, at 75 n.2 ("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.").

79. Note that hybrid systems differ from partial contextualism. The latter approach is still a form of contextualism because it permits the parties to submit extrinsic evidence at stage one in all cases. Partial contextualism merely limits the *types* of extrinsic evidence that courts may consider during the ambiguity determination. *See supra* text accompanying note 74. Under hybrid systems, by contrast, extrinsic evidence is completely barred during the first stage of the interpretive process in some situations.

80. *See, e.g.*, Bohler-Uddenholm Am. Inc. v. Ellwood Group, Inc., 247 F.3d 79, 95 n.4 (3d Cir. 2001) ("In our analysis, we differentiated between using extrinsic evidence to support an alternative interpretation of a term that sharpened its meaning (legitimate) and an interpretation that completely changed the meaning (illegitimate)."); *In re* Tobacco Cases I, 111 Cal. Rptr. 3d 313, 320-21 (Ct. App. 2010) ("The reason underlying the rule [allowing evidence of course of performance] is that it is the duty of the court to give effect to the intention of the parties where it is not *wholly at variance* with the correct legal interpretation of the terms of the contract, and a practical construction placed by the parties upon the instrument is the best evidence of intention . . . ." (emphasis added and citation and internal quotation marks omitted)); *see also* Silverstein, *supra* note 61, (manuscript at 61-64) (describing this position in more detail and collecting authorities).

    A classic example of the distinction between qualifying a term and completely overriding a term is set out in Nanakuli Paving & Rock Co. v. Shell Oil Co., 664 F.2d 772 (9th Cir. 1981). There, Nanakuli, an asphaltic paving contractor, and Shell entered into a contract under which Shell was to supply asphalt to Nanakuli at "Shell's posted price at the time of delivery." *Id.* at 777-78. Nanakuli argued that the contract obligated Shell to provide Nanakuli with "price protection." This means that after Shell raised its asphalt price, it was required to continue charging Nanakuli the old price for quantities Nanakuli needed to fulfill its obligations under construction contracts for which Nanakuli had already made its bid using Shell's original price. *Id.* at 777. Before the Ninth Circuit, Shell argued that Nanakuli's extrinsic evidence regarding price protection was inadmissible. *Id.* at 779. The court disagreed, explaining that incorporation tools evidence is admissible when it

As suggested by the third and fourth points, there are actually "innumerable gradations" of textualism and contextualism in the caselaw.[81]

Fifth (and last), the law of contract interpretation is extraordinarily convoluted. "In virtually every jurisdiction, one finds irreconcilable cases, frequent changes in doctrine, confusion, and cries of despair."[82] The precise formulation of a rule is frequently inconsistent with the way the rule is applied.[83] And courts often set forth inconsistent principles within a single opinion.[84] In fact, the caselaw is so muddled that commentators differ over which approach to interpretation—textualism or contextualism—is the majority rule.[85] Partly as a result of this complexity, most (or perhaps all) states fall somewhere along a continuum between textualism and contextualism, rather than

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does not "totally negate" an express term but instead merely qualifies the term. *Id.* at 780, 805. An example of total negation would be using extrinsic evidence to establish that Nanakuli rather than Shell was entitled to set the price for asphalt under the contract. *Id.* at 805. But including price protection in the agreement only created a limited exception to the express provision that Nanakuli must pay Shell's posted price. *Id.* at 780, 805. Price protection merely requires that Shell sell to Nanakuli at the *old* posted price rather than the current one for brief periods after a price increase. Thus, price protection only qualifies or "cuts down" the posted price term. It does not completely negate it. *Id.*

81. 6 LINZER, CORBIN ON CONTRACTS, *supra* note 78, § 25.13, at 146; *see also* Peter Linzer, *The Comfort of Certainty: Plain Meaning and the Parol Evidence Rule*, 71 FORDHAM L. REV. 799, 805-06 (2002) ("A detailed survey will reveal countless variations around the country and remarkable gradations of what seem to be fixed rules, even within a given jurisdiction.").

82. Eric A. Posner, *The Parol Evidence Rule, The Plain Meaning Rule, and the Principles of Contract Interpretation*, 146 U. PA. L. REV. 533, 540 (1998); *accord* CALAMARI AND PERILLO, *supra* note 17, § 3.1, at 106 (noting that the courts do not consistently follow the rules of contract interpretation); *id.* § 3.2(b), at 110 n.29 (collecting secondary authorities that address the confused state of the law in Alaska, California, Illinois, Montana, Oregon, Texas, and Wisconsin and further noting that "[o]ther jurisdictions could be cited"); 11 WILLISTON AND LORD, *supra* note 17, § 33:42, at 1190 ("Not only do various jurisdictions disagree as to how and when extrinsic evidence of the circumstances surrounding the execution of a contract becomes admissible, but the decisions within a given jurisdiction are often difficult and sometimes impossible to reconcile on this point.").

83. *See* 6 LINZER, CORBIN ON CONTRACTS, *supra* note 78, § 25.14[A], at 148-161 (collecting examples).

84. *See id.* § 25.15[c], at 192 ("At times a state court seems to be saying contradictory things."); *id.* at 192-95 (discussing Wadi Petroleum v. Ultra Res., 65 P.3d 703, 706-10 (Wyo. 2003), to illustrate the problem); *see also* Silverstein, *supra* note 61 (manuscript at 41-43) (collecting authorities).

85. *Compare* BURTON, *supra* note 4, § 4.3.2, at 126 ("Most courts follow the four corners rule when deciding whether a contract is ambiguous, sometimes under the guise of the parol evidence rule."), *and* Schwartz & Scott, *supra* note 3, at 928 n.1 ("A strong majority of U.S. courts continue to follow the traditional, 'formalist' approach to contract interpretation. A state-by-state survey of recent court decisions shows that thirty-eight states follow the textualist approach to interpretation. Nine states, joined by the Uniform Commercial Code for sales cases (UCC) and the Restatement (Second) of Contracts, have adopted a contextualist or 'antiformalist' interpretive regime. The remaining states are indeterminate."), *with* 11 WILLISTON AND LORD, *supra* note 17, § 30:5, at 80 ("While there is authority that the court is limited in its consideration solely to the face of the written agreement, many more courts take the position that a court may provisionally receive all credible evidence concerning the parties' intentions to determine whether the language of the contract is reasonably susceptible to the interpretation urged by the party claiming ambiguity; if it is, this evidence may then be admitted and heard by the trier of fact.").

firmly in one camp.[86] And the law in some jurisdictions is simply too opaque to permit classification as either textualist or contextualist.[87]

Like the courts, contracts scholars are generally divided into textualist and contextualist camps,[88] with a clear majority fitting into the latter group.[89] Commentators have also proposed various hybrid and compromise positions. To illustrate, some maintain that the applicable interpretive approach should vary with the type of agreement, often distinguishing transactions between businesses from consumer and employment contracts.[90] Others have argued for positions that do not fit precisely into the textualist-contextualist continuum. For example, Professors Alan Schwartz and Robert

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86. Silverstein, *supra* note 15, at 259-60; Cohen, *supra* note 15, at 142 (concluding "that courts are never completely committed" to textualism or contextualism); Posner, *supra* note 82, at 553 ("No jurisdiction has a bright-line hard-PER or soft-PER. Courts might state one or the other as a general rule, but all sorts of subsidiary doctrines provide exceptions."); *id.* at 534-35 (explaining that "hard-PER" and "soft-PER" refer to both contract interpretation and the parol evidence rule).

87. *See* Silverstein, *supra* note 15, at 301. There are two generally prevailing theories as to why the confusion in the caselaw exists. Some believe that it is because courts fail to carefully distinguish between interpretive principles like the plain meaning rule, on the one hand, and the parol evidence rule, on the other hand. *See, e.g.*, BURTON, *supra* note 4, §§ 3.1, at 64, and 4.2.4, at 120; *see also* Kniffin, *supra* note 59 (discussing how courts and scholars confuse interpretation and the parol evidence rule). Others suggest that it is because interpretation and the parol evidence rule cannot truly be distinguished. *See, e.g.*, CALAMARI AND PERILLO, *supra* note 17, § 3.9, at 128-29; Linzer, *supra* note 81, at 801. I think both explanations have considerable validity. For a description of the parol evidence rule, see *infra* note 190.

Note that the picture appears to be clearer abroad, with contextualism now dominating both in other nations and in international law. *See* MCMEEL, *supra* note 7, § 2.01 (explaining that the general trend in common-law jurisdictions is towards adoption of the contextualist approach); CATHERINE MITCHELL, INTERPRETATION OF CONTRACTS: CURRENT CONTROVERSIES IN LAW 58 (2007) (explaining that the same trend exists in European civil-law jurisdictions); United Nations Convention on Contracts for the International Sales of Goods, art. 8(3), Apr. 11, 1980, S. Treaty Doc. No. 98-9 (1983), 1489 U.N.T.S. 3; UNIDROIT Principles of International Commercial Contracts, art. 4.3 (2010), https://perma.cc/22KQ-E4SA; Principles of European Contract Law, art. 5:102 (1998), *available at* http://www.jus.uio.no/lm/eu.contract.principles.parts.1.to.3.2002/.

88. Kostritsky, *supra* note 12, at 43-44.

89. CALAMARI AND PERILLO, *supra* note 17, § 3.10, at 130 (noting that "the Plain Meaning Rule has been condemned by the writers [i.e., legal scholars]"); KNAPP ET AL., *supra* note 22, at 413 (observing that "contract theorists have been practically unanimous in their rejection of the plain meaning rule"); Schwartz & Scott, *supra* note 3, at 938 ("The (almost) scholarly consensus shares the UCC and Restatement view . . . that [courts should be permitted] to access a broad evidentiary base in determining both the terms of the contract and the meaning to be attached to those terms."). For older sources that support a contextualist approach to interpretation, see, for example, JAMES BRADLEY THAYER, A PRELIMINARY TREATISE ON THE LAW OF EVIDENCE 428-29 (1898); 9 JOHN HENRY WIGMORE, A TREATISE ON THE ANGLO-AMERICAN SYSTEM OF EVIDENCE IN TRIALS AT COMMON LAW § 2470 (3d ed. 1940); and Arthur L. Corbin, *The Interpretation of Words and the Parol Evidence Rule*, 50 CORNELL L.Q. 161, 188-89 (1965). For modern sources, see, for example, BURTON, *supra* note 4, § 6.1.2.1, at 209; CALAMARI AND PERILLO § 3.10, at 130; FARNSWORTH, *supra* note 16, § 7.10, at 453-54; 5 KNIFFIN, CORBIN ON CONTRACTS, *supra* note 31, § 24.7, at 36-39; and 6 LINZER, CORBIN ON CONTRACTS, *supra* note 78, §§ 25.14, at 39, and 25.14[B], at 163.

90. *See infra* Part IV.B.

Scott contend that when commercial entities transact with each other, they should be permitted to decide which interpretive approach a court will use should a dispute over meaning arise.[91] Some of these perspectives are discussed further in Part IV.

III. The Primary Policy Issues in Contract Interpretation

The policy debate over contract interpretation focuses on three topics: (1) interpretive accuracy; (2) transaction costs; and (3) enforcement costs.[92] "Transaction costs" are expenses incurred negotiating and drafting agreements.[93] Other names for these expenses include "contracting costs" and "specification costs."[94] "Enforcement costs" are expenses incurred resolving disputes over contractual meaning.[95] Other terms for these expenses include "litigation costs" and "administrative costs."[96] Note that the dispute over accuracy is sometimes conceptualized in terms of which interpretive approach best reduces "error costs"—i.e., the costs that arise when courts make a mistake

91. *See infra* Part IV.C.

92. Walt, *supra* note 9, at 286 ("Notice next that the [interpretation] debate focuses on a few variables affecting the value of a contract: specification costs, adjudicatory error costs, and administrative costs. . . . The disagreement is not principally over other variables that might affect contract value."); *see, e.g.*, Cohen, *supra* note 15, at 148 ("The real question is which [interpretive] methodology has the lowest error rate and at what cost."); *id.* at 133 (observing that a "number of scholars have argued that the optimal contract rules of interpretation and implied terms are determined by the tradeoff between ex ante negotiation and drafting costs and ex post litigation costs"); Schwartz & Scott, *supra* note 3, at 930 ("Since no interpretive theory can justify devoting infinite resources to achieving interpretive accuracy, any socially-desirable interpretive rule would trade off accuracy against contract-writing and adjudication costs."); Alan Schwartz & Robert E. Scott, *The Limits of Contract Law*, 113 YALE L.J. 541, 573 (2003) ("An interpretive style can be assessed along two dimensions: (1) the likelihood that the style will generate the correct answer . . . ; and (2) the costs that the style imposes on courts and parties."); *see also* MITCHELL, *supra* note 87, at 108 ("The first and most obvious reason for confining a court's enquiry to the four corners of the agreement relates to the possible *costs* involved in the contextual approach. . . . Two particular kinds of costs are pertinent: *transaction* costs . . . and *enforcement* costs . . . ." (emphasis added)). For a source that identifies a broader set of factors, see Katz, *supra* note 8, at 524-37. However, Professor Katz describes transaction costs and enforcement costs as the "most obvious considerations relevant to choosing an interpretive regime." *Id.* at 525.

93. MITCHELL, *supra* note 87, at 108 (referring to "transaction costs" as the costs associated with "reaching and recording the deal"); Eyal Zamir, *The Inverted Hierarchy of Contract Interpretation and Supplementation*, 97 COLUM. L. REV. 1710, 1755-56 (1997) (same).

94. Cohen, *supra* note 15, at 132-33 (referring to negotiating and drafting costs as "contracting costs"); Walt, *supra* note 9, at 264 ("Specification costs are costs contracting parties incur in recognizing a need to provide a term, agreeing to its formulation, and supplying the term."). Note that the phrase "transaction costs" is often used in a broader sense that encompasses both contracting costs and enforcement costs. *See, e.g.*, Richard A. Posner, *The Law and Economics of Contract Interpretation*, 83 TEX. L. REV. 1581, 1583-84 (2005). This Article, however, employs the narrower definition set forth in the body text.

95. MITCHELL, *supra* note 87, at 108 (referring to "enforcement costs" as the costs associated with "insuring compliance in resolving disputes").

96. Cohen, *supra* note 15, at 133 (employing the phrase "litigation costs"); Walt, *supra* note 9, at 273 ("The administrative costs of an interpretive and default regime include the cost of construing and enforcing contracts under it.").

in interpreting an agreement.[97] Thus, the contract interpretation debate can also be understood as focusing on three types of costs: error costs, transaction costs, and enforcement costs.[98]

Contractual obligation and contract law are primarily grounded upon three broad values—autonomy, efficiency (defined as welfare maximization), and fairness.[99] These values help to explain the centrality of accuracy, transaction costs, and enforcement costs in the academic literature and caselaw regarding contract interpretation.[100]

Interpretive errors made by courts undermine autonomy because the errors result in parties being governed by contractual terms that differ from those to which they consented.[101] Inaccurate interpretations also cause unfairness by redistributing a

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97. *See, e.g.*, Cohen, *supra* note 15, at 147; Kostritsky, *supra* note 12, at 58; Walt, *supra* note 9, at 263.

98. *See* Walt, *supra* note 9, at 286 (quoted in note 92 above); *id.* at 262-63 ("An economic case for incorporation [a type of contextualism] . . . assesses three variables affecting the contract, and its performance and enforcement: specification costs, judicial error costs, and administrative costs. The economic defense of incorporation assumes that an interpretive and default regime ought to be adopted if it minimizes the sum of these costs for most contracts."); *cf.* Kostritsky, *supra* note 12, at 57 ("This article suggests that a model for judicial intervention that can solve interpretive challenges . . . should strive to minimize the sum of four costs: the costs of contracting, the costs of opportunism . . . , the costs of enforcement and the error costs from intervention (the cost of a court making an erroneous interpretation.").

99. Richard E. Speidel, *Changing Your Mind: The Law of Regretted Decisions by E. Allan Farnsworth*, 31 LOY. U. CHI. L.J. 255, 257-58 (2000) ("At least three major overlapping themes can be identified in contract law. I will call them 'Autonomy,' 'Efficiency,' and 'Fairness.'"); Nancy Kim, *Evolving Business and Social Norms and Interpretation Rules: The Need for a Dynamic Approach to Contract Disputes*, 84 NEB. L. REV. 506, 509-10 (2005) (describing autonomy, efficiency, and fairness as the "three most acknowledged and often-cited . . . objectives of contract law"); *see also* ERIC A. POSNER, CONTRACT LAW AND THEORY 225-30 (2011) (identifying three different types of theories of contractual obligation—reliance theories (which concern fairness), rights theories (which concern autonomy), and welfarist theories (which concern efficiency)); Whitford, *supra* note 7, at 947 ("I will consider three basic contract law policies, in an effort to assess the appropriate role of the jury and the fact/law distinction in contract interpretation: autonomy (which includes concerns both about freedom of contract and protection of reasonable expectations); efficiency in contract performance, which often counsels certainty (or predictability) for law; and redistribution (called fairness by some).").

100. For authorities that recognize the importance of efficiency and fairness in the choice of interpretive rules, *see* Goldstein, *supra* note 7, at 74 ("When and what kinds of extrinsic evidence should courts admit in order to interpret the meaning of a contract? . . . [T]he answer has profound implications for whether courts achieve the goals of predictability and fairness that motivate the law of contracts."); J.J. Spigelman, *Contractual Interpretation: A Comparative Perspective*, 85 AUSTR. L.J. 412, 413 (2011) ("Like many other aspects of contract law, interpretation requires the resolution of a tension between certainty or efficiency on the one hand and accuracy or fairness on the other."); *but cf.* Schwartz & Scott, *supra* note 3, at 934 ("We argue that contract law that regulates transactions between firms should seek only to maximize efficiency.")

101. *See* Schwartz & Scott, *supra* note 3, at 943 ("This judicial preference for [interpretive] accuracy largely rests on libertarian grounds. Some courts are reluctant to impose the state's coercive power on a reluctant party unless the court is relatively certain that the party failed to do what the contract required.").

portion of an agreement's value from one party to the other. Finally, mistakes in construction reduce efficiency because, among other things, they decrease the usefulness of contracts: Judicial errors make it more difficult for parties to accomplish their commercial and personal goals via contracting. This, in turn, deters people and businesses from entering into transactions that would otherwise promote their own welfare and the welfare of society.

Transaction costs and enforcement costs also reduce efficiency. As such expenses rise, the benefits to contracting fall. For instance, at some level, the cost of negotiating and drafting an agreement and the expected cost of enforcing the deal surpass the predicted value of the transaction. When that happens, rational parties will not proceed with an otherwise welfare-enhancing exchange.[102]

A. Interpretive Accuracy

As noted above, the purpose of contract interpretation is to ascertain the intent of the parties.[103] But which school of interpretation best accomplishes this task? Both sides vigorously maintain that it is their approach.[104]

Adherents of textualism typically offer the following arguments in support of their position. First, the express terms of a contract are the best evidence of contractual intent.[105] The parties likely chose the words of their agreement with care to reflect their mutual understanding.[106] By contrast, contextual evidence is often unreliable.[107] To begin with, human memory is flawed and parties have powerful incentives to commit

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102. *Cf.* Walt, *supra* note 9, at 265 ("Accordingly, parties will select a less efficient over a more efficient, domain-specific term whenever the marginal specification costs exceed the marginal increase in contract value from supplying the more efficient term.").

103. *See supra* notes 16-17 and accompanying text.

104. 2 STEWART MACAULAY ET AL., CONTRACTS: LAW IN ACTION 304 (3d ed. 2011) ("In the vast academic literature on interpretation, the question whether admitting evidence about context will increase or decrease error costs is hotly contested."); Cohen, *supra* note 15, at 145 ("Scholars disagree, however, over whether strict approaches to interpretation and implied terms, such as textualism, lead to more court error than broader approaches, such as contextualism.").

105. ALCES, *supra* note 7, at 149 ("The case favoring 'plain meaning' is clear: Courts cannot read the minds of litigants, so the clear expression of their intent is the best evidence of what that intent actually is (or, at least, was)."); Cohen, *supra* note 15, at 131 (explaining that textualists presume that "the express terms of the contract . . . best approximate the parties' intentions"); Slamow v. Del Col, 594 N.E.2d 918, 919 (N.Y. 1992) ("The best evidence of what parties to a written agreement intend is what they say in their writing.").

106. *See* Steuart v. McChesney, 444 A.2d 659, 662 (Pa. 1982) ("Where the contract evidences care in its preparation, it will be presumed that its words were employed deliberately and with intention. . . . Courts in interpreting a contract do not assume that its language was chosen carelessly." (internal quotation marks omitted)).

107. *See* Steven Shavell, *On the Writing and Interpretation of Contracts*, 22 J.L. ECON. & ORG. 289, 311 (2006) (observing that "extrinsic evidence . . . is highly imperfect"); *see also* MITCHELL, *supra* note 87, at 94 ("Rather, the hallmark of a more serious kind of formalism in contract would be the tendency to regard the contractual text as supreme evidence of the parties' intentions, over more elusive and equivocal evidential material, such as trade customs, previous dealings and so on . . . ."); *id.* at 116 ("One reason for drafting comprehensive documents is to provide a more reliable source of evidence than witnesses . . . .").

fraud on the court, particularly regarding what took place during preliminary negotiations.[108] "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."[109] In addition, extrinsic evidence frequently supports multiple different understandings of the disputed contractual text because the evidence is ambiguous and/or contradictory.[110] Finally, agreements are most often drafted using standard English rather than a specialized dialect, such as one specific to the parties' industry.[111] Accordingly, the basic tools of textualism—the contract itself and general dictionaries—are more likely to capture the intent of the parties than extrinsic evidence concerning the parties' context.[112]

Second, judges can more skillfully apply textualist methodology. Members of the judiciary are better at adopting the perspective of a reasonable recipient of a written agreement who is focused on the ordinary meaning of the contractual language than they are at adopting the perspective of someone who participated in the preliminary negotiations and is familiar with the parties' surrounding circumstances.[113] In part, that is because judges often misunderstand the economic context in which business contracts are made, even when presented with significant evidence on the subject.[114] Such evidence overwhelms them with information that they lack the training to fully

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108. *See* Goldstein, *supra* note 7, at 75-76 ("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. Parties lie and misremember, especially regarding extrinsic evidence such as prior negotiations, course of performance, and course of dealing."); *id.* at 98-100 (summarizing the literature on flawed memory and dishonesty and using this research to critique contextualism); MITCHELL, *supra* note 87, at 116 ("There is also the danger that witness evidence is self-serving and unreliable."); *see also* Katz, *supra* note 8, at 531-32 (explaining that it is even possible to manipulate contextual evidence by filling "the negotiating history with self-serving proposals and offers . . . in the hopes of influencing the ultimate [interpretive] result" should a dispute arise; but further expressing skepticism about the scope of this danger).

109. Goldstein, *supra* note 7, at 111.

110. *Id.* at 76 ("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.").

111. *See* BURTON, *supra* note 4, § 4.6.2, at 148 (explaining that textualists might argue that "deciding the question of ambiguity from within the four corners of the contract document implements the parties' subjective intentions in most cases, *i.e.*, when the judge knows and uses the parties' common language, which in most cases will be standard English").

112. 6 LINZER, CORBIN ON CONTRACTS, *supra* note 78, § 25.4, at 36 (explaining that textualists can argue that contextualist methods are more likely to result in judges and jurors embracing faulty extrinsic evidence presented by, among others, "lying parties who concoct self-serving and outlandish interpretations after the fact" than textualist methods are to result in the barring of evidence of a special meaning genuinely intended by the parties).

113. MITCHELL, *supra* note 87, at 116.

114. *See* VICTOR GOLDBERG, FRAMING CONTRACT LAW: AN ECONOMIC PERSPECTIVE 163 (2006); *see also* MITCHELL, *supra* note 87, at 116 ("A court's conclusions on the social context of a commercial agreement may be impressionistic at best, despite hearing testimony of witnesses and experts.").

comprehend.[115]

Third, because contextualism allows parties to assert that they wrote their contract using some type of private language or an industry dialect in which words have a different meaning from standard usage,[116] courts often must verify which special language the parties employed.[117] But there are many potential alternative systems of usage and the court might pick the wrong one.[118] Under textualism, this concern does not exist because the court presumes that the parties spoke using ordinary English in constructing their agreement, reducing the risk of an interpretive error.[119]

To elaborate, during the ambiguity determination, a textualist court only needs to decide one issue—the meaning of a contractual term within ordinary usage. But a contextualist court must decide two issues—(1) which system of usage the parties employed (standard English or one of many specialized industry or private dialects), and (2) the meaning of the disputed term within the relevant system of usage.[120] "Because incorporation [a form of contextualism] makes possible two sources of interpretive error while formalism [another name for textualism] makes possible only one, incorporation increases interpretive error costs."[121]

Fourth, textualists maintain that more cases reach trial under contextualism,[122] and that juries are often confused or deceived by the extrinsic evidence submitted by the parties.[123] For instance, disputes over interpretive matters frequently require juries

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115. *See* MITCHELL, *supra* note 87, at 115 ("The contextual approach arguably increases the chances for error by increasing the amount of information deemed relevant to the interpretation exercise. Judges may have to deal with a significant amount of contextual material, some of it connected to particular frameworks of analysis whose conventions will be unfamiliar to them.").

116. *See supra* notes 68-71 and accompanying text.

117. Schwartz & Scott, *supra* note 92, at 587.

118. *Id.*

119. *Id.*

120. Walt, *supra* note 9, at 268-69.

121. *Id.* at 269; *accord* ROBERT E. SCOTT & JODY S. KRAUS, CONTRACT LAW AND THEORY 602 (4th ed. 2007) ("Each term has many possible meanings under the [Uniform Commercial] Code's [contextualist] regime, but many terms have only one possible meaning under a plain meaning [textualist] regime. Judicial interpretive error is more likely under the Code's regime because the Code requires courts to choose among so many more meanings for each term than courts would have to choose among under a plain meaning regime."); Jody S. Kraus & Steven D. Walt, *In Defense of the Incorporation Strategy*, *in* THE JURISPRUDENTIAL FOUNDATIONS OF CORPORATE AND COMMERCIAL LAW 193, 198 (Jody S. Kraus & Steven D. Walt eds., 2000) (making the same point); *see also* SCOTT & KRAUS, *supra*, at 601 ("By insulating the plain meaning of terms from deviant interpretations, the plain meaning rule preserves a valuable collective good, for everyone—namely, a set of terms with a clear, unambiguous meaning that is already understood by the vast majority of potential contractors. This reduces the prospect of the parties and courts misinterpreting their agreement."); Ricks, *supra* note 17, at 805 (explaining that textualism discourages parties from writing contracts using non-standard usage).

122. *See infra* note 229 and accompanying text.

123. *See* 6 LINZER, CORBIN ON CONTRACTS, *supra* note 78, § 25.16[B], at 219 ("Critics of loose rules of admissibility of extrinsic evidence fear that unscrupulous parties will bamboozle juries with fake stories about what the contract was supposed to mean . . . ."); Whitford, *supra*

to make difficult credibility determinations regarding conflicting witness testimony.[124] Such challenges lead to more mistakes in the ascertaining of contractual meaning.[125]

Fifth, the first four arguments are strengthened by the fact that parties often intentionally misuse extrinsic evidence to distort the meaning of an otherwise clear agreement. Under contextualism, parties are motivated to pore over their preliminary negotiations, prior dealings, and industry custom, in the search for some statement, document, or practice that can be deployed to alter the contract and obtain an unbargained-for advantage.[126] Indeed, they have an incentive to manipulate evidence concerning the preliminary negotiations while such negotiations are still underway: "[P]arties . . . may be tempted to fill the negotiating history with self-serving proposals and offers under a more substantive interpretive regime, in the hopes of influencing the ultimate result."[127] And judges have difficulty policing such manipulated contextual evidence.[128] Professors Ronald Gilson, Charles Sabel, and Robert Scott explain:

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note 7, at 943 ("There is a constant fear that juries will be influenced by perjured testimony, especially about precontractual bargaining.").

124. *See* MITCHELL, *supra* note 87, at 116 (explaining that the "reliance on documents may 'restrict arbitrator discretion and minimize the need for arbitrators to rely on and assess the credibility of testimony'") (quoting Lisa Bernstein, *Merchant Law in a Merchant Court: Rethinking the Code's Search for Immanent Business Norms*, 144 U. PA. L. REV. 1765, 1819 (1996)).

125. *See* 5 KNIFFIN, CORBIN ON CONTRACTS, *supra* note 31, § 24.7, at 53 (noting that judges often argue that "juries might incorrectly assess the extrinsic evidence" that is admissible under a contextualist approach); *see, e.g.*, W.W.W. Assocs., Inc. v. Giancontieri, 566 N.E.2d 639, 642 (N.Y. 1990); *see also* MITCHELL, *supra* note 87, at 110 ("[T]he greater the amount of contextual material, the greater the possibility for error. Decision-makers may easily become 'bewildered by a large set of conflicting evidence.'") (quoting Adrian Vermeule, *Three Strategies of Interpretation*, 42 SAN DIEGO L. REV. 607, 614 (2005)); 6 LINZER, CORBIN ON CONTRACTS, *supra* note 78, § 25.17, at 241 & n.4 ("It is a commonplace that underlying the restrictive use of the parol evidence rule is distrust of juries in contract cases.").

126. MITCHELL, *supra* note 87, at 113 ("A further problem is that much reliance on context may be done strategically—the problem of 'threshing through the undergrowth' for the chance remark upon which to build a case. The suspicion is often raised of the strategic reliance on context to sanction an escape from a bad bargain[,] . . . even in circumstances where the written terms appear relatively complete."); *accord* Steuart v. McChesney, 444 A.2d 659, 663 (Pa. 1982) ("Likewise, resort to the plain meaning of language hinders parties dissatisfied with their agreement from creating a myth as to the true meaning of the agreement through subsequently exposed extrinsic evidence."); Linzer, *supra* note 81, at 804 (offering the following as a possible justification for the plain meaning rule: "strict rules protect against the fear that the more we allow the words of a contract to be challenged in the name of the parties' actual intent, the more we produce disorder or even chaos, waiting to be exploited by unscrupulous litigants who demand a bonus to do what they already promised to do"); *see also* MCMEEL, *supra* note 7, § 1.109 (discussing one judge's concern that parties will employ "the whole armoury of modern civil justice techniques to tease out some surrounding circumstances which might contradict the plain meaning of an instrument").

127. Katz, *supra* note 8, at 531-32. However, Professor Katz expresses some skepticism regarding the efficacy of such efforts. *See id.* at 531 ("I am inclined to regard this latter risk as relatively less important, since in most cases the parties will have more symmetric and effective access to their common negotiating history than they will to each others' standard forms.").

128. *See* Cohen, *supra* note 15, at 145-46.

> Under a contextualist theory, a party for whom a deal has turned out badly has an incentive to claim that the parties meant their contract to have a different meaning than the obvious or standard one. Such a party can often find in the parties' negotiations, in their past practices, and in their trade customs, enough evidence to ground a full, costly trial, and thus to force a settlement on terms more favorable than those that the contract, as facially interpreted, would direct.[129]

Let's now turn to the arguments offered by contextualists on the issue of interpretive accuracy. Contextualists' primary contention here is that meaning can only be determined by considering the context in which language is used.[130] First, as dictionaries demonstrate, most words have multiple meanings in the abstract.[131] Thus, the terms within the four corners of a contract, standing alone, are nearly always consistent with more than one understanding,[132] necessitating the consideration of extrinsic evidence to decide which meaning was intended.[133] Second, words and phrases can possess alternative meanings such as trade usages that are not set forth in dictionaries: "Usages of varying degrees of generality are recorded in dictionaries, but there are substantial differences between English and American usages and between usages in different parts of the United States. Differences of usage also exist in various localities and in different social, economic, religious and ethnic groups."[134] As a result, even if the text

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129. Gilson et al., *supra* note 6, at 41.

130. *See, e.g.*, RESTATEMENT (SECOND) OF CONTRACTS § 202 cmt. d. (AM. L. INST. 1981) ("Meaning is inevitably dependent on context."); BURTON, *supra* note 4, § 6.1.2.2, at 210 ("Significant context always is necessary to ascertain reasonable and relevant meaning(s)."); FARNSWORTH, *supra* note 16, § 7.10, at 454 ("Indeed, it is questionable whether a word has a meaning at all when divorced from the circumstances in which it is used."); 5 KNIFFIN, CORBIN ON CONTRACTS, *supra* note 31, § 24.7, at 39 (noting that some courts "recognize that it is impossible to ascertain the intended meaning of contract terms without reference to evidence of surrounding circumstances"); MURRAY, *supra* note 37, § 87[B], at 452 ("[Meaning] can only be discerned in the context of all the surrounding circumstances.").

131. BURTON, *supra* note 4, § 6.1.2.2, at 210, and § 6.2.2, at 220; 5 KNIFFIN, CORBIN ON CONTRACTS, *supra* note 31, § 24.7, at 30; *see also* RESTATEMENT (SECOND) OF CONTRACT § 201 cmt. a (AM. L. INST. 1981) ("Moreover, most words are commonly used in more than one sense.").

132. BURTON, *supra* note 4, § 6.1.2.1, at 206 ("First, Corbin, Article 2 of the UCC, and the Restatement (Second) all hold that all language is general and ambiguous, so a court never should find that contract language is unambiguous."); Goldstein, *supra* note 7, at 86-87 ("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.").

133. RESTATEMENT (SECOND) CONTRACTS § 212 cmt. b (AM. L. INST. 1981) ("It is sometimes said that extrinsic evidence cannot change the plain meaning of a writing, but meaning can almost never be plain except in a context."); 5 KNIFFIN, CORBIN ON CONTRACTS, *supra* note 31, § 24.7, at 36 ("Before the meaning of words in a contract can be plain and clear, at least some of the surrounding circumstances must be known[.]").

134. RESTATEMENT (SECOND) CONTRACTS § 201 cmt. a (AM. L. INST. 1981); *accord id.* § 219 cmts. a & b; Burton, *supra* note 5, at 351; Stephen C. Mouritsen, *Contract Interpretation With Corpus Linguistics*¸ 94 WASH. L. REV. 1337, 1350 (2019) ("Dictionaries are not complete repositories of every sense in which a given word has been used and every context in which a given word has appeared."); Goldstein, *supra* note 7, at 75 (noting that "alternative meanings" exist that may not be "set forth in a standard dictionary"); *see also* RESTATEMENT (SECOND)

of an agreement is clear on its face, it is always possible that the parties employed a special meaning when crafting their deal.[135] And such meanings can be discovered only by reviewing evidence from outside the instrument.[136] Third, the proposition that context is essential to the construction of agreements finds support in the philosophy of language, linguistics, and other related subjects:

> However there are lessons to be learned from these other fields. One insight stands out: in ascertaining the meaning of an utterance, the context in which it is made is indispensable. It follows that any legal rule which purports to cut down or delimit the contextual scene in which a contract is made is presumptively unsound.[137]

The cumulative implication of these three points is that "plain meaning" simply does not exist.[138] "A word has no meaning apart from . . . [contextual] factors; much less does it have . . . one true meaning."[139] Accordingly, the text of a contract can never

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OF CONTRACT § 202 cmt. f (AM. L. INST. 1981) ("Moreover, the same word may have a variety of technical and other meanings.").

135. Pac. Gas & Elec. Co. v. G.W. Thomas Drayage & Rigging Co., 442 P.2d 641, 645 (Cal. 1968) ("The fact that the terms of an instrument appear clear to a judge does not preclude the possibility that the parties chose the language of the instrument to express different terms."); RESTATEMENT (SECOND) OF CONTRACT § 202 cmt. f. (AM. L. INST. 1981) ("Parties to an agreement often use the vocabulary of a particular place, vocation or trade, in which new words are coined and common words are assigned new meanings."); Goldstein, *supra* note 7, at 75 ("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.").

136. RESTATEMENT (SECOND) CONTRACTS § 214 cmt. b (AM. L. INST. 1981) ("Even though words seem on their face to have only a single possible meaning, other meanings often appear when the circumstances are disclosed."); FARNSWORTH, *supra* note 16, § 7.12, at 465 (same); 5 KNIFFIN, CORBIN ON CONTRACTS, *supra* note 31, § 24.7 at 36 ("[P]roof of the circumstances may make plain and clear a meaning that was not apparent when in the absence of such proof some other meanings seemed plain and clear.").

137. MCMEEL, *supra* note 7, § 2.43; *see also* Whitford, *supra* note 7, at 939 ("As all linguistic scholars know, language in context is often understood quite differently than language which appears solely in a decontextualized, written form."); *see generally* MCMEEL, *supra*, §§ 2.37, 2.39-.40, 2.43, 2.57 (discussing the relevancy of the philosophy of language, linguistics, and related fields for contract interpretation).

138. BURTON, *supra* note 4, § 4.6.1. at 144 ("The chief criticism of the plain meaning and four corners rules has been that there are no plain meanings that an interpreter can find on a contract document's face."); Gilson et al., *supra* note 6, at 36 ("Contextualist jurisdictions . . . reject the notion that words in a contract can have a plain or unambiguous—context free—meaning at all."); *see also* Kraus & Walt, *supra* note 121, at 234 n.39 ("Indeed, we suspect that very few terms have a precise and unambiguous 'plain meaning.' When meaning seems clear, it is usually because context makes it so.")

139. Corbin, *supra* note 89, at 187; *accord* KNAPP ET AL., *supra* note 22, at 413 ("Contract scholars . . . have consistently rejected the idea that words can have only one precise meaning."); MURRAY, *supra* note 37, § 87[B], at 452 ("There is, however, a general consensus rejecting the myth that language can have a singular, unalterable meaning."); Goldstein, *supra* note 7, at 75 ("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

so clearly support a particular understanding as to justify the categorical exclusion of extrinsic evidence that might support a different understanding.[140] And this entails that barring evidence of the context fatally undermines the interpretive process. *Corbin on Contracts* explains:

> The cardinal rule with which all interpretation begins is that the purpose of interpretation is to ascertain the intention of the parties. The plain meaning rule can exclude proof of their actual intentions. There is universal agreement that the first duty of the court is to put itself in the position of the parties at the time the contract was made. It is wholly illogical for the court to do this without being informed by extrinsic evidence of the circumstances surrounding the making of the contract.[141]

Justice Roger Traynor presented the argument against the existence of plain meaning this way in his seminal opinion in *Pacific Gas & Electric Company v. G.W. Thomas Drayage & Rigging Company*:

> A rule that would limit the determination of the meaning of a written instrument to its four-corners merely because it seems to the court to be clear and unambiguous, would either deny the relevance of the intention of the parties or presuppose a degree of verbal precision and stability our language has not attained. . . . If words had absolute and constant referents, it might be possible to discover contractual intention in the words themselves and in the manner in which they were arranged. Words, however, do not have absolute and constant referents. . . . The meaning of particular words or groups of words varies with the verbal context . . . . Accordingly, the meaning of a writing can only be found by interpretation in the light of all the circumstances that reveal the sense in which the writer used the words. The exclusion of parol evidence regarding such circumstances merely because

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study language.").

140. 5 KNIFFIN, CORBIN ON CONTRACTS, *supra* note 31, § 24.7, at 54 ("[T]he conclusions are inescapable that words used in a contract do not have only one true meaning and that words are never so 'plain and clear' that proof of surrounding circumstances and other extrinsic aids to interpretation can be excluded."); THAYER, *supra* note 89, at 428-29 (explaining that there is no "lawyer's Paradise where all words have a fixed, precisely ascertained meaning . . . and where, if the writer has been careful, a lawyer, having a document referred to him, may sit in his chair, inspect the text, and answer all questions without raising his eyes.").

141. 5 KNIFFIN, CORBIN ON CONTRACTS, *supra* note 31, § 24.7, at 37; *accord* Corbin, *supra* note 89, at 188-89 ("First and foremost, extrinsic evidence is always necessary in the interpretation of a written instrument."); *id.* at 162 (contending that "it is wholly impossible" for "the court to put itself in the position of the parties at the time the contract was made . . . without being informed by extrinsic evidence of the circumstances surrounding the making of the contract"); CALAMARI AND PERILLO, *supra* note 17, § 3.10, at 130 (arguing that the "plain meaning rule has been properly condemned because the meaning of words varies" with changes in context); *see* BURTON, *supra* note 4, § 6.1.2.2, at 211 ("The necessity of context for ascertaining meaning(s) is the strongest argument against the four corners rule here.").

> the words do not appear ambiguous to the reader can easily lead to the attribution to a written instrument of a meaning that was never intended.[142]

Relatedly, contextualists maintain that it is actually impossible to exclude all material from outside the four corners of the contract when engaging in interpretation. In Professor Arthur Corbin's famous words, "when a judge refuses to consider relevant extrinsic evidence on the ground that the meaning of written words is to him plain and clear, his decision is formed by and wholly based upon the completely extrinsic evidence of his own personal education and experience."[143] The only question, then, is which context gets emphasized—the background of the judge (under textualism) or the background of the parties to the transaction (under contextualism).[144] And according to contextualists, the parties' training and practices, as well as the surrounding industry conditions, are clearly more useful in attempting to ascertain the parties' contractual intent than any features of the court's experience.[145]

To elaborate, judges frequently come from environments that are quite different from "the specialized worlds of trade" that serve as the context for many business transactions.[146] In such cases, "the parties' linguistic reference" is far more likely to

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142. 442 P.2d at 644-45 (internal quotation marks and citations omitted); *see also id.* at 643 ("The exclusion of testimony that might contradict the linguistic background of the judge reflects a judicial belief in the possibility of perfect verbal expression. This belief is a remnant of a primitive faith in the inherent potency and inherent meaning of words.") (citation omitted).

143. Corbin, *supra* note 89, at 164; *accord* 5 KNIFFIN, CORBIN ON CONTRACTS, *supra* note 31, § 24.7, at 39 (containing the same language); Goldstein, *supra* note 7, at 90 (arguing that at stage one, textualism "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"); *see also* Kent Greenawalt, *A Pluralist Approach to Interpretation: Wills and Contracts*, 42 SAN DIEGO L. REV. 533, 545 (2005) ("The notion of interpreters confining themselves to a document is a bit misleading. Any interpreter brings to bear her knowledge of the language and of general circumstances.").

144. 5 KNIFFIN, CORBIN ON CONTRACTS, *supra* note 31, § 24.7, at 36 (explaining that when a court uses textualism to reject the consideration of extrinsic evidence, the court "is substituting its own linguistic education and experience for that of the contracting parties"); Katz, *supra* note 8, at 519-20 ("The choice for the court, therefore, is not whether to rely on context and substance, but which context and substance to rely on: the parties' or its own.")

145. Corbin, *supra* note 89, at 164 (explaining that while the judge's education and experience is more reliable than both (1) "irrelevant and incredible extrinsic evidence" sometimes submitted by attorneys, and (2) "mere forensic assertion in place of any evidence," it will often "not be the best evidence," particularly since "the purpose of all the evidence is the ascertainment of the intention of the parties (*their* meaning), and not the meaning that the written words convey to" the judge); Posner, *supra* note 82, at 568-70 (discussing Corbin's argument) ("The parol evidence rule excludes extrinsic evidence from consideration, while allowing the judge to rely on his or her personal knowledge, even though the former, more so than the latter, would enable the court to determine the parties' intentions.").

146. *See* Mellon Bank, N.A. v. Aetna Bus. Credit, 619 F.2d 1001, 1011 n.12 (3d Cir. 1980) ("Judges today come from a variety of backgrounds—private law practice, government service, business, academia—and their fields of experience represent an even wider variance. The parties who appear before the court in these times of complex commercial transactions come from a variety of specialized worlds of trade.").

provide insight into their intent than the judge's language background.[147] "Using the interpreter's context injects arbitrariness into the process; it bears no reliable relation to the parties' intention and, indeed, may be quite foreign to them."[148] Moreover, evidence of the context can be particularly useful to less experienced judges, bringing their "information sets" more closely into alignment with those of seasoned judges who may already have some understanding of the relevant commercial practices.[149]

Contextualists also contend that the construction of certain types of agreements is particularly likely to benefit from the use of extrinsic evidence. Consider standard form contracts, which constitute the vast majority of written agreements.[150] The nondrafting party to such an instrument seldom reads most or even any of the boilerplate terms[151]—especially when that party is a consumer or employee rather than a business.[152] Instead, the nondrafter focuses only on the central, negotiated terms, such as price, quantity, and time of delivery.[153] Likewise, contracts drafted by attorneys (whether standard form or individually negotiated) frequently contain language that neither consumers nor merchants fully comprehend.[154] Given these points, boilerplate and attorney-crafted terms are less likely to reflect the mutual understanding of the parties than the totality of the circumstances surrounding the execution and implementation of their agreement.[155]

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147. *See id*. ("It is the parties' linguistic reference that is relevant, not the judges'.").

148. BURTON, *supra* note 4, § 2.1.3, at 40.

149. *See* Katz, *supra* note 8, at 526.

150. Jens Dammann, *Flytraps, Scarecrows, and the Transparency Paradox: The Case for Redesigning the Law on Vague Boilerplate Contracts*, 2018 U. ILL. L. REV. 185, 186 (collecting authorities).

151. Todd D. Rakoff, *Contracts of Adhesion: An Essay in Reconstruction*, 96 HARV. L. REV. 1173, 1179 (1983) ("Virtually every scholar who has written about contracts of adhesion has accepted" that "the adhering party is in practice unlikely to have read the standard terms before signing the document . . . .").

152. *See* Wayne R. Barnes, *Toward a Fairer Model of Consumer Assent to Standard Form Contracts: In Defense of Restatement Subsection 211(3)*, 82 WASH. L. REV. 227, 237 (2007) ("The fact that consumers do not read standard form contracts is so well accepted and documented as to be virtually enshrined as dogma within the contracts literature."); Anthony Niblett, *Tracking Inconsistent Judicial Behavior*, 34 INT'L REV. L. & ECON. 9, 11 (2013) (noting that "employees and consumers rarely read standard-form contracts"); Michael L. Rustad & Thomas H. Koenig, *Wolves of the World Wide Web: Reforming Social Networks' Contracting Practices*, 49 WAKE FOREST L. REV. 1431, 1456 ("Contract scholars have established that very few consumers actually read or review standard-form boilerplate . . . .").

153. Zamir, *supra* note 93, at 1771 ("In the case of detailed standard-form contracts, customers frequently do not bother to read most of the provisions of the form, focusing instead on a few central issues such as price and time of delivery.")

154. *Id.* at 1771 ("In many cases, the contract document is drafted by lawyers . . . [and] is usually phrased in legal language, using terminology that laypersons—consumers and merchants alike—do not fully understand.").

155. *Id.* at 1772-73 ("Similarly, it may be assumed that interpretation of a contract that takes into account the totality of circumstances, including previous dealings between the parties and representations and promises made prior to contracting and during the course of performance, would be more authentic than an interpretation that refers only to the wording of the contract document."). For Professor Zamir's full argument with respect to standard-form and attorney-drafted agreements, see *id.* at 1771-77. *See also* Schwartz &

Lastly, contextualists have no sympathy for textualist concerns that extrinsic evidence may confuse or fool juries. First, judges can use preliminary proceedings such as summary judgment to prevent baseless arguments from reaching trial.[156] Second, as explained by *Corbin on Contracts*, textualists' worries regarding juries prove too much:

> If the jury system is so defective that juries cannot be allowed to hear the story of black meaning white, they should not be allowed to decide wrongful death actions, complex anti-trust suits and patent cases, much less psychological defenses in capital murder cases. Since we are not about to abolish the jury system generally, there is no reason to constrict it in the one area of interpretation of integrated contracts.[157]

And the same argument applies to the claim that judges lack the capacity to apply contextualist methodologies. In sum, textualism violates "the basic concept that a court should make its decisions based on full information, not conjecture."[158]

Note that proponents of *partial* contextualism have an additional argument at their disposal. Recall that partial contextualism allows the judge to consider only certain types of extrinsic evidence—most commonly, objective evidence or evidence of the incorporation tools—when assessing whether a contract is ambiguous.[159] Categories of extrinsic evidence that fit into those groupings, like course of performance and trade usage, are considered more difficult to fabricate than other evidence classifications, such as preliminary negotiations.[160] Accordingly, the textualist attacks on the reliability of extrinsic evidence discussed above[161] possess considerably less force when directed against partial contextualism than when used to challenge full contextualism,

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Scott, *supra* note 3, at 938 n.31 ("Those who argue for mandatory contextualist interpretations often justify such rules as necessary to prevent exploitation of unsophisticated individuals, susceptible to cognitive biases, who enter into written contracts with sophisticated parties who supply written contract terms that alter previously settled understandings."); Gilson et al., *supra* note 6, at 38 (same); Katz, *supra* note 8, at 531 (explaining that contextualism might reduce incentives for drafters of standard form agreements "to sneak one-sided but inefficient terms into the fine print").

156. 6 LINZER, CORBIN ON CONTRACTS, *supra* note 78, § 25.14 at 163 ("Surely, the best justification for a plain meaning approach is when an obligor puts forth an unpersuasive interpretation in apparent bad faith. But as Corbin noted famously, the courts have the power to direct verdicts and grant summary judgments, and it is common sense to look skeptically at 'black is white' arguments. So the four corners approach cannot be justified simply to keep sophistry away from a jury.").

157. *Id.* § 25.4, at 37; *see also* Posner, *supra* note 82, at 567 ("The concern is that if juries considered all of the extrinsic evidence, rather than just the writing, they would not render good judgments. . . . If juries are incompetent, why would limiting them to certain kinds of evidence lead to a more accurate result?"). *But see* 6 LINZER, CORBIN ON CONTRACTS, *supra* note 78, § 25.25, at 325 ("The extrinsic evidence [in the context of contract interpretation], however, is not of a physical fact, but of the contracting parties' state of mind when they or their agents . . . wrote the contract. That is inherently more slippery than a true fact question, and thus may justify somewhat greater control of a jury.").

158. 6 LINZER, CORBIN ON CONTRACTS, *supra* note 78, § 25.14, at 163.

159. *See supra* notes 74-78 and accompanying text.

160. *See supra* text accompanying note 77.

161. *See supra* notes 107-110 and accompanying text.

under which all forms of extrinsic evidence are reviewed at stage one of the interpretive process.[162]

Textualists can respond to some of these arguments with the following four points. First, plain meaning does in fact exist.[163] That is because the "plain meaning" sought by textualism is *not* acontextual in nature. Textualists do not advocate that judges construe agreements without considering any context; that would be impossible.[164] Instead, when assessing ambiguity, textualism simply involves a different

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162. *See supra* note 73 and accompanying text. The leading academic exponent of partial contextualism is Professor Steven Burton. *See* BURTON, *supra* note 4, § 6.1.2, at 203-11 (defending a version of partial contextualism that he calls "objective contextual interpretation"); *id.* at 209 ("What elements should a court consider when deciding whether a term or contract is ambiguous in a contested respect? . . . [A] court should consider the whole document, the document's evident purpose(s), proffers concerning the objective circumstances when the contract was made, trade usages, and proffers concerning any practical construction [i.e., course of performance]. This collection of elements is the objective context. It excludes the course of negotiations, a party's statements of intention made in the course of negotiations, a party's testimony as to its own past intentions, any course of dealing, and any other indices solely of subjective intention."). But various others, including both judges and commentators, have advocated for similar interpretive systems. *See, e.g.*, Posner, *supra* note 94, at 1598-99 ("There is a happy medium, and that is to allow extrinsic ambiguity to be shown only by *objective* evidence."); Cunningham, *supra* note 76, at 272, 301-12 (defending Judge Posner's position, as articulated in a series of cases); Goldstein, *supra* note 7, at 76-79 (endorsing an approach for "negotiated commercial contracts" that "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," but would exclude "extrinsic evidence typically associated with the subjective intent of the parties, such as evidence of the parties' course of performance or course of dealing" unless the contract is determined to be ambiguous, and even then such evidence would be employed "not to interpret the contract, but to apply equitable principles"); *id.* at 112-13, 126-27 (further explaining this approach). Burton specifically contends that objective contextual interpretation ("OCI") is more accurate than textualism. *See* Burton, *supra* note 5, at 353 ("OCI also would be more accurate [than textualism] because it allows a judge to perform this task [the assessment of ambiguity], on a motion for summary judgment or similar motion, on the basis of the applicable term and material parts of the ex ante context.").

    Note that some categories of extrinsic evidence might not be as "objective" as they appear. *See* Lisa Bernstein, *Custom in the Courts*, 110 NW. L. REV. 63, 66 (2015) [hereinafter, Bernstein, *Custom*] ("This Article presents a detailed study of all of the sales-related trade usage cases digested under the Code's trade usage provision from 1970 to 2007."); *id.* at 67 ("Rather, in a majority of cases, the existence and content of [trade] usages was proven solely through the testimony or affidavits of the parties and/or their employees, a type of testimony that may be either deliberately or subconsciously self-serving. In addition, there was not a single case in which either party introduced any data that the alleged usage was regularly observed."); *id.* at 87-88, 94-95 (questioning the reliability of trade usage evidence given the findings described in the prior parenthetical).

163. Ricks, *supra* note 17, at 769 ("But the claim that plain meaning is impossible is false, as are its premises. . . . Plain meaning rests instead on our unreflective, public, conventional practice of language use. Most meaning is plain."); *id.* at 803 ("Wittgenstein's language theory rests the plain meaning rule on firm philosophical ground. Plain meaning is possible.").

164. BURTON, *supra* note 4, § 6.1.2.1, at 208 ("[L]anguage is conventional, never private, and always within a context of use."); Goldstein, *supra* note 7, at 109 ("Even when courts apply the plain meaning rule, they are not discerning meaning outside of any context. Of course,

context from that used under contextualism—one that focuses on the contract itself and the rules of standard English rather than on extrinsic evidence. Professor Val Ricks (in the first quotation) and Aaron Goldstein (in the second) explain:

> There *is* a context, of course. There always is a context in every use of language. . . . (Scholars, courts, and lawyers who claim the plain meaning rule finds "acontextual" meaning (such as Corbin and Farnsworth) are employing a red herring . . . . 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.[165]

> Even when courts do not utilize extrinsic evidence, judges bring to a text all of their internalized rules for common usage—rules of grammar, syntax, etc.—through which they interpret the contract, 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.[166]

In fact, contextualists concede that textualism does not attempt to engage in acontextual interpretation when they lament that the plain meaning rule emphasizes the judge's *context* rather than the parties'.[167]

Second, textualist construction does not presume that words possess "one true meaning"[168] or "absolute and constant referents."[169] After all, textualism recognizes the possibility of both patent ambiguities and subject-matter-latent ambiguities, requiring the consideration of extrinsic evidence in some cases.[170]

Third, while it may be true that all language is ambiguous in the abstract,[171] that

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such a thing would be impossible."); Ricks, *supra* note 17, at 784 ("Though language can never be understood apart from the context in which it is used . . . ."); Schwartz & Scott, *supra* note 3, at 961 ("[A]ny inquiry into the intended meaning of words is necessarily contextual . . . .").

165. Ricks, *supra* note 17, at 801-02 (footnotes omitted).

166. Goldstein, *supra* note 7, at 109-10 (footnotes omitted).

167. *See supra* notes 143-149 and accompanying text.

168. *See supra* text accompanying note 139.

169. *See supra* text accompanying note 142.

170. *See supra* text accompanying notes 53-56 and notes 61-64; BURTON, *supra* note 4, § 4.6.2, at 147 ("Second, *pace* the skeptics, the two rules [the plain meaning rule and the four corners rule] do not assume that clarity in any case results from words with 'some one real or absolute meaning' apart from some context. After all, the two rules fully recognize that language can be ambiguous and depend on context . . . for its meaning."); Ricks, *supra* note 17, at 801 n.173 ("But no one suggests that any word has 'one true meaning.' That is the red herring.") (quoting Corbin, *supra* note 89, at 187); *see also id.* at 785 ("In this far more precise and well-considered theory, plain meaning occurs even though words have neither absolute and constant referents nor inherent meaning.").

171. *See supra* notes 131-132 and accompanying text.

does not entail that extrinsic evidence is always necessary to construe an agreement.[172] This is so primarily because the words on the face of a contract are not legally ambiguous unless the language is reasonably susceptible to *both* parties' asserted meanings—unless the agreement is ambiguous in the contested respect.[173] "Lawyers and judges never ascertain the meaning of contract language in the abstract. They choose only between the meanings advanced by the parties in a dispute."[174] And in many lawsuits, the construction advanced by one party "can be dismissed easily" as "far-fetched" without considering extrinsic evidence, resulting in a finding that the contract is unambiguous.[175]

Note that given these three points, nothing in the philosophy of language, linguistics, or any other field of study supports the conclusion that the plain meaning rule is impossible to implement.[176] Thus, both textualism and contextualism are perfectly workable interpretive systems.[177]

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172. *See supra* note 133 and accompanying text (discussing this claim made by contextualists).

173. *See supra* notes 40-41 and accompanying text.

174. BURTON, *supra* note 4, § 6.1.2.1, at 206 (also recognizing the "ambiguity of all language in the abstract").

175. *Id.* § 4.6.2, at 146-47; *see id.* at 147 ("There may be plenty of ambiguity in a contract in the abstract while there is none as concerns the dispute before the court."); *see also* Ricks, *supra* note 17, at 802 ("No extrinsic evidence is necessary for meaning to occur . . . ."); *id.* at 803-04 ("Under Wittgenstein's theory, the meaning of contractual language might be clear within the four comers of the document but ambiguous or different outside of that context or when more context is added. . . . But the possibility of altering the meaning or rendering it ambiguous by adding more facts—in effect, changing the context—does not mean that the words are not plain and clear in their present context. . . . So while, at the same time, the addition of more or other facts may change the otherwise plain meaning of a contract, the judge can, so far as theory is concerned, discern the plain, objective meaning of a contractual term within the limited context of the four corners of a contract.").

176. Ricks, *supra* note 17, *passim*; *e.g.*, *id.* at 769 ("[P]lain meaning is immune from attack on grounds of impossibility. . . ."); *id.* at 801 ("Applying the plain meaning rule is clearly possible and not philosophically problematic."); BURTON, *supra* note 4, § 4.6.2, at 146-47 (concluding that the "skeptical argument" against textualism "misses its target when aimed" at the way that interpretive approach is "generally employed by the courts"); *id.* § 4.6.1, at 144 (describing the "argument from skepticism" as the position that "there are no plain meanings that an interpreter can find on a contract document's face"); Goldstein, *supra* note 7, at 110 ("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 contracts."); Greenawalt, *supra* note 143, at 592 ("In the discussion of wills, we have reviewed and rejected arguments that a plain meaning rule is actually incoherent."); Walt, *supra* note 9, at 289 ("Earlier legal literature often dismissed formalism by questioning the notion of literal or 'plain' meaning. This is a mistake: the operative notion of meaning is coherent, and formalism is a plausible strategy. If formalism is a poor interpretive and default regime, it fails because it does not optimally reduce total contracting costs.").

177. Ricks, *supra* note 17, at 802-03 ("These are the same kinds of rules that operate in whatever context language occurs, whether the more narrow context of the plain meaning rule or the broader context of the *PG&E*/*Soper* [contextualist] rule. There is no qualitative difference in the practice employed under either rule, from the standpoint of language

Fourth, from the fact that all forms of interpretation take into account context, it does not follow that maximizing the evidence regarding such context is the best way to identify the intent of contracting parties in litigated cases.[178] As Professor Catherine Mitchell observes, "we may all agree that meaning is always contextual, but disagree over what is the correct context, over how much context is relevant or necessary to accessing meaning . . . ."[179] And textualists contend that a "minimum evidentiary basis ordinarily will convey sufficient contextual information."[180] Put another way, for all the reasons set forth at the beginning of this section,[181] textualists maintain that barring extrinsic evidence during the ambiguity determination establishes a context for interpretation that is more likely to result in accurate constructions than any context that involves the review of extrinsic evidence.[182]

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theory."); *id.* at 808 ("Philosophically, either rule [textualism or contextualism] is possible. Which one chooses is a political and legal choice, not a philosophical mandate.").

178. Katz, *supra* note 8, at 520-21 ("In its claim that all interpretation requires some context, [the contextualist argument] seems plainly right. Where the argument goes wrong, however, is in concluding that this claim, together with the goal of carrying out the parties' intentions, commits one to a substantive approach to interpretation; such a conclusion does not follow."); Posner, *supra* note 94, at 1598 ("From the undeniable fact that contract interpretation requires that the interpreter know the language in which the contract is written, the meaning of a contractual commitment, and much else besides, it does not follow that 'all' the circumstances relating to making sense of the contract should be matters for inquiry at trial.") (quoting 9 JOHN HENRY WIGMORE, A TREATISE ON THE ANGLO-AMERICAN SYSTEM OF EVIDENCE IN TRIALS AT COMMON LAW § 2470, at 224, 227 (3d ed. 1940)); *see also* Ricks, *supra* note 17, at 803 ("Nor does anything in this language theory require that, for meaning to be plain or to exist at all, one must seek as much context as possible, or seek one context as opposed to another.").

179. MITCHELL, *supra* note 87, at 9; *see also* Ricks, *supra* note 17, at 801 ("Scholars, courts, and lawyers who claim the plain meaning rule finds "acontextual" meaning (such as Corbin and Farnsworth) are employing a red herring; what they really want is a different context, one more consistent with their political preferences.").

180. Schwartz & Scott, *supra* note 3, at 952; *see* Posner, *supra* note 94, at 1598 ("The critics have missed the point. The four corners rule merely bespeaks skepticism that taking evidence is always the best way to resolve a legal dispute over a contract's meaning.").

181. *See supra* notes 105-1129 and accompanying text.

182. Kostritsky, *supra* note 12, at 58 ("The new formalist view is that error costs inevitably rise with contextualist approaches to interpretation and so should be avoided and only a truncated base of evidence should be admitted.").

Note that freedom of contract and closely-related concepts such as consent and autonomy are often used as a justification for textualism or contextualism. *See, e.g.*, Shay v. Aldrich, 790 N.W.2d 629, 648, 654 (Mich. 2010) (Markman, J., dissenting); BURTON, *supra* note 4, § 4.6.1, at 145; Katz, *supra* note 8, at 514; Ricks, *supra* note 17, at 807. But the interpretive approach that best promotes these values is the one that most successfully produces accurate interpretations. Accordingly, freedom of contract, consent, and autonomy do not provide independent grounds for favoring textualism or contextualism beyond the issue of accuracy. Instead, the most these principles do is support allowing the parties to choose which interpretive system will govern their agreement should a dispute arise. *See* Katz, *supra*, at 514 ("It does seem to me, however, that a principled liberal should be in favor of allowing people entering into contracts to choose between formal and substantive modes of contract interpretation, based on what seem to them to be good and sufficient reasons . . . ."); *see also infra* Part IV.C.

B. Transaction Costs

One of the chief arguments in favor of contextualism is that it reduces transaction costs.[183] It does so by enabling the parties to negotiate and draft less complete contracts[184]—with a complete contract being one that contains all of the pertinent terms and clarifying elaboration.[185] First, parties need not "reduce all the terms and standards that govern the agreement to writing" because the court can fill any "gaps through the process of contextual interpretation."[186] Second, transactors do not have to spend time carefully specifying the meaning of every term that is written down because extrinsic evidence is always available to substantiate any asserted non-standard meaning the parties might have intended, such as a trade usage.[187]

Contextualists maintain that textualism has the opposite effect. That approach incentivizes parties to commit greater resources to the negotiating and writing of their contracts in order to minimize gaps and clarify meanings.[188] That is because in any post-execution dispute over the instrument's construction, the judge will look no

183. SCOTT & KRAUS, *supra* note 121, at 601 ("[P]erhaps the strongest[] argument in favor of contextualism over plain meaning is that by taking context into account when interpreting a term, courts reduce parties' costs of specifying the terms of their agreement."); Kraus & Walt, *supra* note 121, at 193 ("Yet the chief virtue of the incorporation strategy for interpretation is its promise to yield specification costs well below that of plain-meaning regimes."); Cohen, *supra* note 15, at 132 (calling this a "key economic argument for an expansive court role in interpreting and implying terms").

184. *See* Cohen, *supra* note 15, at 132 (Contextualism "enables and encourages parties to write less complete contracts than they otherwise would. Writing less complete contracts saves on drafting and negotiating costs so long as the court-supplied interpretations and terms sufficiently approximate the parties' intentions."); MACAULAY, *supra* note 104, at 304 ("If courts taking a contextualist approach to interpretation are good at ascertaining what the parties intended, perhaps parties can then expend less effort and expense in the drafting of contracts, leaving it to the courts to fill in details and correct errors.").

185. For a more technical definition of a "complete" contract, see Cohen, *supra* note 15, at 126 ("Traditionally, a complete contract refers to one that provides a complete description of a set of possible contingencies and explicit contract terms dictating a performance response for each of these contingencies."). Truly complete contracts are an impossibility when the word "complete" is understood in a robust sense. *Id.* at 126-27. So references to "complete" agreements in the body text should be interpreted somewhat loosely.

186. MITCHELL, *supra* note 87, at 109.

187. SCOTT & KRAUS, *supra* note 121, at 604 ("By interpreting terms in light of the context, the [Uniform Commercial] Code allows parties to use the terminology that has evolved to suit transactions in their particular trade. The context-specific meaning of such terms incorporates the evolved wisdom of decades or more of transactional practice in specific trades."); Kraus & Walt, *supra* note 121, at 199 ("The key presumption of the incorporation strategy is that contractors naturally and costlessly use terms that have domain-specific meanings. These terms presumably have evolved to address the particularized needs and expectations of contractors within a given domain."); Posner, *supra* note 94, at 1600 ("Were evidence of trade usage barred in contract litigation, parties to contracts would be driven to include additional detail in their contracts, for example[,] definitions of terms that might be taken in the wrong sense by a court ignorant of how the terms were used in the industry to which the contract pertained.").

188. *See* Katz, *supra* note 8, at 525 (explaining that textualism may induce parties "to put greater effort into specifying additional considerations or supplying additional interpretive materials at the contract-writing stage").

further than the four corners of the document at the first stage of the interpretive process.[189] And if the court finds the contract to be facially unambiguous (as well as a complete integration under the parol evidence rule) any understandings of the parties not expressly reduced to writing will be inoperative since the parties may not present extrinsic evidence to construe or supplement such an agreement.[190] Professor Adam Badawi elaborates:

> In more formal regimes, where judges . . . are likely to put more effort into discerning the meaning of contract terms before turning to extrinsic evidence, parties will have an incentive to devote more resources to contract drafting because it is more likely that the terms of the contract will have an effect on the outcome of any litigation that arises.[191]

The costs of preparing a more complete agreement are often prohibitively high.[192]

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189. *See supra* notes 36, 39, and accompanying text; Katz, *supra* note 8, at 525 ("For example, the anticipation that issuing banks will not look beneath the surface of any supporting documents when processing a letter of credit may induce the issuer to provide a more elaborate set of documentary conditions up front."); Walt, *supra* note 9, at 264 ("Parties bear specification costs under formalism because they must supply a term for it to apply to their contract.").

190. *See supra* notes 36, 42-43, 55-56, and accompanying text; RESTATEMENT (SECOND) OF CONTRACTS §§ 209, 210, 213, 215-16 (AM. L. INST. 1981) (explaining the operation of the parol evidence rule).

Some elaboration regarding the parol evidence rule is in order. The parol evidence rule begins with the concept of an "integration." An integration is a written document that is intended by the parties to constitute a final expression of one more terms of their contract. *Id.* § 209(1). An integration is "partial" when it is intended to be final with respect to only *some* of the contractual terms. KNAPP ET AL, *supra* note 22, at 416. An integration is "complete" when it is intended to be final with respect to *all* terms of the agreement. RESTATEMENT (SECOND) OF CONTRACTS § 210(1). The parol evidence rule itself contains two pieces. First, the rule prohibits parties from introducing extrinsic evidence intended to prove contractual terms that *contradict* either type of integration and that were agreed upon prior to or contemporaneously with the execution of the integration. *Id.* §§ 213(1), 215. Second, the rule prohibits parties from introducing extrinsic evidence intended to prove contractual terms that *add* to a complete integration and that were agreed upon prior to or contemporaneously with the execution of the integration. *Id.* §§ 213(2), 216(1).

191. Adam B. Badawi, *Interpretive Preferences and the Limits of the New Formalism*, 6 BERKELEY BUS. L.J. 1, 33-34 (2009); *see also* Kraus & Walt, *supra* note 121, at 199 ("A plain-meaning regime imposes on parties the additional costs of either translating the understandings already carried by the domain-specific meanings of available specialized terms into an equivalent statement using the plain meaning of terms, or settling on a less efficient contractual term that can be specified at a lower cost."); Walt, *supra* note 9, at 264-65 ("Parties who prefer to give a term a meaning consistent with applicable business norms (a 'domain-specific' meaning), but inconsistent with the term's literal meaning, must stipulate that meaning. Otherwise, a court will not give the term of the contract that meaning. Specification costs are incurred in providing for a domain-specific meaning.").

192. *See* Cohen, *supra* note 15, at 128-29 ("Scholars have offered numerous reasons why the costs of contractual completeness are often high."); *see also* Kostritsky, *supra* note 12, at 63 & n.101 ("Many of the parties' potential problems are not addressed in the contract because of various barriers to inclusion. . . . The barriers to inclusion are: the complexity of the environment, uncertainty about future events and uncertainty about future behavior of the parties.").

Accordingly, if contextualism lessens the need for contractual completeness, the reduction in transaction costs—i.e., the decrease in time and money expended negotiating and drafting the deal—is likely to be substantial.[193]

Most textualists essentially concede that contextualism lowers transaction costs in comparison to their system. But they argue it does so at the price of greater enforcement costs.[194] That is, in part, because contextualism induces parties to draft worse contracts—contracts with more open terms and ambiguities.[195] Textualist interpretation motivates parties to spend additional time preparing their agreements, leading to better contracts that reduce litigation.[196]

The next section reviews the debate over which approach minimizes enforcement costs. For now, assume that textualists are correct that there is a trade-off between transaction costs and enforcement costs when switching from one interpretive system to the other. "In balancing contracting and litigation costs, it is important to keep in mind that contracting costs are certain and incurred across all contracts, while litigation costs, though often much larger than contracting costs, are incurred in only a small fraction of contracts."[197] A critical question, then, is what will be less expensive:

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193. Walt, *supra* note 9, at 265 ("The size of the reduction in specifications costs realized by incorporation is likely to be significant."); *id.* at 266-67 ("Because the scope of an incorporation regime covers a wide range of contracts, the reduction in specification costs is significant, even if the per contract specification cost is low."); *id.* at 264-68 (providing further elaboration).

194. Cohen, *supra* note 15, at 133-34 (explaining a model developed by Judge Posner under which, "as parties spend less on ex ante contracting and rely more on extrinsic evidence to prove their intent, drafting costs go down but expected litigation costs rise," because there is an increased likelihood of litigation and the expense of any litigation that does occur will be greater); MITCHELL, *supra* note 87, at 109 ("The difficulty is that relying on the court's gap-filling function may reduce transaction costs, but at the expense of increasing enforcement costs if and when disputes arise . . . ."); Lawrence A. Cunningham, *Contract Interpretation 2.0: Not Winner-Take-All but Best-Tool-for-the-Job*, 85 GEO. WASH. L. REV. 1625, 1633-34 (2017) ("[F]ormalism might induce greater ex ante investment in drafting clarity with reduced ex post costs of dispute resolution whereas contextualism might reduce ex ante drafting costs while increasing ex post enforcement costs.").

195. Cohen, *supra* note 15, at 134 ("[I]f courts adopt a contextualist methodology, . . . they will encourage parties to write less complete contracts than they otherwise would prefer."); *id.* at 137 ("If a court is willing to 'insure' parties through flexible interpretations and implied terms it creates a classic moral hazard problem: the parties have less incentive to write good contracts themselves.").

196. *See id.* at 133-34 (again explaining Posner's model, as discussed in note 194 above); *supra* notes 188-191 and accompanying text; *see also* STEPHEN A. SMITH, CONTRACT THEORY 275 (2004) ("A narrow approach . . . giv[es] contracting parties incentives to write their contracts using words that a judge can understand with little or no additional information."). Some textualists also argue that these better contracts also improve accuracy. *See* Kostritsky, *supra* note 12, at 57 ("Part of the new formalists' aim is to provide parties with incentives to engage in more careful drafting as a way of reducing judicial errors.").

197. Cohen, *supra* note 15, at 134; *accord* Posner, *supra* note 94, at 1600 ("The need to add this detail would increase the costs of negotiation and drafting, while the benefits would be realized only in the small minority of cases that would result in a legal dispute."); *see also* Walt, *supra* note 9, at 266 ("[S]pecification costs are large when aggregated across transactions. The relevant measure of the size of these costs obviously sums specification costs over all of the contracts governed by incorporation.").

drafting a more complete contract for every transaction (under a textualist regime), a contract that can be interpreted with minimal contextual evidence when a dispute arises; or drafting shorter, less complete agreements (under a contextualist regime) that increase the likelihood of a lawsuit and require the assessment of substantially more material should there be litigation?[198] Given how rare contract disputes are relative to the total number of agreements executed, one can plausibly argue that reducing transaction costs via the contextualist approach better minimizes overall expenses.[199] But the actual answer to the question is unknown. And even if we could be reasonably certain about which interpretive system best reduces overall transaction and enforcement costs, we would also need to know the *magnitude* of the difference between the two systems in order to weigh cost reduction against interpretive accuracy and any other factors under consideration.[200]

Some textualist authorities dispute the proposition that contextualism has lower transaction costs. These sources maintain that because contextualism allows extrinsic evidence to override express terms,[201] it induces parties to spend additional time writing their contracts in an effort to minimize that danger. In other words, contextualism encourages transactors to draft longer agreements that contain extra language designed to reduce the risk that courts will adopt a mistaken interpretation after listening to extrinsic evidence.[202] Examples of such language include: (1) further detail in the operative terms of the agreement that specify the parties' obligations;[203] (2) broad provisions that purport to bar the judge from considering extrinsic evidence when

198. *See* SCOTT & KRAUS, *supra* note 121, at 602 ("The plain meaning regime reduces the expected costs of contracting by reducing the expenditures on litigation to resolve disputes; the contextualist regime reduces the costs of specifying the terms of a contract. Which is best turns on the difficult empirical question of which regime yields the lowest net total costs of contracting.")

199. Walt, *supra* note 9, at 263 ("Although there is an inevitable tradeoff between specification and error costs, incorporation reduces specification costs significantly more than it increases error and administrative costs."); *see* SMITH, *supra* note 196, at 276 ("The costs entailed in writing such a [complete] contract . . . outweigh its benefits. It is more efficient, therefore, for the law to complete contracts when the extra detail is needed.").

200. *See* Kraus & Walt, *supra* note 121, at 193 ("Even if plain-meaning regimes have lower interpretive error costs, the incorporation strategy is superior if its lower specification costs outweigh its higher interpretive error costs.").

201. *See supra* notes 68-71 and accompanying text.

202. MACAULAY, *supra* note 104, at 304 ("Concern has been expressed by some commentators, however, about the possibility that erroneous interpretations by contextualist courts can cause contractual parties to expend greater resources in the drafting of contracts."); Bernstein, *Custom*, *supra* note 162, at 98 ("When transactors want to control the meaning of their contract through express terms and are drafting in the shadow of the incorporation strategy as it operates in practice, they will need to include additional detail and/or additional provisions to fortify their contract's terms against usage-based interpretation."); *id.* at 112 (concluding that the UCC's contextualist approach raises transaction costs in comparison with textualism).

203. MACAULAY, *supra* note 104, at 304 ("The argument is that they may [be] driven to be very specific in their written contract to reduce the risk that courts will adopt an erroneous interpretation after hearing evidence about context.").

construing the instrument;[204] (3) wording that expressly rejects specific interpretations potentially derivable from evidence of the surrounding circumstances;[205] and (4) recitals that identify contractual purposes and other contextual information that can influence subsequent judicial construction.[206] Terms of this nature are less useful or necessary when textualism is the governing system because that approach shields facially unambiguous language from extrinsic evidence,[207] resulting in shorter agreements and reduced transaction costs.

Finally, bear in mind that there are reasons to be skeptical that interpretation rules significantly influence contract negotiation and drafting practices. The odds of an interpretive dispute—let alone a lawsuit—over any given agreement are incredibly low.[208] Thus, the incentives created by either textualism or contextualism to work out more details and address a greater number of contingencies in case a conflict arises might actually be quite minimal.[209] When large businesses engage in extremely complex deals, such as mergers and acquisitions, where many millions of dollars are at stake, it is plausible to think that the attorneys drafting the contract will be influenced by rules of interpretation in the governing jurisdiction. But such transactions are a very small fraction of all agreements. As a result, parties and lawyers may prepare most written contracts with little or no concern for whether a dispute over the instrument will be adjudicated under textualism or contextualism.[210]

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204. *See, e.g.*, Madison Indus., Inc. v. Eastman Kodak Co., 581 A.2d 85, 90 (N.J. Super. Ct. App. Div. 1990) (explaining in dicta that the court would have enforced a general provision barring all course of performance, course of dealing, and usage of trade evidence had the UCC governed the contract at issue); Schwartz & Scott, *supra* note 3, at 955-56 & nn.69-70 (collecting examples of such provisions from actual contracts). For a discussion of the potentially limited efficacy of these types of provisions under the UCC, see Bernstein, *Custom*, *supra* note 162, at 70-71, 71 n.29.

205. Bernstein, *Custom*, *supra* note 162, at 98-100 (explaining the type of contractual phrasing that would be necessary to nullify the impact of trade usage evidence). For example, in *Nanakuli Paving & Rock Co. v. Shell Oil Co.*, 664 F.2d 772 (9th Cir. 1981), discussed above in note 80, Shell could have inserted the following language to override the extrinsic evidence regarding price protection: "Price protection shall not be provided under this agreement." *See also* Bernstein, *supra*, at 100 (further noting that the UCC's contextualist interpretive rules probably have "particularly undesirable effects" on transaction costs when parties seek to engage in "contractual innovation"—i.e., when parties wish to alter "common contractual provisions, usage-based understandings, or commonly used contractual structures").

206. A recital is a preliminary statement explaining the reasons for entering the agreement and/or showing the existence of particular facts that constitute the background for the transaction. Normally, each recital begins with the word "whereas." Ameripath, Inc. v. Hebert, 447 S.W.3d 319, 331 (Tex. App. 2014).

207. *See supra* notes 36-39 and accompanying text.

208. *See* BURTON, *supra* note 4, § 1.2.1, at 12 ("And, in light of the millions of contracts concluded each day, interpretive disputes must be rare; by far, most contracts are performed without a hitch.").

209. *Cf.* MACAULAY, *supra* note 104, at 304 ("All this [namely, the conflicting arguments regarding transaction costs] assumes that when drafting contracts, parties consider the rules governing interpretation and draft their contracts with those rules in mind. How likely is that?").

210. Circumstances specific to the parties are a more plausible basis for variations in contract

C. Enforcement Costs

Perhaps the signature argument textualists offer in favor of their interpretive approach is that enforcement costs are higher under contextualism than under textualism.[211] Both courts and scholars have regularly pressed this claim.[212] The claim has two components: enforcement costs are greater in a contextualist regime because (1) there are more lawsuits, and (2) the lawsuits that are filed last longer. As used here, "last longer" denotes more than the mere passage of time. Rather, it means moving into later stages of the litigation process, with each stage requiring new activities that entail the expenditure of resources.[213]

Start by recalling that a much broader range of material is relevant in deciding whether a contract is ambiguous under contextualism. Textualism generally recognizes only patent ambiguities.[214] Thus, when attempting to convince the court that a contract is reasonably susceptible to more than one meaning, a party may rely solely upon the language within the four corners of the agreement. The judge is barred from considering any other evidence (though consulting dictionaries is permissible).[215] Contextualism recognizes both patent and latent ambiguities.[216] Accordingly, a party appearing before a contextualist court may use the language of the agreement as well as extrinsic evidence to establish the existence of an ambiguity.[217] Next, remember that textualists maintain that extrinsic evidence has many problematic features: it is frequently unreliable, contradictory, and/or ambiguous.[218] This means that contextualism both dramatically increases the *quantity* of interpretive material that courts must consider at the ambiguity stage *and* reduces the *quality* of the material that goes into

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negotiation and drafting practices. *Cf.* Katz, *supra* note 8, at 528 n.83 (explaining that it is cost-justified to write "trade usage explicitly into a contract . . . for usages . . . that govern contingencies that are especially likely to arise" in a given transaction).

211. MITCHELL, *supra* note 87, at 108 ("The first and most obvious reason for confining a court's enquiry to the four corners of the agreement relates to the possible costs involved in the contextual approach."); Bayern, *supra* note 1, at 1118 ("I take those costs [of dispute resolution] to be the chief modern reason that contract textualism is at least plausible in some contexts.").

212. MITCHELL, *supra* note 87, at 108 (noting that the costs of the contextualists approach, including enforcement costs, "has been a particular concern of some judges"); Cohen, *supra* note 15, at 133 ("Law and economics scholars often argue that contextualism is associated with higher litigation costs than textualism.").

213. Note that the number of lawsuits filed and the length of those suits are only indirect measures of enforcement costs. Directly quantifying such costs would require analyzing party and court expenditures on items like attorney's fees, taxable costs, filing fees, and time spent by the judiciary addressing interpretation disputes. Nonetheless, there appears to be almost universal agreement that the number of actions brought and how long those actions last are sufficient proxies.

214. Textualism also recognizes subject-matter latent ambiguities. *See supra* notes 61-66 and accompanying text. But set that point aside.

215. *See supra* notes 36, 42-43, 55-56, and accompanying text.

216. Here, "latent ambiguity" refers only to non-standard-meaning latent ambiguities. *See supra* notes 61-66 and accompanying text.

217. *See supra* notes 49-50, 57-58, and accompanying text.

218. *See supra* notes 107-1110 and accompanying text.

the ambiguity determination. These two features of contextualism raise enforcement costs from the textualist baseline through five main pathways.

First, as noted previously, textualism incentivizes parties to write good contracts—contracts that contain few gaps and employ precise language—because the ambiguity determination is restricted to the four corners of the agreement.[219] Contextualism is generally thought to have the opposite effect. It encourages parties to draft poor contracts—contracts with more open terms and ambiguities—because the parties know that should a dispute arise over construction, they can submit extrinsic evidence that addresses the issue.[220] A badly written contract raises the likelihood of an interpretive disagreement that can result in a lawsuit.[221] It also increases the chances that the judge will find the contract to be ambiguous if a case is filed, requiring that the action proceed to stage two of the interpretation process.[222] Accordingly, contextualism increases both the number of lawsuits that are commenced and the length of those proceedings in comparison to textualism.[223]

Second, it is far more difficult for contextualist courts to decide contract interpretation cases on the pleadings. Since a party is entitled to argue that an agreement is ambiguous via extrinsic evidence, the court generally must permit discovery so that such evidence may be gathered.[224] Therefore, the ambiguity determination typically can be made no earlier than at summary judgment.[225] Under textualism, ambiguity

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219. *See supra* notes 188-1191, 196, and accompanying text.

220. *See supra* 184-187, 195, and accompanying text.

221. *See* Carol Goforth, *Transactional Skills Training Across the Curriculum*, 66 J. LEGAL EDUC. 904, 917 (2017) ("[O]ne study from Harvard Law School some years ago apparently suggested that up to twenty-five percent of all contract disputes were really caused by poor drafting. Anecdotal evidence from litigators also provides some support for the notion that poorly drafted contracts result in substantial litigation.").

222. *See* Gilson et al., *supra* note 6, at 62 (observing that disputes over the meaning of contractual terms that are written as general standards "[are] much less amenable to pretrial resolution" than are disputes over terms that are drafted as precise rules).

223. *See id.* at 56 ("Writing a complete . . . contract that specifies ex ante the outcome in each future state of the world significantly reduces ex post enforcement costs by dramatically reducing (if not eliminating) the need for courts to inquire into context.").

224. *See, e.g.*, Pac. Gas & Elec. Co. v. G.W. Thomas Drayage & Rigging Co., 442 P.2d 641, 645 (Cal. 1968) ("Accordingly, rational interpretation requires at least a preliminary consideration of all credible evidence offered to prove the intention of the parties."); Wolf v. Superior Court, 8 Cal. Rptr. 3d 649, 655-56 (Ct. App. 2004) ("Indeed, it is reversible error for a trial court to refuse to consider such extrinsic evidence on the basis of the trial court's own conclusion that the language of the contract appears to be clear and unambiguous on its face."); MITCHELL, *supra* note 87, at 110 (observing that contextualist litigation is expensive because "the relevant 'context' has to be established"); *id.* at 63 (explaining that judges are justifiably concerned that contextualism adds to the costs and delays of litigation because they must consider the context before deciding what the contract means).

225. *See* Bank v. Truck Ins. Exch., 51 F.3d 736, 737-38 (7th Cir. 1995) (Posner, J.) (observing that contextualist interpretation "makes it difficult to decide contract cases on the pleadings"); A. Kemp Fisheries, Inc. v. Castle & Cooke, Inc., Bumble Bee Seafoods Div., 852 F.2d 493, 497 n.2 (9th Cir. 1988) (stating that under California law, "courts may not dismiss on the pleadings when one party claims that extrinsic evidence renders the contract ambiguous"); ConocoPhillips Co. v. Lyons, 299 P.3d 844, 849 (N.M. 2012) ("'The standard to be applied in determining whether a contract [term is ambiguous] . . . is the same standard

may be assessed via a motion to dismiss because the court need look no further than the four corners of the document during the first stage of the interpretive process.[226]

Third, it is easier to establish that a contract is ambiguous when extrinsic evidence is available because the parties have more material out of which to craft reasonable constructions of the operative language.[227] And contextualism motivates parties to invest heavily in the search for evidence that can support their preferred construction of the contract. Professor Catherine Mitchell explains: "A further problem is that much reliance on context may be done strategically—the problem of 'threshing through the undergrowth' for the chance remark upon which to build a case. The suspicion is often raised of the strategic reliance on context to sanction an escape from a bad bargain . . . ."[228]

Because of the second and third pathways, lawsuits will generally last longer when courts employ contextualist methodology; more cases will reach discovery, summary judgment, and trial.[229] In addition, the parties are more likely to file a lawsuit to

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applied in a motion for summary judgment.'") (quoting Randles v. Hanson, 258 P.3d 1154, 1156 (2011)).

226. *See* Kirsch v. Brightstar Corp., 968 F. Supp. 2d 931, 938-39 (N.D. Ill. 2013) (indicating that the ambiguity determination can be addressed via a motion to dismiss); Salewski v. Music, 54 N.Y.S.3d 203, 205 (App. Div. 2017) ("'Whether the language set forth in a release unambiguously bars a particular claim is a question of law appropriately determined on a motion [to dismiss] based upon the entire release and without reference to extrinsic evidence . . . .'") (quoting Zilinskas v. Westinghouse Elec. Corp., 669 N.Y.S.2d 703, 705 (App. Div. 1998).

227. *See* 5 KNIFFIN, CORBIN ON CONTRACTS, *supra* note 31, § 24.7, at 36 ("[P]roof of the circumstances may make plain and clear a meaning that was not apparent when in the absence of such proof some other meanings seemed plain and clear."); Goldstein, *supra* note 7, at 75 ("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."); Whitford, *supra* note 7, at 939 ("Written language that appears to have a plain meaning when considered alone suddenly appears ambiguous when evidence suggests that the parties understood the language to have a different meaning.").

228. MITCHELL, *supra* note 87, at 113; *accord id.* ("One may use the 'context' to seek an unbargained for advantage in imposing terms after the parties are in a contractual relationship, even in circumstances where the written terms appear relatively complete."); Cohen, *supra* note 15, at 133 ("For example, allowing more contextual evidence may encourage parties to spend more on litigation because the marginal benefit of expenditures to develop such evidence is higher than under a textualist regime."); Gilson, *supra* note 6, at 41 (quoted in the text accompanying note 129 above); Katz, *supra* note 8, at 530 ("Under a regime of substantive interpretation, for instance, parties may be tempted to invest substantial resources in litigation in order to maximize the chance of a favorable outcome."); *id.* at 531 ("Formality, by limiting the scope for ex post interpretive disputes, probably reduces the marginal productivity of litigation expenditure, and thus reduces the amount of such expenditure."); *supra* note 126 and accompanying text; *see also* Steuart v. McChesney, 444 A.2d 659, 663 (Pa. 1982) ("Likewise, resort to the plain meaning of language hinders parties dissatisfied with their agreement from creating a myth as to the true meaning of the agreement through subsequently exposed extrinsic evidence.").

229. Whitford, *supra* note 7, at 952 n.51 ("It must be the case that the combination of a plain meaning rule and a hard PER keep some cases out of the jury's hands altogether . . . in circumstances where alternative interpretive rules would require submission of the case to a jury."); Schwartz & Scott, *supra* note 3, at 963 ("The plain meaning rule operates in tandem with a hard parol evidence rule to reduce expected adjudication costs. If the

begin with since those challenging the apparently clear terms of a contract stand a better chance of surviving the ambiguity stage and making it to a jury than if the courts use textualism.[230]

Fourth, including extrinsic evidence in the first stage of the interpretive process makes it more difficult to predict how judges will adjudicate the ambiguity question.[231] One reason for this is that different pieces of extrinsic evidence often conflict with each other and/or with language in the disputed agreement. And parties do not know

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contract is fully integrated, and if contractual terms are facially clear, then the dispute can be resolved at summary judgment."); *see* Ward v. Intermountain Farmers' Ass'n, 907 P.2d 264, 269-70 (Utah 1995) (Russon, J., concurring) ("When a motion for summary judgment can be defeated merely by the opposing party's affidavit averring that an otherwise clear contract provision was intended to mean something different, attorneys will discontinue the futility of composing summary judgment motions, and every contract dispute will be formally resolved only through trial."); Spigelman, *supra* note 100, at 413 ("Furthermore, the length and cost of the process is increased [by contextualism]."); *see also* BURTON, *supra* note 4, §4.6.2, at 147 ("For both parties and others, investigating the parties' subjective intentions can be costly, if such investigations are possible without rights to discovery and perhaps even then."); Shavell, *supra* note 107, at 311 (observing that "extrinsic evidence . . . is very costly to consider (especially because of the tendency of parties to contest negotiating history, oral statements, course of dealing).").

230. *See* FDIC v. W.R. Grace & Co., 877 F.2d 614, 621 (7th Cir. 1989) (Posner, J.) ("The older view, sometimes called the 'four corners' rule, . . . tends to cut down on the amount of litigation."); Gilson et al., *supra* note 6, at 42 ("The reduction in the chance of an expensive trial . . . reduces the settlement value of a claim, and therefore the incentive for a disappointed party to pursue opportunistic litigation in the first place."). Note that most textualists would probably contend that contextualist interpretation also increases the number of disputes over contractual meaning that do *not* result in a lawsuit. Such disputes are another type of enforcement cost. But this argument does not appear to play a significant role in the secondary literature or caselaw.

231. GOLDBERG, *supra* note 114, at 162 ("The danger of a *Nanakuli-Columbia Nitrogen* [contextualist] interpretative strategy is that parties will be frustrated in trying to devise the terms of their agreement, and they will have little confidence in their ability to predict the outcomes if their disputes do end up in litigation."); 5 KNIFFIN, CORBIN ON CONTRACTS, *supra* note 31, § 24.7, at 53 (noting that various "judges have expressed the view that discarding the plain meaning rule would interfere with predictability and uniformity in interpretation of contracts . . . ."); MCMEEL, *supra* note 7, § 1.107 (observing that after English courts adopted contextualism, "fears were expressed" that this would "generate greater uncertainty in the context of commercial transactions"); MITCHELL, *supra* note 87, at 91 ("The weakness of contextualism is its unpredictability."); Goldstein, *supra* note 7, at 76 ("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."); Spigelman, *supra* note 100, at 412 (arguing that "the general use of extrinsic materials" undermines certainty in "contracts between commercial parties" and results "in an increase in the cost of commercial dispute resolution"); *see also* Hershon v. Gibraltar Bldg. & Loan Ass'n, 864 F.2d 848, 853 (D.C. Cir. 1989) ("Nonetheless, it is fundamentally important that parties be able to rely on the explicit language of written contracts. The public interest in certainty and finality is too critical to allow every agreement to be subjected to collateral attack."); W.W.W. Assocs., Inc. v. Giancontieri, 566 N.E.2d 639, 643 (N.Y. 1990) ("An analysis that begins with consideration of extrinsic evidence of what the parties meant, instead of looking first to what they said and reaching extrinsic evidence only when required to do so because of some identified ambiguity, unnecessarily denigrates the contract and unsettles the law.").

which subset of the textual and extrinsic evidence the court is likely to find dispositive.[232] In addition, if no lawsuit has been filed yet, neither party will even have access to all of the materials the judge is going to consider since discovery will not have commenced.[233] Textualism minimizes or avoids these problems, resulting in greater predictability, because it restricts the ambiguity determination to the four corners of the agreement.[234] Since transacting parties always have access to their contract, there is no mystery over which evidence will be presented to the court during stage one. Furthermore, because the judge reviews far less material when assessing ambiguity in a textualist regime, conflicts between different pieces of evidence should be much rarer.

Fifth, as noted above, interpretation cases are more likely to reach trial under contextualism than under textualism.[235] The results of jury trials are considered notoriously hard to predict.[236] "Hence, if judicial decisions are more predictable than jury decisions, the effect of a plain meaning rule and a hard [parol evidence rule] would be a net increase in the predictability of legal outcomes at the trial [court] level."[237]

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232. *See* MITCHELL, *supra* note 87, at 91 ("Parties, and their lawyers, may . . . have little idea of what outcomes [contextualism] may lead to, since they may be unaware of what particular context, and contextual material, is regarded as controlling."); Whitford, *supra* note 7, at 952 ("The common assumption is that interpretive rules that emphasize plain meaning approaches to written contracts and a hard PER yield greater predictability in judicial outcomes. Partly this is because these rules render irrelevant extrinsic evidence . . . that will often be conflicting and cause uncertainty about how the conflicts will be resolved.").

233. Posner, *supra* note 82, at 572 ("But parties cannot know in advance the effect of extrinsic evidence on judicial decisions under [contextualism], because each party cannot know in advance what the other party might introduce as extrinsic evidence.").

234. Kniffin, *supra* note 59, at 100 n.30 ("The plain meaning rule is intended to avoid unnecessary expenditure of judicial resources and to further predictability; the court avoids examining extrinsic evidence when the court is certain of the meaning of a disputed term, . . . "); Posner, *supra* note 82, at 562 & n.47 ("Courts that support hard-PER argue that this rule increases commercial certainty by enabling parties to predict the promises that courts will enforce.") (collecting authorities); *see also* FARNSWORTH, *supra* note 16, § 7.12, at 465 ("The restrictive view is defended on the grounds that it . . . gives predictability in the interpretation of commonly used terms.").

235. *See supra* note 229 and accompanying text.

236. Valerie P. Hans & Theodore Eisenberg, *The Predictability of Juries*, 60 DEPAUL L. REV. 375, 375 (2011) ("The jury is said to be the least predictable of the decision makers in the legal system."); *see, e.g.*, Dru Stevenson, *The Function of Uncertainty Within Jury Systems*, 19 GEO. MASON L. REV. 513, 513 (2012) ("Indeed, current jury selection methods all but guarantee that jury trial outcomes are uncertain and unpredictable."); Byron G. Stier, *Another Jackpot (In)justice: Verdict Variability and Issue Preclusion in Mass Torts*, 36 PEPP. L. REV. 715, 720 (2009) ("Evidence of verdict variability conforms to lawyers' long-held beliefs about the unpredictability of trial. Juries may well deliver verdicts that substantially differ, though based on identical facts."). *But see* Hans & Eisenberg, *supra*, at 379-80 (reviewing the literature and concluding that juries are "generally predictable in the sense that we know what particular factors will lead to plaintiff verdicts and substantial compensatory and punitive damages awards").

237. Whitford, *supra* note 7, at 952 n.51; *accord id.* at 952 ("The common assumption is that interpretive rules that emphasize plain meaning approaches to written contracts and a hard PER yield greater predictability in judicial outcomes . . . . Partly this is because it is hoped these rules avoid the irrationalities of jury decisions on interpretive issues.").

It is generally accepted that adjudicative uncertainty increases litigation.[238] Therefore, the uncertainty contextualism creates at the ambiguity stage (pathway four) and through the greater number of trials (pathway five) increases the likelihood that parties will file a lawsuit.[239] In addition, because uncertainty reduces the probability of settlement, contextualism tends to lengthen any interpretation litigation that is commenced.[240]

When courts advance the claim that contextualism increases enforcement costs, they often do so with considerable stridency and with language that tends to conflate

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238. James M. Fischer, *Discretion and Politics: Ruminations on the Recent Presidential Election and the Role of Discretion in the Florida Presidential Election Recount*, 69 U. CIN. L. REV. 807, 836 n.99 (2001) ("The view that uncertainty increases litigation costs appears to be generally held."); Peter Siegelman & John Donohue, *Studying the Iceberg from Its Tip: A Comparison of Published and Unpublished Employment Discrimination Cases*, 24 LAW & SOC'Y REV. 1133, 1148 (1990) ("A substantial literature also indicates that uncertainty about the likely outcome of a trial will diminish the chance that the case will be settled."); *see, e.g.*, George L. Priest & Benjamin Klein, *The Selection of Disputes for Litigation*, 13 J. LEGAL STUD. 1, 45 (1984) ("Substantial uncertainty over the outcome of individual trials, of course, will lead in general to high rates of litigation . . . .").

239. *See* MITCHELL, *supra* note 87, at 112 ("A related problem is that litigation over terms and obligations is actually *encouraged* (and hence costs incurred) by courts adopting a contextual approach,…."); 6 LINZER, CORBIN ON CONTRACTS, *supra* note 78, § 25.15[A], at 190 (noting that a "common argument against the loosening of the parol evidence rule" is that "the use of extrinsic evidence to show the ambiguity could open floodgates" to more litigation); *see also* BURTON, *supra* note 4, § 1.1.2, at 7 (explaining that "predictability encourages performance [and] discourages disputes . . . .").

240. *See* Cohen, *supra* note 15, at 133 ("Alternatively, allowing contextual evidence may undermine certainty and therefore make settlement less likely."); *see also* BURTON, *supra* note 4, § 1.1.2, at 7 (explaining that "predictability . . . fosters settlement"); GOLDBERG, *supra* note 114, at 163 ("The role of the formal law, in this view, is to provide an anchor. If the litigation outcome is relatively certain, it provides a clear base point for negotiating a settlement."); Katz, *supra* note 8, at 531 ("To the extent that [textualism/formalism] conditions the outcome of litigation on publicly available information, and reduces the variations of litigants' expectations regarding that outcome, it probably also encourages settlement."). Keep in mind, however, that in various other contexts, commentators have argued that uncertainty encourages settlement. *See, e.g.*, PAUL D. RHEINGOLD, LITIGATING MASS TORT CASES § 10:64 (2020) (noting that "unpredictability of outcome itself is often a stimulus to settlement"); Walter O. Alomar-Jimenez, *Harmonizing eBay*, 1 U. P.R. BUS. L.J. 17, 24 (2010) ("The uncertainty and unpredictability of the outcome of jury trials [in the patent context] also encourages settlement.").

Note also that textualists abroad sometimes argue that discovery and trials last longer under contextualism and that trials are harder to predict. *See, e.g.*, MacLauchlan, *supra* note 6, at 36 (explaining that the English case adopting contextualism "was seen as a recipe for a further increase in the already substantial cost of the discovery process and the lengths of trials"); MCMEEL, *supra* note 7, §§ 1.107, 1.109, 1.110 (same). That might be true under the versions of textualism used in other countries. But as explained previously, textualist and contextualist courts in the United States generally concur on the evidence that may be used at trial after the court has determined that an ambiguity exists. *See supra* note 53 and accompanying text. Accordingly, there generally should be no difference in the length of discovery, the length of trials, or the predictability of trials under the two approaches. Some scholars, however, have argued that a more limited range of interpretive evidence should be admissible at trial. *See, e.g.*, BURTON, *supra* note 4, Ch. 6, at 193, and § 6.1.3.

the various arguments just discussed. An excellent example can be found in *Trident Center v. Connecticut General Life Insurance Co.*[241] There, Judge Alex Kozinski set forth his now famous assault on California's contextualist contract interpretation doctrine.[242] Taking aim at *Pacific Gas & Electric Co. v. G.W. Thomas Drayage & Rigging Co.*,[243] the watershed California Supreme Court decision that paved the way for modern acceptance of the contextualist approach, he wrote the following:

> *Pacific Gas* casts a long shadow of uncertainty over all transactions negotiated and executed under the law of California. As this case illustrates, even when the transaction is very sizeable, even if it involves only sophisticated parties, even if it was negotiated with the aid of counsel, even if it results in contract language that is devoid of ambiguity, costly and protracted litigation cannot be avoided if one party has a strong enough motive for challenging the contract. While this rule creates much business for lawyers and an occasional windfall to some clients, it leads only to frustration and delay for most litigants and clogs already overburdened courts.[244]

Comparable statements abound in the caselaw.[245]

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241. 847 F.2d 564 (9th Cir. 1988).

242. *See* Linzer, *supra* note 81, at 814 (referring to Judge Kozinski's *Trident* opinion as "famous").

243. 442 P. 2d 641 (Cal. 1968).

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

245. Indeed, California Supreme Court Justice Stanley Mosk made essentially the same arguments in one of the cases commonly associated with *Pacific Gas* that was decided later that same year:

> Given two experienced businessman dealing at arm's length, both represented by competent counsel, it has become virtually impossible under recently evolving rules of evidence to draft a written contract that will produce predictable results in court. The written word, heretofor deemed immutable, is now at all times subject to alteration by self-serving recitals based upon fading memories of antecedent events. This, I submit, is a serious impediment to the certainty required in commercial transactions.

Delta Dynamics, Inc. v. Arioto, 446 P.2d 785, 789-90 (Cal. 1968) (Mosk, J., dissenting). Another excellent example can be found in *Steuart v. McChesney* where the Pennsylvania Supreme Court wrote:

> Accordingly, the plain meaning approach enhances the extent to which contracts may be relied upon by contributing to the security of belief that the final expression of *consensus ad idem* will not later be construed to import a meaning other than that clearly expressed. . . . Likewise, resort to the plain meaning of language hinders parties dissatisfied with their agreement from creating a myth as to the true meaning of the agreement through subsequently exposed extrinsic evidence. Absent the plain meaning rule, nary an agreement could be conceived, which, in the event of a party's later disappointment with his stated bargain, would not be at risk to having its true meaning obfuscated under the guise of examining extrinsic evidence of intent. Even if the dissatisfied party in good faith believed that the agreement, as manifest, did not express the *consensus ad idem*, his post hoc judgment would be inclined to be colored by belief as to what should have been, rather than what strictly was, intended.

Some contextualists disagree with the above analysis and contend that textualism has higher enforcement costs. They offer the following arguments in defense of their position. First, because textualism prohibits the review of extrinsic evidence when determining whether an agreement is ambiguous, the principal inputs at stage one are (1) the contract, and (2) the judge.[246] But judges "come from a variety of backgrounds—private law practice, government service, business, academia—and their fields of experience represent an even wider variance."[247] Such differences can lead judges to reach disparate conclusions regarding the same contractual language. Indeed, one commentator contends that "[a]ppellate courts' reviews of four corner determinations are often arbitrary and extremely subjective."[248] Critically, the parties will not know which trial judge is going to interpret their contract until a lawsuit is filed. Nor will they know which appellate judges are going to be assigned to the case if the dispute subsequently reaches a higher court.[249] This makes it immensely difficult for parties to predict the results of ambiguity decisions in textualist jurisdictions.[250] Such uncertainty increases the number of lawsuits and hinders settlements.[251]

Under contextualism, by contrast, courts review extrinsic evidence of the surrounding context when assessing ambiguity.[252] Contracting parties are familiar with that context since it concerns their own business dealings. This means that transactors have substantial information about both of the primary inputs at stage one in contextualist states—(1) the contract, and (2) their own background.[253] Accordingly, parties

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444 A.2d 659, 663 (Pa. 1982) (citations omitted).

246. *See supra* note 36 and accompanying text; *see also* Goldstein, *supra* note 7, at 90 (arguing that at stage one textualism "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"). Other textualist inputs include dictionaries, the rules of grammar, and the canons of construction. *See supra* notes 37-39 and accompanying text.

247. Mellon Bank, N.A. v. Aetna Bus. Credit, 619 F.2d 1001, 1011-12 n.12 (3d Cir. 1980).

248. 6 LINZER, CORBIN ON CONTRACTS, *supra* note 78, § 25.14[B], at 163.

249. Burton, *supra* note 5, at 357 ("The parties will not know which judge(s) they will get in litigation when they negotiate and draft, ascertain their rights and obligations, decide whether to perform or breach, decide whether to challenge the other party's performance, negotiate to settle a dispute, decide whether to litigate, and plan for litigation.").

250. *Mellon Bank*, 619 F.2d at 1010 ("If each judge simply applied his own linguistic background and experience to the words of a contract, contracting parties would live in a most uncertain environment."); 6 LINZER, CORBIN ON CONTRACTS, *supra* note 78, § 25.14[B], at 163 (explaining that "it is difficult to predict how the appellate courts will read words claimed to be ambiguous" in textualist states); *see* Goldstein, *supra* note 7, at 90-91 ("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 preconceptions of the judge determine reasonableness, then the law of contracts is made unpredictable . . . .").

251. Burton, *supra* note 5, at 357 ("Due to the uncertainties [regarding which judge the parties will appear before], moreover, both trial and appellate proceedings would proliferate, the latter because appellate judges will have different backgrounds from both the trial judges and from one another.").

252. *See supra* text accompanying note 49.

253. *Compare supra* notes 143-145 and accompanying text (drawing a similar comparison

are better able to predict the results of ambiguity determinations when judges employ contextualist methods, lowering enforcement costs in comparison with textualism.[254]

Second, as noted previously, textualism arguably provides parties with an incentive to write longer, more complete contracts.[255] Such agreements contain greater complexity, increasing the chance that terms will conflict or otherwise support varying interpretations.[256] That, in turn, makes lawsuits concerning interpretive disputes more likely[257] and raises the odds that the judge will find the agreement to be ambiguous, lengthening any proceedings that are begun.

Third, the average person is often angered or even outraged when a counterparty insists on the strict application of unambiguous contractual language that appears to conflict with the prior contextual understanding of the transactors.[258] This is especially

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between textualism and contextualism in the context of interpretive accuracy).

254. 6 LINZER, CORBIN ON CONTRACTS, *supra* note 78, § 25.14[B], at 163 ("Given the arbitrariness of the decisions [in Texas], the courts would have been better off making them with the additional information offered by the rejected extrinsic evidence."); Burton, *supra* note 5, at 353 ("So, because the parties will not know who the judge will be if litigation ensues, OCI [Objective Contextual Interpretation] better contains pre-litigation costs. OCI better enables the parties to forecast an adjudicatory result when they draft a contract, consider whether to perform or breach, decide whether to challenge the other party's performance, attempt to settle a dispute, and plan for litigation."); Posner, *supra* note 82, at 562. ("Courts that support soft-PER argue that soft-PER increases commercial certainty by allowing judges and juries to consider all relevant evidence."); MacLauchlan, *supra* note 6, at 35 (explaining that allowing the admission of prior negotiations could reduce interpretive uncertainty since it will sometimes reveal "that the parties formed a common intention as to the meaning of the words in dispute"). *But see* Posner, *supra*, at 572 (arguing that parties can better predict case outcomes under textualism because (1) "general interpretive principles" apply to all types of contractual disputes and thus "parties should be able to take account of these principles when . . . predicting judicial enforcement," (2) "judges are appointed or elected from a homogenous group of people" and their "interpretive prejudices are revealed in their decisions and opinions," making "these prejudices relatively predictable at the time of contracting," while (3) "parties cannot know in advance the effect of extrinsic evidence" under contextualism "because each party cannot know in advanced what the other party might introduce as extrinsic evidence . . . should a dispute arise"). Note that Professor Burton is only defending his preferred version of *partial* contextualism in the article cited in this footnote. He actually states that *full* contextualism likely does have higher enforcement costs than textualism. *See* Burton, *supra*, at 352. Note also that textualists might respond that even if ambiguity determinations are less predictable under their approach, summary judgment operates in substantially the same way under both approaches. *See* Silverstein, *supra* note 61 (manuscript at 30-31). As a result, contextualism has no advantage when it comes to predicting whether a case will go to trial or not, which is arguably the issue about which transactors most desire certainty.

255. *See supra* notes 188-1191, 196, and accompanying text; *see also* Cohen, *supra* note 15, at 134 ("Moreover, there is a parallel concern under textualism: parties will have an incentive to write more complete contracts than they would otherwise prefer.").

256. For an excellent example, *see* Dr.'s Assocs., Inc. v. Dupree, 745 N.E.2d 1270, 1281 (Ill. App. Ct. 2001) (discussing a settlement agreement with both a general release extinguishing claims against numerous third-party beneficiaries and a clause stating that the contract was not intended to provide contractual rights to any third-party beneficiaries).

257. Cohen, *supra* note 15, at 134 ("Greater complexity can in fact lead to more litigation, as the chance that terms will conflict or support alternative conduct increases.").

258. *See* Zamir, *supra* note 93, at 1772 (explaining that in many contexts "[i]nsistence on strict

true when the counterparty stated during preliminary negotiations that the relevant language was of no consequence or would not be relied upon should conditions change or a dispute arise.[259] Such conduct may infuriate a consumer or business sufficiently to motivate them to sue, or to resist to the point that the other side is compelled to file an action.[260] Textualism incentivizes parties to stand on express terms that are inconsistent with the other side's reasonable expectations more than contextualism does[261] because the former system prevents litigants from submitting extrinsic evidence regarding their expectations when the contested language of an agreement is clear.[262] Accordingly, textualism might promote a type of behavior that increases the likelihood that contractual partners will become frustrated and accept going to court.[263]

Another possibility is that the interpretive approach that best minimizes enforcement costs varies based on whether a contract is patently ambiguous or not. On the one hand, textualism is probably more efficient in adjudicating disputes over unambiguous agreements. A textualist court may finalize its construction of such a contract at the pleading stage.[264] In a contextualist jurisdiction, interpretive lawsuits normally must proceed to discovery and summary judgment because the parties are entitled to present extrinsic evidence as part of the ambiguity determination.[265] On the other hand, contextualism is likely more efficient in litigating matters that concern ambiguous agreements. In a contextualist jurisdiction, a case involving that type of contract will generally advance straight to discovery and then summary judgment because there is no need to assess patent ambiguity up front.[266] Under textualism, the judge must first establish that the contract is facially ambiguous, typically at the pleading stage, creating an additional step in the lawsuit.[267]

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compliance with the letter of the contract is considered improper and indecent by business persons, suppliers, and consumers alike").

259. *Cf.* Roger W. Kirst, *Usage of Trade and Course of Dealing: Subversion of the UCC Theory*, 1977 U. ILL. L.F. 811, 870-71 (noting that when a party switches from the flexible enforcement of its contracts to strict reliance on written terms, "unfairness may result . . . that upsets assumptions reasonably based on past practice").

260. *Cf.* Linzer, *supra* note 81, at 806 ("The parol evidence rule serves a legitimate end. We enter into written contracts to avoid disputes in the future, and if every contract were simply the beginning point in a testimonial battle, we would gain little by writing things down. But the written word is not as infallible a guide as some think, and people often do not read agreements and often do believe themselves protected when they are told 'don't worry about that clause.'").

261. *See* MITCHELL, *supra* note 87, at 113 (explaining that under textualism, "a party may strategically seek an advantage by relying on the strict words of a contract while knowing that the documents did not reflect the parties' joint understanding").

262. *See supra* notes 36-39 and accompanying text.

263. Silverstein, *supra* note 15, at 277-78.

264. *See supra* note 226 and accompanying text.

265. *See supra* notes 224-225 and accompanying text. This argument substantially overlaps with the second textualist pathway, which is discussed in the text accompanying notes 224-226.

266. *See* Silverstein, *supra* note 61 (manuscript at 29-31) (explaining the operation of contextualism).

267. *See id.* (manuscript at 24-26).

While the analysis in the last paragraph is plausibly correct, it is not terribly useful when trying to compare *overall* enforcement costs under textualism and contextualism for two reasons. First, we do not know the ratio of patently ambiguous to unambiguous agreements that end up in litigation. Second, we know neither the magnitude of the savings created by textualism in cases regarding unambiguous contracts, nor the magnitude of the savings created by contextualism in cases regarding ambiguous contracts.[268]

I recently conducted two studies designed to address which interpretive approach has higher overall enforcement costs.[269] My studies constitute the only empirical work on this topic. In the first study, there was no statistically significant difference between textualism and contextualism for thirteen of the fourteen measures of enforcement costs I employed. For the fourteenth measure, textualism had higher enforcement costs and the difference was statistically significant.[270] In the second study, there was no statistically significant difference between the two interpretive systems under any of the twelve measures I used.[271] Given these results, my two studies provide virtually no support for either the textualist claim that contextualism has higher enforcement costs or the contextualist counterclaim that textualism has higher enforcement costs.[272] Critically, both studies suffered from numerous methodological limitations.[273] This led me to present the results in my prior papers with considerable reservation.[274]

But it is also possible that I failed to find a statistically significant difference in enforcement costs levels because textualism and contextualism do not actually vary with respect to such costs. In other words, the number of lawsuits filed and the length of those proceedings may be substantially the same under the two interpretive

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268. The first point also raises a problem for another textualist argument regarding enforcement costs, which can be thought of as a sixth pathway: "Regimes with simpler interpretive rules produce lower administrative costs than regimes with more complex rules." Walt, *supra* note 9, at 273. Contextualism is more complicated in that more information is relevant during the ambiguity determination. *See id.* at 273-74 ("The existence and content of applicable business norms are not always transparent, and adjudicators do not have easy or reliable access to them. So incorporation is more complex than formalism and therefore in a straightforward way induces higher administrative costs than the latter."). But textualism is more complicated in that it adds a pleading stage to the interpretive process. *See* Silverstein, *supra* note 61 (manuscript at 25-26, 29-30, 36). Which type of complexity is more significant—more information at the first stage of interpretation or more stages? The answer turns, in part, on the ratio of facially ambiguous to unambiguous contracts, something that is unknown.

269. *See* Silverstein, *supra* note 78, at 1058-61, 1085-92; Silverstein, *supra* note 15 at 284-300.

270. Silverstein, *supra* note 15, at 298-300.

271. Silverstein, *supra* note 78, at 1091-92.

272. Silverstein, *supra* note 78, at 1092; Silverstein, *supra* note 15, at 300.

273. *See* Silverstein, *supra* note 78, at 1027-29, 1058-61, 1092-96; Silverstein, *supra* note 15, at 226-53, 286-94, 300-05.

274. *See* Silverstein, *supra* note 78, at 1092 ("[T]he methodological limitations of my research protocol indicate that considerable caution is in order."); Silverstein, *supra* note 15, at 305 ("Given the methodological concerns presented in this subpart, textualists and contextualists are justified in harboring considerable doubts about my results.").

frameworks.[275] In the article that contained my first study, I offered three hypotheses for why this might be the case.[276]

First, the various theories advanced by textualists and contextualists to justify the conclusion that their school of interpretation best reduces enforcement costs could all be false. To illustrate, recall that textualists assert that it is easier to establish the existence of an ambiguity under contextualism because parties have more material available out of which to craft reasonable understandings of the relevant contract language.[277] That seems plausible enough. But perhaps additional evidence typically does not seriously improve a claim that an agreement is ambiguous. The driving force in ambiguity determinations, even in contextualist states, might be the express terms of the contract. Similarly, contextualists maintain that textualism creates incentives to write longer contracts because parties are less able to rely upon extrinsic evidence should a dispute arise. And longer agreements are more likely to have contradicting terms, increasing litigation.[278] This too is a plausible theory. But perhaps the incentives created by textualist rules are too weak to influence drafting practices. In particular, parties may be more concerned about transaction costs than enforcement costs, and so they prefer to take their chances that litigation will result rather than spend time preparing longer agreements.[279] Another possibility is that parties and their lawyers are quite proficient at drafting extensive contracts and so the predicted contradictions seldom materialize.

A second explanation for the findings in my studies is that there is considerable truth in all or most of the textualist and contextualist theories about enforcement costs, but the impacts of each approach largely cancel out. For example, textualists argue that contextualism promotes uncertainty because parties cannot know in advance which evidence a court is likely to find persuasive when deciding whether a contract is ambiguous. Indeed, prior to the commencement of discovery, parties will often not even have access to all of the pertinent materials. This makes it difficult to predict the result of an ambiguity determination.[280] Contextualists counter that textualism promotes uncertainty because the only inputs at the ambiguity stage under that approach are the contract and the judge, and judges vary dramatically in their acontextual understandings of contract language. Moreover, until a lawsuit is filed, the parties will not even know which judge is going to preside over their dispute. This also makes it difficult to predict the outcome of an ambiguity determination.[281]

It is entirely conceivable that both of these theories are correct, but that the resulting levels of uncertainty are substantially equivalent. In other words, the uncertainty created by not knowing what evidence a contextualist judge will find persuasive could

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275. I suggested something similar with respect to transaction costs in the prior section. *See supra* notes 208-2209 and accompanying text.

276. *See* Silverstein, *supra* note 15, at 305-07; *see also* Silverstein, *supra* note 78, at 1037 (summarizing the same three explanations).

277. *See supra* note 227 and accompanying text.

278. *See supra* notes 255-256 and accompanying text.

279. *See supra* note 197 and accompanying text.

280. *See supra* notes 231-232 and accompanying text.

281. *See supra* notes 246-254 and accompanying text.

be largely the same as the uncertainty created by not knowing how a textualist judge is going to view contract language in the absence of any extrinsic evidence—i.e., given only his or her background. One might respond that such equivalence is unlikely. But when all of the possible pathways to increased (or reduced) enforcement costs under each approach are added into the mix, it would not be surprising if the full panoply of countervailing forces sufficiently balance out such that there is no genuine difference between textualism and contextualism with respect to such costs.

A third possibility is that the countless other factors that influence whether a lawsuit is filed and how long it lasts swamp any impact resulting from the interpretive approach in use by the courts. To illustrate, the inherent ambiguities in language could make litigation over the meaning of agreements extremely unpredictable regardless of which school of interpretation is employed. If that is the case, then the construction of contracts may be so uncertain under either system that changing between them has only a small effect on enforcement costs. Indeed, the general lack of predictability in interpretation cases is well known and has been cited as a basis for the claim that a shift towards contextualism will have no effect on the level of uncertainty parties face.[282] Furthermore, the basic problems with language that infect interpretation litigation constitute only one of many factors that can influence whether a case is filed and the length of the proceeding. Others include (1) the rules of procedure and evidence, (2) the capacities of judges, lawyers, and jurors, (3) the nature of the parties (i.e., whether they are businesses or consumers), and (4) the relationship of the parties (i.e., whether they are long-term partners or transacting for the first time). When all of these forces are considered, it makes sense to believe that even if the choice of interpretive approach matters to some degree, the impact on enforcement costs is too trivial to be measurable.

To recap, according to the first explanation for the findings of my two studies, the textualist and contextualist theories about enforcement costs are generally false. According to the second explanation, the theories are largely true, but the impacts of each approach cancel out. And according to the third explanation, the theories are again largely true, but all of the other factors that influence enforcement cost levels swamp any difference between textualism and contextualism. If one of these explanations is valid, then enforcement costs should no longer play a substantial role in debates over the best approach to the construction of agreements.

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One final note is in order. As the material in this part demonstrates, courts and scholars on both sides of the interpretation debate claim superiority on accuracy, transaction costs, and enforcement costs. But many commentators conceptualize the choice

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282. *See* MacLauchlan, *supra* note 6, at 35 ("As I pointed out at the very beginning of this article, contract interpretation cases tend to be the most intractable of all contractual disputes and their outcome is notoriously difficult to predict. It is difficult to believe, therefore, that a more liberal approach to the reception of evidence of prior negotiations would result in any greater uncertainty. Indeed, in those cases where the evidence revealed that the parties formed a common intention as to the meaning of the words in dispute, the opposite might be the case.").

between the two interpretive approaches as one involving trade-offs. These scholars are willing to concede that the other side has the better argument on at least one of the three key issues; they contend, however, that their own side is still superior because it is much stronger on the remaining dimension(s). For instance, as noted in Part III.B,[283] textualists typically acknowledge that contextualism lowers transaction costs; but they believe that it raises enforcement costs by a higher amount.[284] Similarly, some textualists concede that contextualism is more likely to result in accurate interpretations, but maintain that such accuracy is not worth the increased enforcement costs.[285] Some contextualists argue the converse, acknowledging that contextualism has higher enforcement costs, but asserting that those costs are worth paying in exchange for their approach's greater interpretive accuracy.[286] Finally, at least one contextualist has concluded that textualism is superior on both accuracy and enforcement costs, but argues that contextualism lowers transaction costs by more than enough to offset those harms.[287]

IV. Other Policy Issues in Contract Interpretation

Scholars have developed a number of policy arguments regarding contract interpretation that do not fit directly into the accuracy/transaction costs/enforcement costs framework presented in Part III. This section discusses the most important of those arguments.

A. Which Interpretive System Do Parties Prefer?

Textualism is frequently defended on the ground that businesses prefer that

283. *See supra* notes 194-199 and accompanying text.

284. *See also* Cohen, *supra* note 15, at 133 (observing that a "number of scholars have argued that the optimal contract rules of interpretation and implied terms are determined by the tradeoff between ex ante negotiation and drafting costs and ex post litigation costs").

285. *See, e.g.*, Schwartz & Scott, *supra* note 3, at 933 ("Moreover, we concede that a court is more likely to make an accurate interpretation if it sees more evidence, but we argue that sometimes accuracy is not worth the costs of achieving it.").

286. *See, e.g.*, 6 LINZER, CORBIN ON CONTRACTS, *supra* note 78, § 25.4, at 39 (arguing that "certainty," which concerns enforcements costs, "is simply not as important as the parties' intentions discerned from their words, read in the context of all relevant evidence, extrinsic or not," which concerns accuracy); *id.* (acknowledging that "[f]ormalism of the kind found in plain meaning and an 'objectivist' parol evidence rule is much easier to carry out than weighing context, credibility, linguistic sensibility and the many other factors that can go into interpretation of words that may or may not mean what we think they mean"); *see also* Bayern, *supra* note 1, at 1120-21 ("[I]t may be helpful to note that while litigation costs are not insignificant, they are a vanishingly small part of the total value of contracts—of all gains through trade in the economy of the United States. Tampering with the latter out of excess concern with the former poses, at the least, a significant danger of economic loss" because it might undermine "a reliable adjudicatory system that backs up the commercial deals of American businesses.").

287. Walt, *supra* note 9, at 263 ("Although there is an inevitable tradeoff between specification and error costs, incorporation reduces specification costs significantly more than it increases error and administrative costs.").

method of construction.[288] This view finds support in the work of Professor Lisa Bernstein. Bernstein surveyed the contract interpretation practices of merchant courts in the private legal systems of the grain and feed industry and the cotton industry. First, she found that National Grain and Feed Association ("NGFA") arbitrators "take a formalistic approach to adjudication."[289] In particular, "despite their industry expertise, NGFA arbitrators are reluctant to look to" course of performance, course of dealing and usage of trade.[290] And "[t]hey do not permit these considerations to vary either trade rules or written contractual provisions."[291] Second, Professor Bernstein found that even though "cotton arbitrators are chosen for their industry expertise, they use a relatively formalistic adjudicative approach that gives little explicit weight to elements of the contracting context."[292] She observed, for instance, that (1) cotton trade rules do not make course of performance, course of dealing, and usage of trade relevant to the interpretation of agreements, (2) arbitrators "are reluctant to take [course of performance and course of dealing] into account" when deciding issues of construction, and (3) "references to custom or usage in [cotton arbitration] opinions are extraordinarily rare."[293] In sum, the tribunals in both industries Professor Bernstein studied use interpretive methods that are substantially textualist in nature. This supports the conclusion that businesses wish to have their contractual disputes adjudicated using

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288. Uri Benoliel, *The Interpretation of Commercial Contracts: An Empirical Study*, 69 ALA. L. REV. 469, 471 (2017) [hereinafter Benoliel, *Empirical Study*] ("A central theoretical argument that underlies textualist theory is that most parties to a contract would probably prefer a textualist approach over the contextualist approach . . . ."); SMITH, *supra* note 196, at 276 (explaining that textualism is grounded on the assumption that those drafting the contract intended that the terms "be read narrowly and literally"; "[t]he context of commercial drafting, in other words, is one that asks the reader to ignore the context outside of the physical document"); *see, e.g.*, Schwartz & Scott, *supra* note 3, at 932 ("[B]oth the available evidence and prevailing judicial practice support the claim that sophisticated parties prefer textualist interpretation."); Spigelman, *supra* note 100, at 429 ("Nevertheless, the idea that an arbitrator or a judge would be called upon to determine the *true* intention of the parties by going beyond the written contract to encompass anything which disputing parties can relevantly imagine, would be regarded by most parties, at the time of formation of the contract, to constitute a commercial disaster."); *id.* at 412 ("In this paper, I will be concerned with contracts between commercial parties—not with consumers . . . .").

289. Lisa Bernstein, *Merchant Law in a Merchant Court: Rethinking the Code's Search for Immanent Business Norms*, 144 U. PA. L. REV. 1765, 1769-70 (1996) [hereinafter Bernstein, *Merchant Law*].

290. *Id.* at 1769.

291. *Id.* at 1770.

292. Lisa Bernstein, *Private Commercial Law in the Cotton Industry: Creating Cooperation through Rules, Norms and Institutions*, 99 MICH. L. REV. 1724, 1735 (2001) [hereinafter Bernstein, *Private Commercial Law*].

293. *Id.* at 1735-36; *see also* Lisa Bernstein, *The Questionable Empirical Basis of Article 2's Incorporation Strategy*, 66 U. CHI. L. REV. 710, 713-17, 751-53 (1999) [hereinafter Bernstein, *Questionable Empirical Basis*] (concluding, based on an empirical study of the hay, grain and feed, textiles, and silk industries, that usages of trade rarely exist in the form contemplated by the UCC, and thus that "it may be time to reconceptualize the role played by custom in commercial transactions and to rethink the wisdom of the Code's incorporation-based approach to gap filling and contract interpretation . . . .").

textualism.[294]

Commentators have also cited research by Professors Theodore Eisenberg and Geoffrey Miller for the proposition that businesses favor textualist interpretation.[295] Eisenberg and Miller reviewed choice-of-law and choice-of-forum provisions in 2,882 contracts reflecting major transactions and attached as exhibits to SEC filings. Far more of the agreements opted for New York law or a New York forum than for California law or a California forum.[296] In a subsequent article analyzing these findings, Professor Miller explained that New York's contract law is formalistic: "New York judges . . . have little tolerance for attempts to re-write contracts to make them fairer or more equitable, and they look to the written agreement as the definitive source of interpretation."[297] Contract law in California, on the other hand, is more contextualist: "California judges . . . more willingly reform or reject contracts in the service of morality or public policy; they place less emphasis on the written agreement . . . and seek instead to identify the contours of commercial relationships within a broader context framed by principles of reason, equity, and substantial justice."[298] Professor Miller thus concluded that "the verdict of thousands of sophisticated parties whose incentives are to maximize the value of contract terms . . . is that New York's formalist rules win out over California's contextualist approach."[299]

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294. *See, e.g.*, MITCHELL, *supra* note 87, at 103 (explaining that Bernstein's studies "suggest that some contractors, in some circumstances, prefer a more formalist approach to be taken"); Bowers, *supra* note 24, at 591 ("Lisa Bernstein urges strenuously that, as an empirical matter, contractors desire only literal formalist interpretation of their contracts."); Geoffrey P. Miller, *Bargains Bicoastal: New Light on Contract Theory*, 31 CARDOZO L. REV. 1475, 1477 (2010) ("Bernstein's work suggests that industry actors, when given the freedom to devise their own procedures, opt for a system of rules much like that predicted in Schwartz and Scott's [formalist] theory."); Schwartz & Scott, *supra* note 3, at 956.

295. *See, e.g.*, Bernstein, *Custom*, *supra* note 162, at 109; Jody S. Kraus & Robert E. Scott, *Contract Design and the Structure of Contractual Intent*, 84 N.Y.U. L. REV. 1023, 1102-03 (2009); Schwartz & Scott, *supra* note 3, at 956-57.

296. Theodore Eisenberg & Geoffrey P. Miller, *The Flight to New York: An Empirical Study of Choice of Law and Choice of Forum Clauses in Publicly-Held Companies' Contracts*, 30 CARDOZO L. REV. 1475, 1475-77, 1490, 1504 (2009) (finding that parties chose New York law in forty-six percent of agreements and a New York forum in forty-one percent, but chose California law in under eight percent of contracts).

297. Miller, *supra* note 294, at 1478; *see also* Silverstein, *supra* note 15, at 302 ("Classical contract law is marked by clear rules and strict adherence to legal formalities such as the statute of frauds.").

298. Miller, *supra* note 294, at 1478; *see also* Silverstein, *supra* note 15, at 302 ("[M]odern contract law favors general standards, such as 'good faith' and 'unconscionability,' and shows greater sympathy for equitable precepts.").

299. Miller, *supra* note 294, at 1478. Professor Uri Benoliel has also conducted three empirical studies designed to address the interpretive preferences of commercial parties that are comparable to the work of Eisenberg and Miller. The first two projects involved a review of roughly 1500 commercial contracts submitted to the Securities and Exchange Commission ("SEC"). Benoliel, *Empirical Study*, *supra* note 288, at 472; Uri Benoliel, *The Course of Performance Doctrine in Commercial Contracts: An Empirical Analysis*, 68 DEPAUL L. REV. 1, 1-2 (2018) [hereinafter, Benoliel, *Course of Performance*]. In the first study, Professor Benoliel concluded that the presence of merger clauses in a substantial majority of the commercial agreements in his data set supports the proposition that businesses favor

A common explanation for commercial parties' preference for textualism is that merchants favor the certainty of transaction costs to the uncertainty of enforcement costs.[300] Recall that textualists generally contend that their approach has higher transaction costs but lower enforcement costs than contextualism.[301] Transaction costs are incurred with every contract, whereas parties must expend resources on enforcement only when there is an interpretive dispute.[302] And such disputes are quite rare as a percentage of all agreements.[303] The theory here is that businesses would rather (a) spend a modest but predictable additional sum in negotiating and drafting every contract under textualism, than (b) face large and unpredictable increases in enforcement costs under contextualism, where a higher number of agreements devolve into litigation. And because sophisticated parties strongly value certainty, this preference arguably holds even if the total transaction and enforcement costs in a textualist regime are actually somewhat higher than in a contextualist system.

Professor Bernstein offers an alternative explanation. She hypothesizes that businesses "do not necessarily want the relationship-preserving norms they follow in

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textualism. Benoliel, *Empirical Study*, *supra*, at 471-72, 480, 493. But merger clauses are only relevant to whether a document is completely integrated for purposes of the parol evidence rule. *See* RESTATEMENT (SECOND) OF CONTRACTS § 216 cmt. e (AM. L. INST. 1981). And the parol evidence rule does not apply to interpretive evidence. *Id.* § 214(c). Thus, the inclusion of merger clauses in agreements between sophisticated parties does not illustrate a preference for textualism over contextualism. The second study found that eighty percent of the contracts in Professor Benoliel's dataset contain an anti-course of performance clause. Benoliel, *Course of Performance*, *supra*, at 1-2. The pervasiveness of a contract provision that purports to bar courts from considering one important type of extrinsic evidence does provide at least modest support for the position that commercial parties prefer textualism to contextualism. *But cf.* Benoliel, *Empirical Study*, *supra*, at 480 ("From a methodological perspective, it is difficult to 'measure the extent of parties' preferences for [textualist] adjudication by looking at their contracts.' This is due, in part, to the fact that most interpretive rules are *mandatory*; namely the parties normally 'cannot contract directly for [a] textualist or [a] contextualist interpretation approach.'") (first quoting Lisa Bernstein, *Merchant Law in a Modern* Economy, 15 Coase-Sandor Inst. for Law & Econ., Working Paper No. 639 (2013); and then quoting Robert E. Scott, *Text Versus Context: The Failure of the Unitary Law of Contract Interpretation*, *in* THE AMERICAN ILLNESS: ESSAYS ON THE RULE OF LAW 312 (Frank H. Buckley ed., 2013)). The third study was based on a sample of 500 commercial contracts disclosed to the SEC. Uri Benoliel, *Contract Interpretation Revisited: The Case of Severability Clauses*, 3 BUS. & FIN. L. REV. 90, 95 (2019). There, Professor Benoliel concluded that the presence of severability clauses in seventy-one percent of the agreements in his dataset indicates that businesses prefer textualist construction. *Id.* at 93-95, 103-04, 107, 110. But as with the merger clauses in the first study, severability clauses primarily concern issues that are distinct from interpretation. Therefore, drafting practices with respect to severability provisions do not support the proposition that commercial parties favor textualism.

300. *See, e.g.*, Cohen, *supra* note 15, at 134 ("Judge Posner posits that the four corners rule is based on the assumption that parties prefer ex ante contracting to the expense and uncertainty of a jury trial." (citing Posner, *supra* note 94, at 1602-03)); *see also* MITCHELL, *supra* note 87, at 91 ("Given this uncertainty [caused by contextualism], the possibility presents itself that some parties may prefer a more formal interpretative method[.]").

301. *See supra* notes 194-196 and accompanying text.

302. *See* Cohen, *supra* note 15, at 134. The pertinent material from Cohen's piece is quoted in the text accompanying note 197.

303. *See supra* note 208 and accompanying text.

performing contracts to be used by third-party neutrals to decide cases when they are in an end-game situation."[304] In other words, businesses favor a textualist interpretive system that permits them to deploy contextualist methodologies when negotiating informally with the other side, but also preserves "their right to insist on strict adherence to the terms of their written contract if their relationship breaks down."[305] This predilection is grounded on the fact that under contextualism, parties granting concessions that are inconsistent with express contractual terms face the risk that a later interpreting court will treat such accommodating behavior as evidence of a binding course of performance, course of dealing, or trade usage.[306] That danger discourages flexibility in dealing with one's commercial partners,[307] which in turn "may undermine transactors' attempts to create the contracting framework that will best promote successful renegotiations and long-term cooperation."[308] Textualism, by contrast, has the opposite impact: it incentivizes parties to "adopt the types of forgiving strategies that are most likely to promote" business relationships because evidence regarding such conciliatory behavior cannot be used later to override clear contractual language.[309]

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304. Bernstein, *Merchant Law*, *supra* note 289, at 1770.

305. Bernstein, *Private Commercial Law*, *supra* note 292, at 1780-81; *accord* SCOTT & KRAUS, *supra* note 121, at 603 ("Thus, transacting partners might wish to provide a two-tiered structure to their relationship. The first tier consists of the formal legal terms of their agreement. The second consists of the informal norms that govern the enforcement of those terms and the parties' expectations for a cooperative relationship. When the latter break down, the former protects the parties' interests.").

306. *See* Bernstein, *Private Commercial Law*, *supra* note 292, at 1777 ("In contrast, the refusal of cotton tribunals to permit course of dealing or course of performance to vary or modify contractual provisions eliminates the risk that forgiving adjustments will be interpreted as waivers or contractual modifications.").

307. MITCHELL, *supra* note 87, at 118 ("[Bernstein] argues that a court's reliance on flexibility may actually encourage contractors to be inflexible, since they do not want to engage in a pattern of behavior that may then cause flexibility to be imposed upon them by a court. In other words, parties want to maintain control over flexibility, they do not want it forced upon them."); *see also* MACAULAY, *supra* note 104, at 253 ("If an established course of dealing can be used to aid in the interpretation of the written language of the contract, in performing contracts one or both parties may be reluctant to grant informal concessions from strict contractual entitlements, for fear that he/she/it will be foreclosed in the future from insisting upon strict compliance with the written language."); Gilson et al., *supra* note 6, at 70 ("If parties feared that the arbitrators would take informal adjustments into account, they would be unwilling to make them.").

308. Bernstein, *Merchant Law*, *supra* note 289, at 1771.

309. Bernstein, *Private Commercial Law*, *supra* note 292, at 1777; *accord* Bernstein, *Merchant Law*, *supra* note 289, at 1770-71, 1796-1820 (setting forth Professor Bernstein's full recitation of this argument); SCOTT & KRAUS, *supra* note 121, at 602-03 (presenting a shorter version of this argument); *see also* Schwartz & Scott, *supra* note 92, at 592-94 (applying a version of this argument specifically to course-of-performance evidence). At least one court embraced comparable reasoning two decades before Professor Bernstein's first article on this subject. In *Southern Concrete Services, Inc. v. Mableton Contractors, Inc.*, the judge wrote:

> While in some industries it may be virtually impossible to predict future needs under a contract, in other industries, such contracts may not be strictly adhered to for entirely different reasons. Lawsuits are costly and they do not facilitate good business relations with customers. A party to a contract may very much prefer to work out a renegotiation of a contract rather than rest on

If merchants in fact favor textualism, that is powerful evidence that textualism maximizes the value of commercial agreements since businesses—rather than courts or legislators—are in the best position to determine the optimal trade-off of accuracy, transaction costs, and enforcement costs in their dealings.[310]

But contextualism is also regularly defended on the ground that contracting parties prefer that approach.[311] Indeed, the drafters of the UCC justified the contextualist interpretive rules contained in the Code, in part, on the belief that merchants intend and understand trade usage and other aspects of their commercial context to be essential components of business agreements.[312] And subsequent commentators, particularly those from the relational contracting school of thought, have endorsed a similar view.

According to relational contract theory, "[r]eal contracts do not occur primarily between strangers engaged in fixed duration, one-shot deals but rather extend over time, between contractors with developed and perhaps long-standing

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> its strict legal rights. Yet, the supplier or purchaser knows that he may resort to those enforceable contract rights if necessary. If the courts were to conclude that this reluctance to enforce legal rights resulted in an industry-wide waiver of such rights, then contracts would lose their utility as a means of assigning the risks of the market.

407 F. Supp. 581, 584 (N.D. Ga. 1975).

310. *See* Kraus & Walt, *supra* note 121, at 213-14 ("If both [interpretive] regimes are available to contractors, and the majority of contractors choose one consistently over the other, where the only plausible explanation for the choice is that contractors prefer it, then that regime is likely to be the most efficient."); Schwartz & Scott, *supra* note 3, at 930 (explaining, in a closely related context, that "parties are better informed than courts about benefits and costs, so parties commonly have a comparative advantage over courts in making the required tradeoffs").

311. Benoliel, *Empirical Study*, *supra* note 288, at 471 ("Interestingly enough, a major theoretical argument that underlies contextualist theory is [that] . . . most parties probably prefer a contextualist approach for contract interpretation.").

312. *See* LARRY A. DIMATTEO ET AL., VISIONS OF CONTRACT THEORY: RATIONALITY, BARGAINING, AND INTERPRETATION 160 (2007) ("The move to contextualism in the Code was a natural result of Llewellyn's rejection of the promise-will paradigm. In place of the single focus of promissory intent, he advanced the agreement-in-fact model of contract interpretation. . . . The agreement-in-fact or true understanding of the parties required searching into the past of custom and usage (quasi-public) along with the party-to-party communication prior to and subsequent to the time of formation."); Bernstein, *Questionable Empirical Basis*, *supra* note 293, at 746-47 (explaining that "[c]ode drafters and later commentators justified the pervasive incorporation strategy" in part on the ground that "customs are intended and understood by merchants to be an integral part of their agreement"); *see also* U.C.C. § 2-202 cmt. 2 (AM. L. INST. & UNIF. L. COMM'N 2017) ("Such writings [stating the agreement of the parties] are to be read on the assumption that the course of prior dealings between the parties and the usages of trade were taken for granted when the document was phrased. . . . Similarly, the course of performance by the parties is considered the best indication of what they intended the writing to mean."). Note that Bernstein's empirical studies are directed at challenging the approach of the UCC, *see, e.g.*, Bernstein, *Merchant Law*, *supra* note 289, at 1766, including the Code's assumption about the preferences of merchants, *see, e.g.*, Bernstein, *Questionable Empirical Basis*, *supra*, at 751-52.

relationships."[313] In addition, all agreements grow out of a rich social background.[314] As a result, business partners engaged in sustained and repeated dealing do not fully plan for and allocate risks in their contracts. Instead, "the parties depend on relational norms such as flexibility and reciprocity to administer their agreements. Therefore the social context and the 'great sea of custom' form the foundation of the parties' bargain . . . ."[315] Critically, relational norms can govern transactions that end up in litigation only if extrinsic evidence regarding the parties' surrounding context may be submitted to identify the content of such norms.[316]

Another reason parties might prefer contextualism is that they would rather reduce transaction costs than enforcement costs.[317] To repeat, transaction costs are incurred with every contract, while enforcement costs are incurred with only a tiny percentage of agreements—those that result in some type of interpretive dispute.[318] It is thus reasonable for contractors to believe that lowering transaction costs via contextualism will reduce overall expenses by a greater amount than lowering enforcement costs via textualism.[319]

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313. Chapin F. Cimino, *The Relational Economics of Commercial Contract*, 3 TEX. A&M L. REV. 91, 96 (2015).

314. *Id.* at 97; *see also id.* at 96-101 (summarizing relational contract theory, with a focus on the work of Ian Macneil).

315. Robert A. Hillman, *Regulating Contracts by Hugh Collins*, 27 J.L. & SOC'Y 338, 343 (2000) (summarizing the relational contracting theory of Ian Macneil); *accord* ROBERT A. HILLMAN, THE RICHNESS OF CONTRACT LAW 6 (1998) ("Relationalists assert that most exchange occurs within a process of continuous interaction of parties who make incomplete promises at best. Instead of 'discrete' or specific promises, relational norms such as cooperation and compromise govern parties' dealings."); *id.* at 255-66 (setting forth an overview of the relational school of thought).

316. HILLMAN, *supra* note 315, at 257 ("According to [Ian] Macneil, one must investigate the social environment and the 'great sea of custom' that form the foundation of parties' bargains in order to comprehend relational norms and hence to understand contract law.") (quoting I.R. Macneil, *The Many Futures of Contracts* 47 S. CAL. L. REV. 691, 731 (1974)); *id.* at 261 ("The contextual approach of the Uniform Commercial Code and the *Restatement (Second) of Contracts*, reflected in their use of broad terms such as 'agreement,' is consistent with relational analysis. Under the contextual approach, . . . a court investigating an agreement's content must consider not only express language but also any course of dealing, trade custom, or other background factor probative of the parties' reasonable expectations."); Shahar Lifshitz & Elad Finkelstein, *A Hermeneutic Perspective on the Interpretation of Contracts*, 54 AM. BUS. L.J. 519, 554 (2017) ("Given the emphasis of relational contract theory on the relationship between the parties, it is not surprising that this theory rejected the interpretive doctrines supporting the textual-linguistic coalition. Relational contract theory preferred, instead, interpretive techniques that allow the interpreter to consider sources external to the contractual text in order to interpret the contract according to the relationship between the parties. Thus, relational contract theory supports the interpretive doctrines associated with contextualism . . . ."); *see* Henry H. Perritt, Jr., *Implied Covenant: Anachronism or Augur*, 20 SETON HALL L. REV. 683, 716-17 (1990) ("The broad use of extrinsic evidence is a relational approach.").

317. *Compare supra* notes 300-303 and accompanying text.

318. *See* Cohen, *supra* note 15, at 134 (quoted in the text accompanying note 197); *supra* note 208 and accompanying text.

319. *See* MITCHELL, *supra* note 87, at 109-10 (explaining that parties might prefer to reduce transaction costs more than enforcement costs because the former are incurred with

Professor Steven Walt offers some evidence that businesses favor contextualist interpretation. In particular, he observes that parties subject to regimes of partial contextualism, such as the one set forth in the UCC, generally do not attempt to contract out of such systems.[320]

Note further that scholars have challenged claims that the findings of Professors Bernstein, Eisenberg, and Miller support the thesis that businesses prefer textualism. Starting with Eisenberg and Miller, in his follow-up paper, Professor Miller identified roughly seventeen doctrinal areas where the contract law of New York and California differ, only one of which was interpretation.[321] And there are many other legal variations between New York and California beyond the field of contracts,[322] as well as economic and cultural differences between the two states. It is thus impossible to determine the extent to which variations in interpretive regime played a role in the choice-of-law and choice-of-forum decision-making studied by Eisenberg and Miller.[323]

Turning to Professor Bernstein's research, Professor Avery Katz has argued that Bernstein's findings might be explained by the fact that arbitrators serving on commercial tribunals have extensive experience in the grain and feed and cotton industries and thus understand the relevant customs and usages in those fields. As a result, submitting additional contextual evidence in cases before these adjudicators will not sufficiently reduce the risk of an interpretive error to justify the increased enforcement costs associated with such evidence. But generalist judges and juries lack the commercial background of industry experts. Accordingly, the fact that firms prefer textualist interpretation when appearing before private commercial tribunals does not entail that they would have the same preference in a lawsuit heard in state or federal court where

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certainty and in the present while the latter are incurred rarely and well into the future (citing Schwartz & Scott, *supra* note 92, at 585)).

320. Walt, *supra* note 9, at 278 ("A datum consistent with incorporation is the pattern of predominant contracting behavior: parties contracting under incorporation regimes appear not to contract out of them with regularity."). Professor Walt does acknowledge that "factors other than a preference for incorporation could explain this pattern (e.g., asymmetrical information, cognitive bias)." *Id.*

321. *See* Miller, *supra* note 294, at 1481-1522.

322. Benoliel, *Empirical Study*, *supra* note 288, at 479.

323. Bayern, *supra* note 1, at 1121-22 ("As Eisenberg and Miller also point out, there are many provisions of substantive New York law that public firms might favor; an inference that they are specifically choosing textualism is unfounded.") (also identifying two additional problems with relying upon Eisenberg and Miller's study to support the claim that businesses prefer textualism); Benoliel, *Empirical Study*, *supra* note 288, at 479 ("Hence, the dominance of New York choice-of-law clauses over California choice-of-law clauses . . . does not necessarily result from the parties' preference for New York's textualist interpretation rules."); Burton, *supra* note 5, at 347-48 n.64 (explaining that the selection of New York law in Eisenberg and Miller's study "could be made for any of a variety of reasons"); *see also* Miller, *supra* note 294, at 1478-79 n.11 (setting forth multiple other reasons that the sophisticated parties in the Eisenberg & Miller study might have chosen New York over California, including "[n]etwork effects, agency costs, or bargaining problems"—reasons that have nothing do with legal differences between the two states in the area of contract law; but also rejecting such explanations for the study's findings); Juliet P. Kostritsky, *Context Matters-What Lawyers Say About Choice of Law Decisions in Merger Agreements*, 13 DEPAUL BUS. & COM. L.J. 211, 211 (2015) (explaining that "a desire for formalistic law is not the motivating factor" in choice-of-law provisions in merger agreements).

the accuracy-enhancing effects of extrinsic evidence might be worth the added cost.[324]

Professor Steven Walt adds that the grain and feed and cotton industries studied by Professor Bernstein critically differ from other fields of commerce.[325] Consider four examples. First, parties in Bernstein's markets "enter into standardized contracts whose terms are defined by mostly precise and regularly updated industry rules."[326] Second, businesses in those trades frequently enter into contracts with the same counterparty.[327] Third, each market participant's reputation "is communicated to actual or potential financiers and other industry members."[328] And fourth, "[a]ll actual and potential contracting parties must be members of the industry associations."[329] Such features likely impact both transaction cost levels and the importance of interpretive accuracy.[330]

To illustrate, the "contracting environment" of the grain and feed and cotton industries "reflects conditions under which nonlegal sanctions reliably substitute for enforcement" in court.[331] In particular, "the presence of repeat transactions" and trade association membership make it easy to discover the reputation of industry participants. As a result, "breach and therefore litigation" are "predictably . . . infrequent" in both markets.[332] And thus "the expected cost of adjudicatory error . . . is low."[333] Similarly, transaction costs are small in Professor Bernstein's fields because "contacts are standardized and already fairly completely specified by trade association rules,"[334] nullifying the need to expend significant resources negotiating and drafting

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324. Katz, *supra* note 8, at 526-27; *see* Walt, *supra* note 9, at 283 ("The arbitrators' industry-specific knowledge makes the rate of adjudicatory error low . . . [and] the small profit margin on members' contracts makes it likely that the marginal benefit to the parties of a further reduction in error is very low."). Bernstein recognizes the possibility raised by Katz. *See* Bernstein, *Private Commercial Law*, *supra* note 292, at 1735 n.57 ("Given the expertise of these arbitrators, however, these considerations [namely, the commercial context] may enter the moving papers and/or influence the arbitrators' decision-making processes in ways too subtle to detect."); *see also* Bernstein, *Questionable Empirical Basis*, *supra* note 293, at 716 n.18 ("The opinions produced by merchant tribunals reveal that arbitrators' background knowledge of the trade may enable them to better assess the credibility of testimony and may give them a better understanding of the types of evidence that ought to be submitted."). Note that Professor Katz's argument presumes that extrinsic evidence does in fact improve accuracy. As I explained previously, many textualists actually dispute this claim. *See supra* notes 105-129 and accompanying text.

325. Walt, *supra* note 9, at 282 ("[Bernstein's] case studies suffer from a problem of external validity: the population of contracting parties does not share characteristics of the parties and contracting environment of members of the NGFA [National Grain and Feed Association] and cotton associations.").

326. *Id.*

327. *Id.*

328. *Id.*

329. *Id.*

330. *Id.*

331. *Id.* at 283.

332. *Id.*

333. *Id.*

334. *Id.*

agreements. Professor Walt hypothesizes that "[i]n these circumstances, formalism appears to have lower adjudicatory error and specification costs than incorporation."[335]

The features of the grain and feed and cotton industries discussed in the previous two paragraphs are not shared by the "general population of contracting parties and contracts."[336] To illustrate, unlike the standardized agreements in the areas of commerce Professor Bernstein studied, there is considerable variation in the express terms of contracts executed by firms across the economy.[337] Likewise, many deals are "discrete"—i.e., they are "not part of repeat transactions or long-term contracts."[338] This means that agreements "are often entered into between strangers in circumstances in which reputational bonds are not strong,"[339] making contract enforcement outside the legal system much more difficult. Professor Walt therefore concludes that exchanges in the grain and feed and cotton industries "are not representative of the domain of contracts to which contract law belongs."[340] It follows that the perspectives of members of the grain and feed and cotton markets cannot be generalized to all commercial parties.[341]

Note that Professor Walt's analysis supports the proposition that the interpretive preferences of contracting parties are actually heterogeneous, a view shared by other scholars.[342] For example, some commentators theorize that risk-averse persons favor contextualism, while those who are risk-neutral would rather operate under textualism.[343] If contracting parties do indeed hold diverse preferences regarding interpretation, then perhaps the rules that govern the construction of agreements should not be uniform across all types of cases. Alternatively, perhaps individuals and businesses should be allowed to decide for themselves which interpretive principles will govern

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335. *Id.*

336. *Id.*

337. *Id.*

338. *Id.*

339. *Id.* at 283-84.

340. *Id.* at 284.

341. *Id.* at 282 ("The inference to the preference of typical contracting parties is unjustified because the implicit generalization upon which it is based is unsound."); *see also* Burton, *supra* note 5, at 348 n.64 (contending that Bernstein's studies "cannot be easily generalized" beyond the specific industries addressed in her work). Note that Professor Walt's arguments suggest that relational contract theory is often more consistent with textualism than with contextualism, contrary to my discussion above. *See supra* notes 313-316 and accompanying text; Robert E. Scott, *The Case for Formalism in Relational Contract*, 94 NW. L. REV. 847, 848 (2000) ("As the title of this paper implies, the case for formalism in interpreting relational contracts emerges out of this analysis."); *id.* at 852-53 (explaining that all contract theorists are relationalists now, but that it does not follow that contract law should abandon its largely formalistic structure).

342. *See, e.g.*, Schwartz & Scott, *supra* note 3, at 930 ("[P]arty preferences over interpretive rules are heterogeneous."); Badawi, *supra* note 191, at 5 ("That there is variation in interpretive preferences is evident from the decisions of some transactors . . . to opt out of the UCC as well as from the choices of transactors *not* to opt out of the contextual default rules supplied by the UCC.").

343. *See* Cohen, *supra* note 15, at 143-44 (discussing such theories); *see also infra* notes 367-372 and accompanying text (discussing one such theory in more detail).

a dispute over the meaning of their agreement. These two possibilities are discussed in the next two subparts.

B. Hybrid Interpretive Systems

Much of the interpretation debate presumes that one system of construction is always superior to the other.[344] In part, that is because courts and scholars treat contract law as "unitary"—as if a "single set of legal rules . . . applies to all agreements."[345] But the best interpretive regime might fluctuate based on the circumstances, such as the type of contract and the identity of the signatories. This view is increasingly popular in the secondary literature.[346] Some scholars believe, for instance, that textualism should be used to construe agreements between businesses, while contextualism is the best approach for contracts involving consumers.[347] Others have developed

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344. Badawi, *supra* note 191, at 4 ("The underlying assumption that one interpretive approach is intrinsically superior to another has, at least to some degree, persisted in more recent debates.").

345. Gilson et al., *supra* note 6, at 34, 42.

346. Cunningham, *supra* note 194, at 1627 ("Increasingly, however, some scholars are acknowledging the reality that different settings warrant different approaches."); *see, e.g.*, Badawi, *supra* note 191, at 5 ("This article argues that the desirability of an interpretive regime depends, at least to some degree, on the attributes of the underlying transactions and not solely on the independent merits of formal or contextual interpretation."); Bayern, *supra* note 1, at 1103 ("Despite a variety of attempts to present a single interpretive regime as universally optimal . . . this Part contends that there has been no persuasive account of the reasons or scope for such a general interpretive regime."); Bowers, *supra* note 24, at 620 ("The foregoing analysis suggests that . . . [t]here may be a class of contract problems which the parties might prefer to have addressed using a textual strategy and another class for which they might be inclined to take comfort from a contextualist approach."); Gilson et al., *supra* note 6, at 28 (explaining that the goal of their article is to transcend the traditional textualist/contextualist debate and identify "the features in the transactional setting that dispose contracting parties to choose a particular [interpretive] regime and a complementary form of adjudication to govern their relation, rather than another"); Katz, *supra* note 8, at 538 (explaining that this essay presents a "basic framework" for determining "in which contexts and for which parties formalism is most useful and in which contexts and for which parties a substantive approach is most useful"); Kostritsky, *supra* note 12, at 44 ("This article argues that it is wrong to think that courts must make a dichotomous choice always to prefer extrinsic evidence or always to exclude it. Sometimes the appropriate interpretive methodology should explicitly forego extrinsic evidence while at other times it should embrace extrinsic evidence."); *contra* Walt, *supra* note 9, at 261-62 (arguing in favor of the universal applicability of interpretive rules on grounds of judicial competency).

347. Katz, *supra* note 8, at 538 ("One does see distinctions drawn in the case law and in the commentary between different sorts of contracts; it is generally acknowledged that formalism is relatively more important to experienced commercial actors, and substantive interpretation better suited to transactions involving consumers and other amateurs."); Schwartz & Scott, *supra* note 3, at 938 n.31 ("Those who argue for mandatory contextualist interpretations often justify such rules as necessary to prevent exploitation of unsophisticated individuals, susceptible to cognitive biases, who enter into written contracts with sophisticated parties who supply written contract terms that alter previously settled understandings."); *see also* Bernstein, *Merchant Law*, *supra* note 289, at 1820-21 & n.168 (acknowledging that the case for contextualist interpretation is "far stronger in merchant-to-

sophisticated theories to explain when each interpretive approach is likely to be superior or preferred by contracting parties.

Consider the work of Professor Adam Badawi. Professor Badawi constructed a model in which transacting parties favor textualist interpretive rules when it is easier and less expensive to draft a complete contract—again, a contract that contains all of the pertinent terms and clarifying elaboration—and contextualist rules when it is more difficult and costly to write such an agreement.[348] On the one hand, if parties are capable of preparing a complete contract at a reasonable price, then most or all of the necessary details are likely to be contained within the four corners of their instrument. In such situations, the parties ought to prefer textualist interpretive methods that prevent the use of extrinsic evidence to override their carefully drafted terms.[349] On the other hand, when parties cannot write a complete contract, or when the cost of doing so is prohibitive, their agreement will contain critical gaps and ambiguous language.[350] In that event, transactors should favor contextualist interpretation because it permits them to deploy extrinsic evidence to fill the gaps and clarify the ambiguities that were impossible or too expensive to address prior to formation.[351]

The "key variables" that determine whether a complete contract is reasonably feasible, according to Professor Badawi, are the "frequency and certainty" of the transaction.[352] When parties regularly engage in a particular type of exchange, the marginal cost of preparing each contract decreases.[353] For example, the parties can develop reusable standard forms that contain most of the provisions required for each deal.[354] Likewise, when a sale involves few contingencies, the parties are better able to identify all of the terms needed to govern the transaction.[355] As a result, exchanges that are frequent and certain "present optimal conditions for drafting nearly complete contracts."[356] By contrast, if a particular type of exchange is rare, then the cost to prepare the agreement will be high relative to the number of transactions.[357] And when a sale involves many unknowns, it can be difficult or even impossible to construct language that effectively addresses every contingency.[358] This means that transactions that are atypical and/or involve significant uncertainty are likely to result in a less complete agreement.[359]

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consumer transactions" than in merchant-to-merchant transactions).

348. Badawi, *supra* note 191, at 1, 5-7.
349. *Id.* at 1, 5-6.
350. *Id.* at 1.
351. *Id.* at 11.
352. *Id.* at 1.
353. *Id.* at 8, 31.
354. *Id.*; *see also id.* at 33 (observing that frequent transactions "create a large economy of scale").
355. *Id.* at 10.
356. *Id.* at 5-6.
357. *Id.* at 33.
358. *See id.* at 10, 36, 38.
359. *Id.* at 33.

Professor Badawi supports his model with some empirical evidence.[360] On one side, the commodity industries studied by Professor Bernstein that appear to favor textualist methods involve high frequency transactions with little uncertainty.[361] On the other side, parties generally appear to prefer contextualist interpretation when engaged in mergers and acquisitions or entering construction contracts, two fields where transactions are typically unique in nature and/or involve more uncertainty.[362]

Professor Badawi's theory is illustrative of the academic work defending hybrid interpretive schemes.[363] For instance, in the model developed by Professors Gilson, Sabel, and Scott, the optimal approach to interpretation turns on (1) the level of uncertainty parties face, (2) the "thickness" of the relevant market—with a thick market being "one in which many commercial actors are exchanging goods or services by using the same or similar contracting behavior and strategies," and (3) the sophistication of the parties.[364]

Professor Avery Katz has cataloged and analyzed a broad array of factors that can influence party preferences regarding interpretive rules, including (1) transaction costs, (2) enforcement costs, (3) the likelihood of a dispute, (4) the availability of nonlegal sanctions, (5) "party attitudes toward risk" and their "abilities to spread or diversify it," (6) renegotiation costs, (7) the risk of opportunism by the counterparty and its impact on incentives to invest in the commercial relationship, (8) the level of control parties have over their agents in the negotiation process and during litigation, and (9) the importance and cost of services provided by third parties that are related to the underlying transaction.[365] From this list, Professor Katz derives "some general rules of thumb . . . regarding the proper balance between form and substance" in the construction of agreements.[366]

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360. *Id.* at 40 ("Evidence from several industries suggests that the attributes of transactions have an appreciable effect on the desire for more formal or more contextual types of contract interpretation.").

361. *Id.* at 20.

362. *Id.* at 40-44 (noting, among other things, that "the one time nature" of mergers and acquisitions "means that even where there is time and the incentive to fill . . . gaps, it is difficult to do so because the parties cannot rely on past experience with this specific transaction to devise precise gap-filling terms"); *id.* 46-48 (explaining, among other things, that the "presence of gaps in construction contracts stems, in part, from the intense level of detail that these projects usually involve").

363. *See* Cunningham, *supra* note 194 (surveying the literature on hybrid approaches and defending such systems against purely textualist and contextualist theories).

364. Gilson et al., *supra* note 6, at 29-30 & n.12, 43-46; *see also id.* at 56 n.121 ("[A] thin market . . . exists when each contracting party must negotiate a bespoke agreement [i.e., a custom-made agreement] with its counterparty."). As part of their analysis of sophistication, the authors also draw a distinction between business and consumer transactors. *Id.* at 33-34.

365. Katz, *supra* note 8, at 524-37.

366. *Id.* at 535. The rules are presented throughout the text as Professor Katz discusses the factors that can influence interpretive preferences, *id.* at 524-535, and in a summary chart, *id.* at 536; *see also* Hermalin et al., *supra* note 1, at 90-91 (setting forth, in a piece co-authored by Professor Katz, a comparable set of "general rules of thumb" that identify the circumstances in which textualist interpretation is more efficient than contextualist interpretation, and vice versa); Kostritsky, *supra* note 12, at 93-96 (suggesting "a series of heuristics . . . [that] may help to shape the debate about when [con]textualist [sic] and when

To illustrate the impact of one factor, consider risk aversion. Interpretive decisions are likely to be more consistent across cases when all judges are operating with the same quantity of textual and contextual information than when they are not. But judges often "vary in their background experience with regard to commercial matters."[367] As a result, on the one hand, if no extrinsic evidence is reviewed during the first stage of the interpretive process, then less experienced judges must base their decisions on a more limited set of information than judges who already have a deeper understanding of the industry practices and modes of thinking that are reflected in contextual evidence. On the other hand, if extrinsic evidence is allowed during the ambiguity determination, that will make "less experienced judges' information sets more closely resemble the more experienced judges' information sets."[368] Contextualism allows litigants to use extrinsic evidence to fill gaps in judicial knowledge and experience. Accordingly, the variance in interpretation outcomes should be lower under that approach than under textualism.[369] Since interpretive variance "introduces risk into the contractual relationship,"[370] it follows that, other things being equal, risk-averse parties ought to favor contextualism over textualism, whereas risk-neutral parties will have no such preference.[371]

Professor Katz further explains that the risk-neutral "category includes larger or more diversified business and other contractual repeat players, who can diversify interpretation risk over a greater number of transactions."[372] Tolerance for risk is thus one of several factors in Professor Katz's list supporting the conclusion that small traders who infrequently engage in particular types of transactions "will tend to benefit" from contextualism, while "large and experienced mercantile traders should prefer their contracts to be governed by" textualism.[373] Other factors include the difference between these two groups of firms with respect to (a) capacity to manage risk, (b) access to nonlegal enforcement mechanisms, and (c) the ability to spread contract negotiation and drafting expenses across multiple deals.[374]

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formalist interpretation will achieve the parties' goals").

367. *Id.* at 526.

368. *Id.*

369. Of course, this assumes that extrinsic evidence does more good than harm. If textualists are correct that the problematic features of such evidence result in contextualism actually reducing interpretive accuracy in comparison to textualism, *see supra* notes 105-129 and accompanying text, then the introduction of extrinsic evidence during the ambiguity determination could actually increase variance rather than limit it. *See* Walt, *supra* note 9, at 268-69 (arguing that contextualism increases variance).

370. Katz, *supra* note 8, at 526.

371. *Id.* at 526-27; *see also* Schwartz & Scott, *supra* note 92, at 576 ("A risk-neutral party cares about the mean of the interpretation distribution but not the variance. This is because the variance term measures risk while risk-neutral parties are indifferent to risk.").

372. Katz, *supra* note 8, at 527.

373. *Id.* at 537; *accord* Hermalin et al., *supra* note 1, at 91 ("It follows from these heuristic principles that substantive interpretation is relatively more valuable to small and infrequent traders . . . [while] large and experienced traders should prefer their contracts to be governed by relatively formalistic rules of interpretation.").

374. Katz, *supra* note 8, at 537.

Finally, in this section, I have focused on hybrid interpretive systems that prescribe the application of textualism for some classes of contracts and contextualism for different classes. But there are other types of hybrid and compromise approaches that also steer a middle ground between textualist and contextualist interpretation. For example, recall that a number of courts allow extrinsic evidence of a special meaning to "qualify" express terms of an agreement, but bar such evidence when it is offered in support of an interpretation that would "completely negate" written contractual language.[375] Professor Kent Greenawalt identifies another alternative: allow extrinsic evidence of non-standard meanings, but require that the party asserting such a meaning meet a higher burden of proof than the normal preponderance of the evidence standard used in civil cases.[376] There is some precedent for such a system in existing law. In particular, a party may submit extrinsic evidence that would otherwise be blocked by the parol evidence rule when seeking to obtain equitable reformation of a written contract that does not accurately set forth the terms the parties orally agreed to during their preliminary negotiations. But the instrument's inaccuracy must result from a mutual mistake, such as an unnoticed scrivener's error, and the mistake must be established by clear and convincing evidence.[377]

C. Should the Rules Governing Contract Interpretation Be Default Rules?

The last substantive argument that I wish to address is the position that contracting parties should be entitled to choose which interpretive rules govern their agreement. According to this view, contract interpretation doctrine should consist of default rules, like the bulk of the rest of contract law, rather than mandatory rules. "Default rules are rules that parties can contract around, whereas mandatory rules apply regardless of the parties' intentions."[378] Courts generally treat the law of interpretation as mandatory.[379] And many commentators have historically accepted this state of affairs: "For both sides in the interpretation debate, when a court (or legislature) chooses either a textualist or contextualist approach to interpretation, that choice applies to all transactional prototypes, and particular parties cannot choose ex ante to have their particular contract interpreted according to the disfavored approach."[380] But other

375. *See supra* note 80 and accompanying text.

376. *See* Greenawalt, *supra* note 143, at 580-81.

377. *See* FARNSWORTH, *supra* note 16, § 7.5, at 430-35.

378. Cohen, *supra* note 15, at 135.

379. Schwartz & Scott, *supra* note 92, at 583. Professors Schwartz and Scott further explain why courts have adopted this approach: "Judges are reluctant to invoke the coercive machinery of the state to require a party to perform a contract (or to pay damages) unless the judge is satisfied that the contract actually directed what the party failed to do. It seemingly follows that courts, not parties, should choose the rules that determine how contracts are read." *Id.*

380. Gilson et al., *supra* note 6, at 42; *accord* Schwartz & Scott, *supra* note 3, at 939 ("Just about everyone who creates, applies, or analyzes the interpretive rules believes that they should be mandatory.") (probably referring to people working in the legal field); *see also* Gilson et al., *supra*, at 34 (noting that courts and scholars generally ignore the "issues of who can best decide when and to what extent context should supplement text in interpreting a

scholars contend that contractors should be allowed to specify in their agreements the interpretive principles that govern any litigation over contractual meaning. Indeed, this view is apparently endorsed by most economists who have studied contract interpretation.[381]

Perhaps the leading advocates of the default rule position in the legal academy are Alan Schwartz and Robert Scott. Their argument that contracts between *businesses*[382] should be governed by default interpretation rules goes as follows. First, contracting parties wish to maximize the gains from trade, and courts should embrace this goal in construing commercial agreements.[383] Second, private parties are better than judges at identifying efficient interpretive rules for their contractual relationships because they possess more information about transaction costs, enforcement costs, and the benefits of accurate interpretations.[384] Third, "party preferences over interpretive rules are heterogeneous," in part, because the optimal trade-off of costs and benefits varies from contract to contract.[385] Given these three points, a court should defer to the parties' choice of interpretive rules "just as it defers . . . to party preferences over a contract's substantive terms."[386] In other words, when an agreement sets forth the interpretive approach that the parties wish the court to use in construing the agreement's substantive provisions, the court should follow that instruction.[387] After all, sophisticated parties can waive the right to a jury trial, or even the right to a trial in court at all. So why not let them waive the right to submit extrinsic evidence or the right to restrict the ambiguity determination to the four corners of the agreement?[388]

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particular contract, and hence how and by whom interpretive regimes should be designed").

381. Cohen, *supra* note 15, at 135 ("[E]conomists generally agree that the rules governing interpretation . . . , like other contract rules, should be default rules rather than mandatory rules.") (also summarizing the general case for default rather than mandatory terms).

382. Schwartz & Scott, *supra* note 3, at 939 n.36 ("Recall that our theory holds only for the interpretation of contracts between business firms.").

383. *Id*. at 930.

384. *Id.* at 942, 944.

385. *Id.* at 930.

386. *Id.* at 930-31.

387. *Id.* at 942; *see also id.* at 943 ("Goal neutrality gives the parties control over the substantive terms of the contract. It takes an argument to reject the obvious implication that the parties should also have control over the rules that determine how those terms are identified and understood."). Schwartz and Scott further argue that the default interpretation rules ought to be textualist in nature because the majority of businesses favor that interpretive approach. *Id.* at 931, 940, 944-47, 955-57.

388. Schwartz & Scott, *supra* note 3, at 930-31, 939 n.36, 942-44. In particular, see *id.* at 943 ("Sophisticated parties now can waive the right to a jury trial, or even the right to a trial in court, so they seemingly also should be able to waive the protection of exhaustive interpretive hearings."). Professor Shawn Bayern generally concurs with Schwartz and Scott that parties should be free to choose the rules of interpretation that govern the adjudication of a dispute over contractual meaning. Bayern, *supra* note 1, at 1101 ("The article's first, most general argument is that contracts should be interpreted using the methodology that best suits their circumstances on grounds of morality and policy. Apart from limited exceptions, the methodology that satisfies this criterion will be the one that the parties preferred . . . ."); *id.* at 1104 ("Moreover, with limited exceptions . . . , I agree with

Professor Avery Katz concurs with Schwartz and Scott. Recall that Professor Katz identifies an extended list of factors that can influence a party's perspective on the best interpretive system.[389]

> Because the list of economic and commercial considerations relevant to the choice between formal and substantive interpretation is long, and because the various considerations may well cut in opposite directions in individual cases, drawing specific conclusions regarding how to apply the above framework must be tentative at best. Indeed, it is for these very reasons that I argue that public lawmakers are not in a particularly good position to issue strong prescriptions regarding the proper balance between form and substance, and that private parties should be allowed the leeway to choose their favored interpretive regime.[390]

Similarly, Professor Lisa Bernstein contends that the UCC should be amended to allow merchants to opt out of either all or some of the statute's contextualist provisions.[391]

V. The Challenges of Conducting Empirical Research on Contract Interpretation

All of the issues discussed in Parts III and IV raise questions of empirical fact that can be answered only with empirical evidence.[392] Most importantly, determining

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Schwartz and Scott that the parties' preferences should ordinarily dictate the choice of an interpretive regime."); *id.* at 1125 ("If parties can agree to arbitrate disputes, it would be odd to refuse to let them structure their dispute in court in typical cases . . . ."). However, Professor Bayern also argues "that courts should adopt a contextualist mode of interpretation for determining the parties' choice of interpretive regime." *Id.* at 1102. In other words, judges "should use all available information to determine the agreement that parties had . . . about their preferred mode of interpretation." *Id.*; *accord id.* at 1135. Professor Bayern calls this approach "*meta-contextualism* because it uses a contextualist mode of interpretation to answer the meta-interpretive question about what interpretive regime to apply." *Id.* at 1102. The argument in favor of this position is set forth primarily on pages 1135 to 1138 of his article.

389. *See supra* notes 365-366 and accompanying text.

390. Katz, *supra* note 8, at 535; *accord id.* at 500 ("In general, private lawmakers are likely to be in a better position to make practical use of the economic analysis of contracts, in part because the detailed information that is necessary to implement such analysis intelligently is much likelier to be available at the individual level."); *id.* at 538 ("From an efficiency standpoint, the information available at the general level at which courts and legislatures must operate is inadequate to determine the relative magnitude of the relevant transaction costs. From an autonomy standpoint, the traditional stance of the court system neglects the possibility that different parties in different contexts might prefer—or ought to be delegated the power to choose—one interpretive approach over another.").

391. Bernstein, *Merchant Law*, *supra* note 289, at 1820-21; *see also* Hermalin et al., *supra* note 1, at 90 (explaining that in the absence of certain special assumptions, and given that "it is difficult to draw strong general conclusions regarding how interpretation should proceed" because of the numerous ways that an interpretive regime can influence the parties, "perhaps the best that can be said is that private parties should be allowed the leeway to choose their favored interpretative regime—a leeway not always recognized by the legal system. . . .").

392. However, the position that contract interpretation law should consist of default rules, *see*

which interpretive approach is superior across the dimensions of accuracy, transaction costs, and enforcement costs cannot be accomplished in the abstract.[393] The same is true with respect to identifying the interpretative preferences of contracting parties.[394] To be sure, many of the arguments concerning the optimal method for construing agreements presented in the caselaw and secondary literature are both sophisticated and reasonably persuasive. But without supporting quantitative empirical evidence and statistical analysis, these arguments constitute merely well-informed speculation.

Unfortunately, very few scholarly sources marshal the type of empirical evidence necessary to advance the policy debate over contract interpretation.[395] And those that do suffer from methodological problems that make their findings inconclusive at best. To elaborate, I have found no studies assessing either the comparative accuracy of textualism and contextualism or the level of transaction costs under the two approaches.[396] There are only two studies that attempt to measure enforcement costs—the two I completed—both of which have multiple methodological limitations.[397] And

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supra Part IV.C., can be defended on strictly moral grounds, such as autonomy and freedom of contract, *see supra* note 182.

393. Cohen, *supra* note 15, at 148 ("The real question is which methodology has the lowest error rate and at what cost. It is hard to answer that question in the abstract."); MITCHELL, *supra* note 87, at 114 ("Whether formalist or nonformalist judges will produce more errors depends on empirical evidence."); *id.* at 101-02 ("Modern versions of formalism in contract rely on empiricism to substantiate their claims. It would perhaps be more accurate to say that commentators on formalism have *recognized* that neoformalism must be justified on the basis of empirical evidence."); Bayern, *supra* note 1, at 1117 ("[I]it is hard to discern a meaningful justification for the 'minimal evidentiary base' [argued for by Professors Alan Schwartz and Robert Scott] based on theoretical argumentation alone, rather than an argument with more empirical sensitivity. . . . It is hard to see how the practical question of evidentiary utility could be decided as a theoretical matter.") (quoting Schwartz & Scott, *supra* note 92, at 572); *see also* Katz , *supra* note 8, at 505 ("But the proper compromise between form and substance, if it is to be based on utilitarian calculations, depends on an empirical judgment, made over the universe of potential cases, of how the relevant informational and transactional factors balance out.").

394. Bayern, *supra* note 1, at 1145 ("As with other interpretive matters, however, it is difficult to derive from theoretical principles what parties actually want [in terms of interpretation rules]. The world of contracting is too diverse and complicated to be reduced to simple theories that aggregate large groups of parties.").

395. *See* Burton, *supra* note 5, at 352 (stating that "[t]here is no empirical evidence" on the issues of accuracy, transaction costs, and enforcement costs); Walt, *supra* note 9, at 278 ("The case for incorporation relies on estimates of specification, error, and administrative costs. Direct survey or experimental evidence of the size and direction of these costs does not exist . . . ."); *id.* at 285 ("The case for incorporation is incomplete in two respects. Its estimates of specification, error and administrative costs are based only on limited indirect evidence. At crucial points the estimates rely on empirical hunches."); *see also* MITCHELL, *supra* note 87, at 102 (noting that neoformalists/textualists "have not necessarily been concerned with providing [empirical] evidence" to support their claims"). And of course the judiciary cannot be expected to compile empirical evidence regarding contract interpretation.

396. *But cf.* Lawrence Solan et al., *False Consensus Bias in Contract Interpretation*, 108 COLUM. L. REV. 1268 (2008) (reporting the results of experimental studies conducted with both judges and laypeople regarding the interpretation of insurance contracts and offering recommendations for reducing interpretive errors based on the findings).

397. *See supra* notes 269-274 and accompanying text; *see also* Bayern, *supra* note 1, at 1121 ("I

similar problems infect the handful of studies concerning the interpretive preferences of commercial parties, such as those conducted by Professor Lisa Bernstein.[398]

More seriously, a number of scholars have proposed that it might not be feasible to obtain conclusive empirical evidence regarding the central issues of contract interpretation. Professor Lawrence Cunningham wrote, for instance, that ["c]alculating writing costs and costs of judicial error is nearly impossible as a practical matter. At best, the costs can be suggested and only then in a relative sense . . . ."[399] Likewise, Professor Bernstein concluded that "[t]here is no way to directly test" whether transaction cost levels are lower under the UCC's version of partial contextualism than under textualism.[400] She elaborates:

> To do this [test], one would need a representative sample of contracts from a cross-section of industries, a jurisdiction with similar demographics that adopted a formalist interpretive approach (which is impossible given that the UCC has been adopted in every state but Louisiana), and controls that would take into account the wide variety of other considerations that might affect firms' drafting decisions. Furthermore, even if this data were available, it would be difficult to definitively interpret.[401]

I faced a comparable set of methodological challenges in my work on enforcement costs.[402] These challenges actually led me to abandon three of my proposed studies.[403]

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am aware of no empirical evidence suggesting that the economic savings in reducing the evidentiary base for commercial litigation would be significant.").

398. *See supra* notes 321-341 and accompanying text; *supra* note 299; *see also* Bayern, *supra* note 1, at 1121 ("As commentators on all sides of the debate seem to agree, empirical evidence of parties' meta-interpretive preferences is extremely limited."); Benoliel, *Empirical Study*, *supra* note 288, at 471 ("While the theoretical debate over the parties' preferences is very rich, there is scant existing empirical literature aiming to assess the parties' actual preferences."); Spigelman, *supra* note 100, at 429-30 (contending that businesses prefer textualist interpretation but noting that this claim is based on the author's "own, necessarily limited experience" and that the author "knows of no empirical research" that supports the belief).

399. Cunningham, *supra* note 76, at 274; *accord* Cunningham, *supra* note 194, at 1634 ("The net costs [of interpretive approaches] can be modeled. But at bottom, these models pose empirical questions that evade definitive resolution."); *see also* Walt, *supra* note 9, at 278 (explaining that measuring "specification, error, and administrative costs. . . under different interpretive and default regimes would be difficult"); Whitford, *supra* note 7, at 950 ("Ultimately the question whether a formalized or particularized approach to interpretation best achieves autonomy values raises empirical questions about how well contracting parties adapt or would adopt to formalized interpretive rules for written contracts, and how often juries or judges make mistakes applying particularized interpretation rules. It is the kind of empirical question on which empirical investigation can throw light but is unlikely ever to resolve completely.").

400. Bernstein, *Custom*, *supra* note 162, at 96 n.121.

401. *Id.*

402. *See* Silverstein, *supra* note 78, at 1027-29, 1039-85, 1092-96; Silverstein, *supra* note 15, at 226-53, 286-94, 300-05. For a relatively concise summary, see Silverstein, *supra* note 78, at 1092-93.

403. *See* Silverstein, *supra* note 78, at 1039-58, 1061-85

In the next few paragraphs, I elaborate on three of the challenges, each of which will arise any time a scholar attempts to assess the impacts of the two primary interpretive systems by contrasting data gathered from textualist and contextualist jurisdictions.

The first challenge is the complexity and confusion in the contract interpretation caselaw. In my initial study of enforcement costs, I tried to measure and compare the quantity of interpretive litigation in two sets of states, five that follow textualism and five that follow contextualism.[404] But in essentially every jurisdiction, the jurisprudence is a mixture of the two schools of thought rather than a pure version of either framework. This made it difficult to label a state as textualist or contextualist for my study. While I believe I selected ten states for the project that fit firmly in either the textualist or contextualist camp, my classification decisions are not immune from criticism. To illustrate, I categorized Arizona and New Jersey as contextualist.[405] But there are multiple precedents in each jurisdiction that apply the textualist approach.[406] Similarly, Texas courts consistently note that textualism is the governing system in their state,[407] and thus I included Texas in my textualist group. But courts in Texas sometimes implement textualism in a manner that makes it operate more like contextualism.[408] Given such examples, one could fairly object that the sets of states I chose for my research are too similar in their contract interpretation practices for any enforcement cost differences between textualism and contextualism to show up in my results.[409]

All (or virtually all) empirical studies built on a comparison of data collected from

404. Silverstein, *supra* note 15, at 286-91. In the second study, I attempted to measure the same thing in a single set of states during two time periods—one when the states employed textualism and the other when they employed contextualism. Silverstein, *supra* note 78, at 1058-59, 1085-86.

405. Silverstein, *supra* note 15, at 286.

406. *Compare* Conway v. 287 Corp. Ctr. Assocs., 901 A.2d 341, 346-47 (N.J. 2006) (explaining that New Jersey has adopted contextualist contract interpretation), *with*, for example, Barr v. Barr, 11 A.3d 875, 882 (N.J. Super. Ct. App. Div. 2010) (stating that extrinsic evidence may only be considered in interpreting a contract if the language on the face of the agreement is reasonably susceptible to more than one meaning, which is the textualist approach); *compare* Taylor v. State Farm Mut. Auto. Ins. Co., 854 P.2d 1134, 1138-41 (Ariz. 1993) (explaining that Arizona has adopted the contextualist approach), *with*, for example, Scalia v. Green, 271 P.3d 479, 482 (Ariz. Ct. App. 2011) ("In interpreting an easement created by deed or grant, we apply the rules of contract construction. . . . When a deed is unambiguous, we will not consider extrinsic evidence of the parties' intent.") (citation omitted)).

407. *See, e.g.*, David J. Sacks, P.C. v. Haden, 266 S.W.3d 447, 450-51 (Tex. 2008) ("An unambiguous contract will be enforced as written, and parol evidence will not be received for the purpose of creating an ambiguity . . . . Only where a contract is ambiguous may a court consider the parties' interpretation and 'admit extraneous evidence to determine the true meaning of the instrument.'") (quoting Nat'l Union Fire Ins. Co. v. CBI Indus., 907 S.W.2d 517, 520 (Tex. 1995).

408. *See* 6 LINZER, CORBIN ON CONTRACTS, *supra* note 78, § 25.14[a], at 158 (further arguing that the Texas Supreme Court's interpretive method "misleads planners into thinking they can rely on plain meaning when in fact the courts are not that rigid"); *id.* at 155-61; *see also* URI, Inc. v. Kleberg Cnty., 543 S.W.3d 755, 763-69 (Tex. 2018) (endorsing both textualism and contextualism).

409. Silverstein, *supra* note 15, at 301.

jurisdictions categorized as "textualist" and "contextualist" will suffer from this weakness. Such studies are actually contrasting two blended approaches to the construction of agreements rather than comparing pristine versions of textualism and contextualism. It is hard to see how the findings from this type of research could definitively answer questions such as which system of interpretation best minimizes enforcement costs, transactions costs, and error costs. Put simply, the law of interpretation is too impure to allow for a genuinely reliable assessment of whether textualism or contextualism is superior across these and various other dimensions when employing a study methodology similar to mine.[410]

Perhaps more American states follow an unadulterated approach to interpretation than I realize. A comprehensive review of the caselaw might uncover a greater number of such jurisdictions than I found during my work on the two enforcement cost studies. However, this is my fourth article addressing contract interpretation. In conducting research for the four papers, *every* state I investigated contained both textualist and contextualist authorities. This is consistent with the consensus among scholars and judges that the law governing the construction of agreements is deeply confused in all states. If that consensus is correct, then it will either be exceedingly difficult or actually impossible to design empirical studies that effectively address the issues at the center of the debate over contract interpretation by analyzing the impacts of variations in interpretive practices across state lines.

The second challenge is that textualist and contextualist jurisdictions differ from each other in countless ways beyond their rules for construing agreements. To compare the effects of any variation in interpretation doctrine, a study must control for those other differences. That is extremely difficult to do. In my two studies on enforcement costs, I developed a plausible control mechanism.[411] But the mechanism was far from perfect; it could not control for numerous variables.[412] And I suspect that the vast majority of potential studies driven by a comparison of data from textualist and contextualist states will be encumbered by the same issue.

The third challenge is that beliefs about the law can influence behavior in ways that make it hard to empirically measure the impact of differences in legal doctrine. Suppose, for example, that sophisticated contracting parties (and/or their attorneys) generally believe that contextualism raises enforcement costs in comparison to textualism. This might lead such parties to act in ways that increase the probability that textualist principles will govern their agreements. They could use tools like choice-of-law and choice-of-forum clauses, or they could locate more of their business activity in textualist states. Sophisticated parties would be particularly motivated to follow

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410. In fact, sometimes "textualist" and "contextualist" doctrine is so similar in content that a proposed study is not worth completing at all. I abandoned one project on this ground. For that study, I had planned to compare textualist common-law interpretation with contextualist UCC interpretation in a set of textualist states. But I terminated my work on this study because in jurisdictions that subscribe to textualism, common-law and UCC interpretation doctrine overlap too much to make a comparison fruitful. *See* Silverstein, *supra* note 78, at 1061-85 (summarizing the problems with this project on pages 1084-85).

411. *See* Silverstein, *supra* note 78, at 1058, 1086; Silverstein, *supra* note 15, at 289-91.

412. *See* Silverstein, *supra* note 78, at 1059-61, 1093; Silverstein, *supra* note 15, at 300, 302-03.

such practices for transactions that are more likely to result in an interpretive dispute. If this analysis is correct, then a disproportionate amount of interpretation litigation will be commenced in textualist jurisdictions, distorting any comparison of enforcement costs between textualist and contextualist states. Alternatively, perhaps the view that contextualism increases uncertainty (and thus raises enforcement costs) induces sophisticated parties to settle disputes more quickly when they are embroiled in litigation in jurisdictions that follow the broader interpretive approach. This would have a similarly distortive effect by reducing litigation levels in contextualist states. If contracting parties are changing their behavior because of their *beliefs* about the impacts of interpretation law, then it will be difficult and perhaps impossible to measure the *actual* impacts of the two interpretive approaches based on data pulled from textualist and contextualist sets of jurisdictions.[413]

Comparing data gathered from textualist and contextualist states is not the only method of empirical research that scholars can employ to address contract interpretation issues. It might be possible, for instance, to design experiments that assess which approach is superior with respect to accuracy. And a carefully constructed survey instrument may provide useful data on the interpretive preferences of various sorts of contracting parties. But these forms of empirical work have their own methodological challenges. It is thus more than conceivable that definitive proof as to the optimal method for construing agreements will never be available.

VI. Conclusion

The reader is likely wondering which approach to contract interpretation I think best. This final section briefly sets forth my own views.

Let me begin with two framing points. First, the plethora of well-reasoned theoretical arguments on both sides of the textualist/contextualist debate, combined with the dearth of empirical evidence supporting those arguments, leaves me torn over what constitutes the best interpretation regime. Second, I do not believe that textualism and contextualism differ in their impacts to the degree that most courts and scholars contend. In particular, I have long been skeptical of claims that there is a consequential variation between textualism and contextualism when it comes to litigation

413. Silverstein, *supra* note 15, at 303-04. Robert Thompson identified a similar problem in his empirical study of the factors that lead courts to pierce the corporate veil. Robert B. Thompson, *Piercing the Corporate Veil: An Empirical Study*, 76 CORNELL L. REV. 1036 (1991). He explained that any assessment of these factors "can be affected to the extent that litigants understand the prior learning on a legal issue and use that knowledge to decide which cases to file, to continue on appeal, or to settle." *Id.* at 1046. He offered as an example undercapitalization. Courts frequently state that undercapitalization is the most important factor in deciding whether to pierce the veil. But if defendants are aware of this, then they are probably more likely to settle cases in which the corporate entity was undercapitalized. *Id.* at 1046 n.67. And this means that undercapitalization will not appear in the caselaw as often as other, less significant piercing factors. Therefore, an empirical finding that undercapitalization is seldom litigated in reported decisions (or in other cases) does not necessarily support the conclusion that undercapitalization is less important than as suggested by judicial pronouncements regarding piercing doctrine.

expenses.[414] That is actually one of the reasons I conducted my two empirical studies on interpretive enforcement costs.[415] I also harbor doubts about assertions that the two systems differ significantly with respect to transaction costs.[416] Given these views, interpretive accuracy is the driving factor in my assessment of textualism and contextualism.

I think contextualists have the better case on accuracy. Accordingly, if the law of contract interpretation must be unitary—if the same rules must apply to all contracting parties—then I have a modest preference for contextualism. But I agree with Alan Schwartz, Robert Scott, and various other scholars who contend that sophisticated commercial parties should be entitled to choose which interpretive system will govern their disputes.[417] As a result, I ultimately favor (1) mandatory contextualist interpretation for contracts where at least one party is a consumer, an employee, or a small business, and (2) default contextualist rules for contracts between large and mid-size businesses which permit those parties to opt into textualist construction simply by inserting into their agreements provisions that instruct adjudicators to apply textualism in any subsequent case between the signatories.[418]

I expect vigorous judicial and academic debate over contract interpretation to continue in the years to come. I hope that such discourse incentivizes, and is in turn informed by, new empirical research regarding (1) which system of construction is superior with respect to accuracy, transaction costs, and enforcement costs, and (2) which system is preferred by contracting parties.

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414. *See supra* text accompanying notes 277-282 (explaining the bases for my view).

415. *See* Silverstein, *supra* note 78, at 1092.

416. *See supra* notes 208-210 and accompanying text (articulating the reasons for my view).

417. *See supra* Part IV.C.

418. I recognize that drawing the line between small and mid-size firms will not be easy. One option would be to use the line offered by Professors Schwartz and Scott: "We draw the boundary line here by defining a Category 1 firm as (1) an entity that is organized in the corporate form and has five or more employees, (2) a limited partnership, or (3) a professional partnership such as a law or accounting firm." Schwartz & Scott, *supra* note 92, at 544-45.