

# **THE LAW OF INTERPRETING CONTRACTS**

Richard R. Orsinger  
richard@momnd.com  
<http://www.orsinger.com>

McCurley, Orsinger, McCurley,  
Nelson & Downing, L.L.P.

Dallas Office:  
5950 Sherry Lane, Suite 800  
Dallas, Texas 75225  
214-273-2400

and

San Antonio Office:  
1616 Tower Life Building  
San Antonio, Texas 78205  
210-225-5567

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# The Law of Interpreting Contracts

by

Richard R. Orsinger

*Board Certified in Family Law  
and Civil Appellate Law  
Texas Board of Legal Specialization*

**I. OVERVIEW.** Views on how courts should interpret contracts vary widely. At the simplest level, the views have been contrasted as being either classical or modern, static or dynamic, textualist or contextualist, objective or subjective, literal or purposive, standardized or individualized, binary or multi-faceted. Scholarly writings about contract theory reflect both detractors and defenders of classical rules of contract interpretation, and present several new schools of thought, but the writings, taken as a whole, betray a lack of consensus on an underlying theory to justify either the old or the new approaches. The doctrine of stare decisis favors continuation of old methods, but some writers suggest that courts bend them occasionally, without saying so, to achieve justice in individual cases. And some suggest that courts pick and choose from the available rules of construction in order to reach a desired outcome.

The situation is complicated by the fact that different sets of rules apply to different types of contracts. Common law rules of interpretation apply generally, but state legislatures have adopted statutes, such as the Uniform Commercial Code, which prescribe rules and standards to be applied to certain kinds of contracts. Other contracts are affected by consumer protection laws, real property law, employment law, and securities law, to name a few. Alan Schwartz & Robert Scott, *Contract Theory and the Limits of Contract Law*, 113 Yale L. J. 541, 544 (2003) [“Schwartz & Scott”]. The U.S. government has entered

into a treaty that some say preempts state laws in international contract disputes involving the sale of goods. Plus, contracting parties sometimes opt out of, or expressly invoke, various statutory or common law rules. So contract law is a patchwork.

This article describes old and new approaches to interpreting contracts, and then recounts the rules of contract interpretation that are generally recognized, citing to Texas cases that speak to those rules. The article also considers the role of judge, jury, and appellate court, in cases involving contract interpretation.

## II. THE SCHOOLS OF THOUGHT.

**A. THE CLASSICAL VIEW.** In 1855, a professor of law at Harvard Law School, Theophilus Parsons, published a two volume treatise on contract law, called THE LAW OF CONTRACTS, that radically departed from other books previously written. Instead of just listing cases and their holdings, Professor Parsons expounded his view of the principles of contract law, and supported these views by notes discussing individual cases. Parsons did not write the supporting notes. Parsons employed Harvard law students to read and digest the underlying cases, and submit their summaries to another Harvard student named Christopher Columbus Langdell (1826-1906), who wrote the explanatory notes. These students read, and Langdell synthesized, some 6,000 cases, primarily from England but some from Massachusetts, New

York, and a few other U.S. states. In the spring of 1870, when Langdell took over Parsons' professorship, as well as the deanship of Harvard Law School (he was dean from 1870 to 1895), Langdell undertook to prepare a casebook of contract cases (the first casebook ever), the first volume of which he completed by October 1870.

Prior to Langdell, writings on contract law had grouped cases according to the types of parties involved (innkeepers, merchants, minors, etc.), or subject matter (services, money, property, etc.) rather than by underlying principles. Bruce A. Kimball; *Langdell on Contracts and Legal Reasoning: Correcting the Holmesean Caricature*, 25 *Law & History Review* No. 2 p. 39 (Summer 2007) ("Kimball") <<http://www.historycooperative.org/journals/lhr/25.2/kimball.html>>. Langdell conceived of an ordered intellectual framework for contract law consisting of rules that reflected principles like offer, acceptance, consideration, etc. Langdell's preface to the first edition of his case book reflects his intent:

Law, considered as a science, consists of certain principles and doctrines ... [T]he number of fundamental legal doctrines is much less than is commonly supposed ... It seems to me, therefore, to be possible to take a branch of the law such as Contracts, for example, and, without exceeding comparatively moderate limits, to select, classify and arrange all the cases which had contributed in any important degree to the growth, development, or establishment of any of its essential doctrines.

See Luke Nottage, *Tracing Trajectories in Contract Law Theory: Form in Anglo-New*

*Zealand Law, Substance in Japan and the US*, Sydney Law School Research Paper, at 7 n. 10 (2007b, forthcoming) ("Nottage"), available on-line at: <<http://law.anu.edu.au/anjel/documents/ResearchPublications/ComparativeContractLaw-TheoryDevelopment.pdf>>.

Given its historical priority and age, Langdell's approach is called "classical," even though it represents a modernization of contract law as it had existed up to the late 19<sup>th</sup> Century. Developing underlying principles and rules for various areas of law grew beyond contract law and became a movement in the law generally that came to be called "formalism." The classical approach to contracts moved to preeminence through the efforts of Samuel Williston (1861-1963), a Harvard law professor who served as the Reporter for the Uniform Sales Act of 1906, and authored a treatise on sales law in 1909, which was expanded into a 5-volume treatise on the law of contracts (1920). Professor Williston also served as the Reporter for the American Law Institute's Restatement of Contracts (1932). Williston lived to the age of 101. See Mark Movsesian, *Rediscovering Williston*, 62 *Washington & Lee L. Rev.* 207 (2005). Williston elevated predictability to a primary place in contract law. "A system of law cannot be regarded as successful unless rights and duties can, in a great majority of instances, be foretold without litigation." SAMUEL WILLISTON, *LIFE AND LAW* 209 (1941), quoted in Allen D. Boyer, *Samuel Williston's Struggle With Depression*, 42 *Buff. L. Rev.* 1, 23 (1994). In Williston's view:

In the formation of a bargain, intention of the parties does not mean secret intention, nor generally even intention manifested to third persons, but only the intention manifested to

the other party. If the offeror understood “the transaction to be different from that which his words plainly expressed, it is immaterial, as his obligation must be measured by his overt acts.”

1 WILLISTON ON SALES, p. 5, § 5, quoted in *Whaley Lumber Co. v. Reliance Brick Co.*, 2 S.W.2d 911, 916 (Tex. Civ. App. 1928, no writ).

The classical view ignored the subjective intent of the contracting parties and instead looked solely to the language of the contract to determine what was agreed upon. This approach relied upon the judge’s interpretation of the words of the contract, assisted by rules of construction that didn’t vary from case to case. This rule-based approach to interpreting contracts on their face, while ignoring the surrounding context of the contracting, has subsequently been disparaged as operating exclusively on axiomatic and deductive reasoning, where axioms are uncritically accepted as true, and are applied with a deductive logic (i.e., syllogistically) in a manner wholly independent from surrounding circumstances. “Classical contract law . . . conceived contract law as a small set of core doctrines—axioms—that were justified on the ground that they were self-evident, and as a larger set of doctrines that were justified largely on the ground that they could be deduced from the axioms.” Melvin Eisenberg, *The Emergence of Dynamic Contract Law*, 88 Cal. L. Rev. 1743, 1751 (2000) [“Eisenberg”]. Under the classical approach, the focus was not on the specific parties to the contract, and their conceptions of their agreement, but rather on the words of the contract they signed, without regard to surrounding circumstances. Federal District Judge Learned Hand wrote:

A contract has, strictly speaking, nothing to do with the personal, or individual, intent of the parties. A contract is an obligation attached by the mere force of law to certain acts of the parties, usually words, which ordinarily accompany and represent a known intent.

*Hotchkiss v. Nat'l City Bank*, 200 F. 287, 293 (S.D.N.Y. 1911). Thus, Eisenberg writes, “[a] contract involved what is called a meeting of the minds of the parties. But this does not mean that they must have arrived at a common mental state touching the matter at hand. The standard by which their conduct is judged and their rights are limited is not internal, but external.” Eisenberg, at 1756. This view was reflected in the original Restatement of Contracts (1932):

The meaning that shall be given to manifestations of intention is not necessarily that which the party from whom the manifestation proceeds, expects or understands.

Restatement of Contracts § 226, Comment b.

The central weakness of this approach is that words do not always have a definite meaning. Justice Oliver Wendell Holmes Jr. noted:

A word is not a crystal, transparent and unchanged, it is the skin of a living thought and may vary greatly in color and content according to the circumstances and the time in which it is used.

*Towne v. Eisner*, 245 U.S. 418, 425, 38 S.Ct. 158, 159, 62 L.Ed. 372 (1918). Beyond the underlying problem of words as indicators of thoughts, is the reality that some (many?)

contracts omit important terms, contain conflicting provisions, use vague descriptions, and contain ambiguities. Rules had to be constructed to patch around these deficiencies to allow the judge to reach a meaning without looking beyond the four corners of the document. Some of these rules gave weight to some parts of the contract over other parts (i.e., specific terms control over general terms), but in the instance of true gaps in the agreement it was necessary to provide default provisions that would fill in terms that the agreement omitted, or else to conclude that no contract had been formed. At first these default provisions were stated in common law decisions, but later various legislatures stepped in with uniform default terms to help fill gaps (particularly with regard to the sale of goods), to avoid having to inquire what the parties themselves intended.

In an influential article in the 1899 Harvard Law Review, Holmes articulated an objective standard for interpreting contracts that looked beyond the words of the agreement:

[W]e ask, not what this man meant, but what those words would mean in the mouth of a normal speaker of English, using them in the circumstances in which they were used, and it is to the end of answering this last question that we let in evidence as to what the circumstances were. But the normal speaker of English is merely a special variety, a literary form, so to speak, of our old friend the prudent man. He is external to the particular writer, and a reference to him as the criterion is simply another instance of the externality of the law.

O.W. Holmes, Jr., *The Theory of Legal Interpretation*, 12 Harv. L. Rev. 417, 417-18

(1899). In Holmes's view, objectivity in contract interpretation was not to be achieved by applying unchanging rules to the face of the agreement. It was not a question of what one party meant, or even what the other party understood. To Holmes objectivity meant that the contract should be evaluated through the eyes of a disinterested third party, including in the mix that person's common knowledge. In practice, Holmes approached interpretation questions (statutory as well as contractual) by considering not only the words, but also the context in which the words were written, including not only the document as a whole but also the geographic, historical and societal context which might give meaning to the words. Thus Holmes did not confine himself to applying rules of construction to the four corners of the document, and he did look outside the contract, but he avoided an assessment of the understanding of either party to the contract and instead sought to determine what a reasonable person would take the words to mean. Patrick J. Kelley, *Objective Interpretation and Objective Meaning in Holmes and Dickerson: Interpretive Practice and Interpretive Theory*, 1 Nev. L.J. 112, 117-121 (2001).

The Restatement of Contracts (1932) adopted this reasonable person standard of interpretation, as reflected in Section 230:

§ 230. Standard Of Interpretation Where There Is Integration

The standard of interpretation of an integration, except where it produces an ambiguous result, or is excluded by a rule of law establishing a definite meaning, is the meaning that would be attached to the integration by a reasonably intelligent person acquainted with all operative usages and knowing all



the circumstances prior to and contemporaneous with the making of the integration, other than oral statements by the parties of what they intended it to mean.

Comment b to Section 230 notes:

Where a contract has been integrated the parties have assented to the written words as the definite expression of their agreement. . . . They have assented to the writing as the expression of the things to which they agree, therefore the terms of the writing are conclusive, and a contract may have a meaning different from that which either party supposed it to have.

Although the classical and the objective approaches to interpreting contracts have been under assault for more than half a century, it is enjoying a bit of a resurgence. Justice Richard Posner surmises that “[t]his may be due in part to the fact that fewer and fewer legal academics have significant experience in the ‘real world’ of contract drafting and business litigation.” Richard Posner, *The Law and Economics of Contract Interpretation*, 83 Tex. L. Rev. 1581, 1583 (2005) (“R. Posner”).

**B. LEGAL REALISM.** Beginning in 1906, Roscoe Pound (Dean of Harvard Law School 1919 to 1936) began to argue against what he called “mechanical jurisprudence,” and suggested instead a sociological approach where rules of law would be evaluated on the basis of the social interests that they served. Knapp, Crystal & Prince, *PROBLEMS IN CONTRACT LAW – CASES AND MATERIALS* 11 (Aspen 2003) (“Knapp”), on line at: <<http://www.str2.jura.uni-erlangen.de/other/patterson/contractsmaterials.pdf>>. A school of “Legal Realists” arose, spearheaded by law

professors at Columbia Law School, which denied that judicial objectivity was possible, and instead said that court decisions are the outcome of a decision-making process where the choice of legal rules and perception of the facts are influenced by personalities, points of view, interest, class, etc. Knapp, at 11. Writers on contract law began to debate the justifications for contract rules, and the effect that such rules had on different types of people—a process that goes on today. Some proponents attempted to modernize the prevailing views of contract law. Although he didn’t consider himself to be a Legal Realist, one such instigator of change was Arthur Linton Corbin (1874-1967). In 1903 Corbin became Yale Law School’s first full-time professor, and taught there for 40 years.

<<http://www.law.yale.edu/cbl/3075.htm>>  
Corbin justified his effort to modernize contract law in these terms:

[T]he law does not consist of a series of unchangeable rules or principles engraved upon an indestructible brass plate or, like the code of Hammurabi, upon a stone column. Every system of justice and of right is of human development, and the necessary corollary is that no known system is eternal. In the long history of the law can be observed the birth and death of legal principles. They move first with the uncertain steps of childhood, then enjoy a season of confident maturity, and finally pass tottering to the grave. . . . The law is merely a part of our changing civilization. The history of law is the history of . . . society. Legal principles represent the prevailing mores of the time, and with the mores they must necessarily be born, survive for the appointed season, and perish.

ARTHUR L. CORBIN, ANSON ON CONTRACTS v-vi (3d Am. ed. 1919). Corbin's view of contract interpretation is reflected in the following comment: "The final interpretation of a word or phrase should not be adjudged without giving consideration to all relevant word usages, to the entire context and the whole contract, and to all relevant surrounding circumstances." 3 CORBIN ON CONTRACTS § 5555, at 236 (1960). Further insight into Corbin's thinking is reflected in twelve letters he wrote at different periods of his life, unearthed by Professor Perillo. See Joseph M. Perillo, *Twelve Letters From Arthur L. Corbin to Robert Braucher*, 50 Wash. & Lee L. Rev. 755 (1993) ("[there] will always be two large fields of legal uncertainty--the field of the obsolete and dying, and the field of the new born and growing.") ("I have read all the contract cases for the last 12 years; and I know that 'certainty' does not exist and the illusion perpetrates injustice."). Although "differences arose, in both theory and expression," between Corbin and Williston, Corbin nonetheless considered Williston to be his teacher on contract law, and Corbin collaborated closely with Williston in preparing the original Restatement of Contracts. Arthur L. Corbin, *In Memoriam: Samuel Williston*, 76 Harv. L. Rev. 1327 (1963).

A prominent legal realist in the contract area was Karl N. Llewellyn (1893-1962), who studied under Corbin at Yale Law School. Llewellyn was a professor at Columbia Law School. Llewellyn argued that judges should become familiar with the facts of a case, so they could acquire a "situation sense" that would lead to the right result. Knapp, at 24. Professor Llewellyn published a case book on contract law that broke with Langell's black letter law approach by discussing economic considerations, business practices, and other factors influencing the expectations and be-

haviors of commercial buyers. Nottage, at 9. Llewellyn served as Reporter for the Uniform Commercial Code ("UCC"), a project that was started in 1940 and came to fruition in 1951. Llewellyn was the principal draftsman of Article 2, on sales, which contained provisions relating to the formation and interpretation of contracts. Professor Llewellyn influenced the UCC to be more in accord with prevailing business practices, and to focus more on general standards and less on mechanical rules. Instead of merely enacting the existing body of contract law, the UCC in many instances deviated from the common law of contract that had developed for the sale of goods. See Knapp, at 20. A copy of the UCC is on-line at:

<<http://www.law.cornell.edu/ucc>>.

The Uniform Commercial Code rejected the purely textual approach to interpreting contracts:

1. This Act rejects both the "lay-dictionary" and the "conveyancer's" reading of a commercial agreement. Instead the meaning of the agreement of the parties is to be determined by the language used by them and by their action, read and interpreted in the light of commercial practices and other surrounding circumstances. The measure and background for interpretation are set by the commercial context, which may explain and supplement even the language of a formal or final writing.

Uniform Commercial Code, § 1-205, *Official Comment*, Purposes, ¶ 1.

This expanded view found expression in Restatement (Second) of Contracts (1981) § 202(1):

Words and other conduct are interpreted in the light of all circumstances, and if the principal purpose of the parties is ascertainable it is given great weight.

The Restatement (Second) rejected the reasonable third person perspective of interpreting agreements. Section 212, Comment a, said: “the operative meaning is found in the transaction and its context rather than in the law or in the usages of people other than the parties.”

“Contrary to the formalism of classic contract law and Restatement First, the approach to contract interpretation and gap-filling prescribed by Restatement Second and the U.C.C. is more concerned with arriving at the actual agreement of the parties, or where there is no such agreement, construing the contract in a manner that is fair and reasonable under the circumstances.” Harold Dubroff, *The Implied Covenant of Good Faith in Contract Interpretation and Gap-Filling: Reviling a Revered Relic*, 80 St. John's L. Rev. 559, 572 (2006).

**C. LAW AND ECONOMICS.** Beginning in the early 1960s, Nobel Prize-winning economists began to suggest an economic assessment of legal doctrines. See Schwartz & Scott, at 548. The reliability of promises, it was argued, encourages promissory exchanges. Nancy S. Kim, *Evolving Business and Social Norms and Interpretation Rules: The Need for a Dynamic Approach to Contract Disputes*, 84 Neb. L. Rev. 506, 513 (2005) (“Kim”). A prominent proponent of the economic approach to contract interpretation, Justice Richard Posner of the U.S. Seventh Court of Appeals wrote:

The goal of a system, methodology, or

doctrine of contractual interpretation is to minimize contractual transaction costs, briefly understood as obstacles to efforts voluntarily to shift resources to their most valuable use.

R. Posner, at 1583. Posner suggested a formula:

$$C = x + p(x)[y + z + e(x,y,z)]$$

where C is the “social transaction costs of a contract (‘social’ in the sense of including costs to third parties, such as the courts and future transacting parties, as distinct from just the costs to the parties to the particular contract),” and where “x is the negotiation and drafting cost, p the probability of litigation, y the parties’ litigation costs, z the cost of litigation to the judiciary, and e the error costs.” R. Posner, at 1583. Contracting parties can spend more on the first term (that is x, or negotiating and drafting) in order to reduce the second term (that is  $p(x)[y + z + e(x,y,z)]$ , or the potential cost of litigation and the risk of an erroneous outcome of litigation). Lawyers prefer that; businessmen usually don’t. Default terms, usually provided by statute, tend to reduce the cost of both terms of the formula. So do form contracts.

As far as an overarching philosophy, it could be said that the economic approach views the purpose of contract law as maximizing the “total benefits” created by an agreement. Schwartz & Scott, at 552. In Richard Posner’s view, each party wants to gain from the transaction by “agreeing to terms that maximize the surplus created by the transaction—the excess of benefits over costs, the excess being divided between the parties.” R. Posner, at 1588. Not only is this a motivation for the parties to contract, but it can also be taken as a standard by which to resolve

contractual disputes, if a judge or juror or arbitrator wished to consider that aspect of a transaction as an indication on how to resolve a dispute.

**D. A DYNAMIC APPROACH TO CONTRACTS.** While the debate continues about when and how far to go beyond the face of the agreement in interpreting a contract, a school of thought was developed that views the contracting process not as the single event of signing the document but rather the entire course of dealings of the parties, from negotiations through performance.

The dynamic approach argues that contracts seldom occur at one instant in time, and that the contracting process has a past, present, and future, all of which are important to interpreting the contract. Eisenberg, at 1762. A number of writers subscribe to this so-called “dynamic” theory of contract law, but their descriptions of the approach vary. A central tenet of the dynamic theory is that the goal of contract interpretation is to effectuate the actual objectives of the contracting parties. Eisenberg, at 1745. This goes beyond the Restatement (Second) which gives the intent of the parties “great weight.” One writer views the dynamic approach as a rejection of keeping to any one theory of contract law, and instead considering the tenets proposed by various theories in order to find the best rule for a particular situation. Kim, at 518. The goal, according to this writer, is to find the solution that the parties would have enacted if they had addressed the problem during negotiations. Kim, at 528.

**E. THE IMPACT OF THEORY ON PRACTICE.** Some writings on contract law seek to justify existing rule of interpretation using new and different rationales. Others advocate a change in existing rules, particu-

larly to weaken or dispense with the parol evidence rule. Professor Farnsworth wrote in 1990: “Viewed from the academe, the most significant non-event of the decade was the failure of contract theory to have a significant impact on practice.” E. Allan Farnsworth, *Developments in Contract Law During the 1980's: The Top Ten*, 41 Case W. Res. L. Rev. 203, 225 (1990) (“Farnsworth”). This is still largely true seventeen years later.

**III. IMPORTANT CONCEPTS.** There are certain concepts that are important to the issue of contract interpretation. Some of these are discussed below.

**A. THE GOAL OF INTERPRETATION.** Richard Posner described contract interpretation as “the undertaking by a judge or jury (or an arbitrator . . .) to figure out what the terms of a contract are, or should be understood to be.” R. Posner, at 1581. It is sometimes said that an agreement results from “a meeting of the minds” of the contracting parties, and that in contract interpretation courts are to determine the intent of the parties. The textual approach limits the court to the four corners of the contract as the sole source of determining the parties’ intent, and admits that the result may be something neither party intended. Joseph Perillo noted: “This perspective subordinates the parties’ intentions to the intrinsic meaning of words.” Joseph M. Perillo, *The Origins of the Objective Theory of Contract Formation and Interpretation*, 69 Fordham L. Rev. 427, 431 (2000). The objective approach to contract interpretation considers the words of the contract and part (but not all) of the context surrounding the agreement, but still ignores the subjective intent of the contracting parties.

**B. THE UNIFORM COMMERCIAL CODE (“UCC”).** Promulgated in 1951 by

the National Conference of Commissioners on Uniform State Laws (NCCUSL), working with the American Law Institute (ALI), the UCC is a proposed statutory framework for commercial transactions. It has largely been enacted in all states except that Louisiana has not adopted Article 2 governing sales of goods. The NCCUSL says: “The [Article 2] rules provide for each stage of a contractual relationship from formation to performance. Included are provisions governing implied and express warranties, risk of loss, statute of frauds and extrinsic evidence, interpretation, auction sales, ‘gap-filling’ terms that apply when parties fail to reach agreement, breaches of contract and remedies for breaches of contract.” <[http://www.nccusl.org/Update/uniformact\\_summaries/uniformacts-s-ucc22003.asp](http://www.nccusl.org/Update/uniformact_summaries/uniformacts-s-ucc22003.asp)>

The Uniform Commercial Code began as a rewrite of the Uniform Sales Act, but morphed into a collection of laws relating to various commercial transactions. Article 2 governs sales, including not only sales between merchants but also sales by merchants to consumers and sales between non-merchants. Knapp, at 20. Many of the terms in Article 2 could easily apply to other types of contracts, and some courts have used Article 2 rules by analogy to non-sales transactions. The NCCUSL and ALI recently worked for several years on revisions to Article 2. *See* W. David East, *The Statute of Frauds and the Parol Evidence Rule Under the NCCUSL 2000 Annual Meeting Proposed Revision of U.C.C. Article 2*, 54 SMUL Rev. 867 (2001). Despite opposition from a number of business organizations, the revisions passed the NCCUSL in 2003, but failed to pass at the ALI’s membership meeting later that year. The effort to update Article 2 has been abandoned.

As explained in II.B above, the UCC Article 2 provisions regarding contract interpretation consider not only the text of the agreement but also some actions of the parties, commercial practices, and other surrounding circumstances. Subsequent writers have characterized these and other principles of Article 2 as “vague standards.” Alan Schwartz surmises that the vagueness resulted from the fact that the drafters were primarily academics who wanted vagueness to increase the likelihood that the draft would be accepted by the more conservative membership at large of the NCCUSL and the ALI. Alan Schwartz & Robert E. Scott, *The Political Economy of Private Legislatures*, 143 U. Pa. L. Rev. 595, 646 (1995). Thus the explanation of Article 2 includes politics, not just intrinsic merit.

### **C. THE ORIGINAL AND SECOND RESTATEMENTS OF CONTRACTS.**

The ALI’s first ever restatement was the Restatement of Contracts, adopted in 1932. It was formatted to state the general rule, and if court opinions diverged then it stated the “better rule” and the alternative rule. The Restatement tended toward generalization and predictability, at the expense of diversity and flexibility. Knapp, at 21. Restatement § 226 said this about “interpretation”:

#### § 226. What Is Interpretation

Interpretation of words and of other manifestations of intention forming an agreement, or having reference to the formation of an agreement, is the ascertainment of the meaning to be given to such words and manifestations.

Note that the focus of interpretation is on the meaning of the words used in the agreement, and not the actual intent of the parties.

In 1962, the ALI began rewriting the Restatement of Contracts. The Reporter for the Restatement (Second) of Contracts was Professor E. Allan Farnsworth, of Columbia School of Law. The Restatement (Second) was influenced by the UCC.

The Restatement (Second) of Contracts rejects a purely-textual approach and abandons the objective reasonable person standard. Instead express terms are interpreted in light of “all the circumstances” (subject to the parol evidence rule). If the subjective intent (principal purpose) of the parties can be discerned it is given “great weight.” Indicators of the parties’ intent are to be measured against course of performance, course of dealing, or usage of trade. If the course of performance involves repeated actions, that the other party accepts or acquiesces in, then course of performance is given “great weight” in interpreting the agreement.

Professor John E. Murray, Jr., draws this comparison:

The First and Second Restatement of Contracts contain the following hypothetical: A says to B, I offer to sell you my horse for \$100. B knowing that A intends to offer to sell his cow for that price, not his horse, and that the word 'horse' is a slip of the tongue, replies I accept. Restatement (First) of Contract article 71 illust. 2 (1932); Restatement (Second) of Contracts article 20 illus. 5 (1981). Neither Restatements finds a contract for the sale of the horse. The first Restatement also finds no contract for the sale of the cow, but the Second Restatement concludes that there is a contract for the sale of the cow.

John E. Murray, Jr., *An Essay on the Formation of Contracts and Related Matters under the United Nations Convention on Contracts for the International Sale of Goods*, 8 *Journal of Law and Commerce* 11 (1988) <<http://cisgw3.law.pace.edu/cisg/text/murray8.html>>. For a review of criticisms of the ALI and the Restatement process, see Kristen David Adams, *Blaming the Mirror: The Restatements and the Common Law*, 40 *Ind. L. Rev.* 205 (2007).

**D. INTERNATIONAL COMMERCIAL LAW.** The United Nations Convention on the International Sale of Goods (“CISG”) became effective on January 1, 1988. See McQuillen, *The Development of a Federal CISG Common Law in U.S. Courts: Patterns of Interpretation and Citation*, 610 *Miami L. Rev.* 509 (2007) (“McQuillen”). Like UCC Article 2, it applies to the sale of goods, only on an international scale. Unlike the UCC, the CISG does not apply to consumer transactions. The CISG is a treaty with more than sixty signatories, and the U.S. has subscribed to it, so it is part of the supreme law of the land. On line access to relevant information is available at <<http://cisgw3.law.pace.edu>>.

The CISG looks at the true intent of the parties. Article 8(3) says that courts should give “due consideration. . . to all relevant circumstances of the case including the negotiations, any practices which the parties have established between themselves, usages and any subsequent conduct of the parties.” See McQuillen, at 520.

The CISG contains no statute of frauds or parol evidence rule. Article 11 provides: "A contract for sale need not be concluded in or evidenced by a writing and is not subject to any other requirement as to form. It may be proved by any means, including witnesses." In

ratifying the treaty, the United States did not make the declaration permitted under Article 12, which would have preserved the statute of frauds and parol evidence rules.

On October 23, 2004, the CISG Advisory Council adopted CISG Advisory Council Opinion No. 3, *Parol Evidence Rule, Plain Meaning Rule, Contractual Merger Clause and the CISG*, which stated:

1. The Parol Evidence Rule has not been incorporated into the CISG. The CISG governs the role and weight to be ascribed to contractual writing.
2. In some common law jurisdictions, the Plain Meaning Rule prevents a court from considering evidence outside a seemingly unambiguous writing for purposes of contractual interpretation. The Plain Meaning Rule does not apply under the CISG.
3. A Merger Clause, also referred to as an Entire Agreement Clause, when in a contract governed by the CISG, derogates from norms of interpretation and evidence contained in the CISG. The effect may be to prevent a party from relying on evidence of statements or agreements not contained in the writing. Moreover, if the parties so intend, a Merger Clause may bar evidence of trade usages.

However, in determining the effect of such a Merger Clause, the parties' statements and negotiations, as well as all other relevant circumstances shall be taken into account.

<<http://cisgw3.law.pace.edu/cisg/CISG-AC-op3.html#1>>.

In one case, the Fifth Circuit Court of Appeals held that Texas' parol evidence rule applied despite the CISG, while in another case the Eleventh Circuit Court of Appeals held that the CISG preempted state law, and thus declined to apply the parol evidence rule. See McQuillen, at 521-23; Note, *The Inapplicability of the Parol Evidence Rule to the United Nations Convention on Contracts for the International Sale of Goods*, 28 Hofstra L. Rev. 799 (2000). Several federal district courts have recognized preemption of the parol evidence rule by the CISG. McQuillen, at 521-23.

To cover gaps in the CISG, the private organization UNIDROIT prepared Principles of International Commercial Contracts, in 1994. These principles do not have the force of law, and are perceived as scholarly opinion.

Efforts are underway to see how parties to international contracts with arbitration clauses are approaching the use of CISG or other international norms as opposed to contract law of individual nations. See Christopher R. Drahozal, *Contracting out of National Law: an Empirical Look at the New Law Merchant*, 80 Notre Dame L. Rev. 523 (2005). The early assessment is that they aren't opting out of national law. *Id.*

Globalization of trade brings new concerns into focus. Negotiations and drafting may be conducted in a non-English language that does not translate well into English. An example is that Japanese does not have a future tense. Kim, at 534. It may be difficult for an American judge to envision what a reasonable third person might find the contract to mean, when the Mandarin Chinese contract is between the Singapore branch of a Chinese company and an American company, calling for performance in Indonesia but with payment to be

made in Euros.

#### **E. STANDARD OF INTERPRETATION.**

“Standard of interpretation” was defined in the original Restatement of Contracts § 227 as “the test applied by the law to words and to other manifestations of intention in order to determine the meaning to be given to them.” The Restatement offered a list of potential standards of interpretation: (1) the standard of general usage; (2) a standard of limited usage (usage in a particular locality, or by a sect, or in a particular occupation, or by immigrants using a local dialect); (3) a mutual standard (common to the contracting parties but not others); (4) an individual standard (either the meaning the person making the communication intended the communication to express, or that the person receiving the communication understood from it); (5) a standard of reasonable expectation (the meaning which the party employing the words should reasonably have apprehended that they would convey to the other party); (6) a standard of reasonable understanding (the meaning which the person addressed might reasonably give to them). The standard of interpretation applied by the Restatement to an integrated agreement was “the meaning that would be attached to the integration by a reasonably intelligent person acquainted with all operative usages and knowing all the circumstances prior to and contemporaneous with the making of the integration, other than oral statements by the parties of what they intended it to mean.” *Id.* § 230. These standards differ in whose perspective is used to evaluate the contract. Where there was no integrated contract, the Restatement assumed a standard of interpretation, that the words and actions of the party are given “the meaning which that party should reasonably expect that the other party would give to them.” *Id.* § 233.

The Restatement (Second) of Contracts says this about interpreting agreements:

#### § 212. Interpretation Of Integrated Agreement

(1) The interpretation of an integrated agreement is directed to the meaning of the terms of the writing or writings in the light of the circumstances, in accordance with the rules stated in this Chapter.

In the Restatement (Second) of Contracts, the standard of interpretation is implicit in its rules of interpretation:

#### § 202. Rules In Aid Of Interpretation

(1) Words and other conduct are interpreted in the light of all the circumstances, and if the principal purpose of the parties is ascertainable it is given great weight.

(2) A writing is interpreted as a whole, and all writings that are part of the same transaction are interpreted together.

(3) Unless a different intention is manifested,

(a) where language has a generally prevailing meaning, it is interpreted in accordance with that meaning;

(b) technical terms and words of art are given their technical meaning when used in a transaction within their technical field.

(4) Where an agreement involves repeated occasions for performance by



either party with knowledge of the nature of the performance and opportunity for objection to it by the other, any course of performance accepted or acquiesced in without objection is given great weight in the interpretation of the agreement.

(5) Wherever reasonable, the manifestations of intention of the parties to a promise or agreement are interpreted as consistent with each other and with any relevant course of performance, course of dealing, or usage of trade.

**F. THE FOUR CORNERS RULE.** The “four corners rule” says that the meaning of an unambiguous agreement is to be determined from the words of the contract alone. “The rule bars the parties to a written contract that is ‘clear on its face’-- meaning that a reader who is competent in English but unaware of the agreement’s context would think the writing admitted of only one meaning--from presenting evidence bearing on interpretation, which is to say ‘extrinsic’ evidence--evidence outside the ‘four corners’ of the written contract. The judge alone determines what the contract means when no extrinsic evidence is presented because he is a more competent interpreter of a document than a jury is.” R. Posner, at 1596.

The four corners rule can be justified on the grounds that, because the dispute is resolved from examination of the documents themselves, it is quick, inexpensive, and more certain in outcome. Richard Posner commented on the thrust behind the four corners rule: “[w]ritten contracts would mean little if a party could try to persuade a jury that while the contract said X, the parties had actually agreed, without telling anybody or writing anything down, that the deal was Y.” Richard

A. Posner, *LAW AND LITERATURE* 245-46 (rev. & enlarged ed. 1998). In a judicial opinion, Justice Richard A. Posner said this about the four corners rule:

The older view, sometimes called the “four corners” rule, which excludes extrinsic evidence if the contract is clear “on its face,” is not ridiculous. (There is ancient wisdom as well as ancient prejudice.) The rule tends to cut down on the amount of litigation, in part by reducing the role of the jury; for it is the jury that interprets contracts when interpretation requires consideration of extrinsic evidence. Parties to contracts may prefer, ex ante (that is, when negotiating the contract, and therefore before an interpretive dispute has arisen), to avoid the expense and uncertainty of having a jury resolve a dispute between them, even at the cost of some inflexibility in interpretation.

*Federal Deposit Ins. Corp. v. W.R. Grace & Co.*, 877 F.2d 614, 621 (7<sup>th</sup> Cir. 1989) (Posner, J.).

**G. THE PLAIN MEANING RULE.** The plain meaning rule provides that a judge, if s/he believes that the meaning of a disputed contract term is clear, must refuse to admit extrinsic evidence regarding the meaning intended by either party. Margaret Kniffin, *A New Trend in Contract Interpretation: The Search For Reality as Opposed to Virtual Reality*, 74 Oregon L. Rev. 643, 644 (1995). The court must even refuse to consider extrinsic evidence that the meaning “is not really plain.” Eisenberg, at 1767.

The Restatement (Second) of Contracts § 212, comment b, says:

b. Plain meaning and extrinsic evidence. 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. Accordingly, the rule stated in Subsection (1) is not limited to cases where it is determined that the language used is ambiguous. 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 and statements made therein, usages of trade, and the course of dealing between the parties. See §§ 202, 219-23. But after the transaction has been shown in all its length and breadth, the words of an integrated agreement remain the most important evidence of intention. Standards of preference among reasonable meanings are stated in §§ 203, 206, 207.

In a highly-regarded draft speech in the House of Lords, Lord Hoffman gave the following description of the plain meaning rule:

The "rule" that words should be given their "natural and ordinary meaning" reflects the common sense proposition that we do not easily accept that people have made linguistic mistakes, particularly in formal documents. On the other hand, if one would nevertheless conclude from the background that something must have gone wrong with the language, the law does not require judges to attribute to the parties an intention which they plainly could not have had. Lord Diplock made this point more vigorously when he said in *The Antaios Compania*

*Neviera S.A. v. Salen Rederierna A.B.* 19851 A.C. 191, 201: ". . . if detailed semantic and syntactical analysis of words in a commercial contract is going to lead to a conclusion that flouts business commonsense, it must be made to yield to business commonsense."

*Investors Compensation Scheme v. West Bromwich Building Society*, [1997] UKHL 28 <<http://www.publications.parliament.uk/pa/ld199798/ldjudgmt/jd970619/invest03.htm>>.

Professor Eisenberg has written that "the plain-meaning rule has been largely abandoned." Eisenberg, at 1768. He supports this assertion with a citation to Restatement (Second) of Contracts § 212(1), and comment b of that section: "meaning can almost never be plain except in a context." The absence of citations to state appellate decisions is telling. As we shall see, the plain meaning rule is alive and well in Texas.

**H. INTERPRETATION VS. CONSTRUCTION.** Professor Corbin distinguished contract interpretation from contract construction: interpretation is an effort to determine the meaning of the words, while construction is determining the legal effect of the language. Arthur L. Corbin, *CORBIN ON CONTRACTS* § 534 (1960). Other writers have questioned whether the distinction exists, or whether it is useful. See Glasser & Rowley, *On Parol: The Construction and Interpretation of Written Agreements and the Role of Extrinsic Evidence in Contract Litigation*, 49 Bay. L. Rev. 657 n. 2 (1997) ["Glasser & Rowley"]. The Uniform Commercial Code recognizes an analogous distinction between an "agreement" and a "contract." See the next section.

**I. AGREEMENT VS. CONTRACT.** The UCC distinguishes between an “agreement” and a “contract.” UCC § 1-201(3) provides:

(3) "Agreement" means the bargain of the parties in fact as found in their language or by implication from other circumstances including course of dealing or usage of trade or course of performance as provided in this Act (Sections 1-205 and 2-208). Whether an agreement has legal consequences is determined by the provisions of this Act, if applicable; otherwise by the law of contracts (Section 1-103). (Compare "Contract.")

UCC § 1-201(11) provides:

(11) "Contract" means the total legal obligation which results from the parties' agreement as affected by this Act and any other applicable rules of law. (Compare "Agreement.")

**J. INTEGRATED VS. PARTIALLY INTEGRATED VS. UNINTEGRATED.** “An integrated agreement may be either fully integrated or only partially integrated. A fully integrated contract is one that is a final and complete expression of all the terms agreed upon between or among the parties. A contract is partially integrated if the written agreement is a final and complete expression of some or all of the terms therein, but not all of the terms agreed upon . . . are contained in the written agreement.” Keith A. Rowley, *Contract Construction and Interpretation: From the “Four Corners” to Parol Evidence (and Everything in Between)*, 69 Miss. L. J. 73, 101-02 (1999) (“Rowley”). “If the evidence ... does not indicate that the writing is intended as an integration, i.e., ‘a final expression of one or more terms of an agreement’ .

. . . then ‘the agreement is said to be unintegrated. . . .’” *Conn Acoustics, Inc. v. Xhema Const., Inc.*, 870 A.2d 1178, 1181 (Conn. App. 2005).

The Restatement (Second) of Contracts states the following regarding integration:

#### § 209. Integrated Agreements

(1) An integrated agreement is a writing or writings constituting a final expression of one or more terms of an agreement.

(2) Whether there is an integrated agreement is to be determined by the court as a question preliminary to determination of a question of interpretation or to application of the parol evidence rule.

(3) Where the parties reduce an agreement to a writing which in view of its completeness and specificity reasonably appears to be a complete agreement, it is taken to be an integrated agreement unless it is established by other evidence that the writing did not constitute a final expression.

If the agreement is fully integrated, extrinsic evidence is not admissible to show the parties’ intent or the meaning of the words used. Rowley, at 238. If partially integrated, extrinsic evidence is admissible on the missing parts, but it cannot contradict the portions of the agreement that are final. *Id.* at 238. If the agreement is unintegrated, the parol evidence rule does not apply. Rowley, at 262.

**K. VAGUENESS VS. AMBIGUITY.** Professors Schwartz and Scott differentiate vagueness from ambiguity. They say that a

word is “vague” to the extent that it can apply to a “wide spectrum of referents,” . . . or to “somewhat different referents in different people.” “Ambiguity requires at least two distinct, usually inconsistent, meanings.” Schwartz & Scott, at 570 n. 55. They contrast a famous case over the meaning of the word “chicken” from an even more famous case over which of two ships named “Peerless” the parties meant in a contract. *Id.*

**L. AMBIGUITY.** “An instrument is ambiguous if one or more terms or provisions are susceptible to more than one reasonable meaning.” Rowley, at 90.

The Fifth Circuit Court of Appeals has broken the ambiguity analysis into three parts:

- (i) are the express contract terms ambiguous;
- (ii) are they still ambiguous after considering course of dealing, usage of trade, and course of performance; if so, then
- (iii) admit extrinsic evidence and let the fact finder determine the meaning.

*Paragon Resources, Inc. v. National Fuel Gas Distrib. Corp.*, 695 F.2d 991, 996 (5<sup>th</sup> Cir. 1983) (applying Texas law). The first inquiry is a question of law for the court. The third inquiry is a question of fact for the fact-finder. The Fifth Circuit was uncertain whether the second inquiry was a question of law, or of fact, or both. *Id.* at 996. *See* Rowley, at 339.

“Ambiguity may be patent—appearing “on the face of the contract – or latent –aris[ing] from words which are uncertain when applied to the subject matter of the contract.” Rowley, at 91.

**M. IMPLIED TERMS.** Professor Corbin recognized two types of terms that a court will

read into an agreement when the words are lacking: terms that are implied-in-fact and implied-in-law. Implied-in-fact terms are construed from by the parties' words or conduct. Implied-in-law terms are a judicial construct, whereby the court declares the existence of a legal duty or condition when the words to support it are absent. 3 Arthur L. Corbin, CORBIN ON CONTRACTS § 561, at 276-77 (1960). Corbin says that implied-in-law analysis applies only when there is no indication from the contract language, the parties' conduct, or the surrounding circumstances that the parties reached agreement on the issue. *Id.* § 564. *See* Restatement (Second) of Contracts § 226 (1981) "An event may be made a condition either by the agreement of the parties or by a term supplied by the court."

“You can always imply a condition in a contract. But why do you imply it? It is because of some belief as to the practice of the community or of a class, or because of some opinion as to policy, or, in short, because of some attitude of yours upon a matter not capable of exact quantitative measurement, and therefore not capable of founding exact logical conclusions." Oliver Wendell Holmes, Jr., *The Path of the Law*, 10 Harv. L. Rev. 457, 466 (1897).

Lord Watson is sometimes quoted:

[W]hen the parties to a . . . contract . . . have not expressed their intentions in a particular event, but have left these to implication, a Court of Law, in order to ascertain the implied meaning of the contract, must assume that the parties intended to stipulate for that which is fair and reasonable, having regard to their mutual interests and to the main objects of the contract. . . .

[W]hen one . . . of these [unforeseen] possibilities becomes a fact, the meaning of the contract must be taken to be, not what the parties did intend (for they had neither thought nor intention regarding it), but that which the parties, as fair and reasonable men, would presumably have agreed upon[.]

*Dahl v. Nelson, Donkin, & Co.*, 6 App. Cas. 38, 59 (1881).

**N. FILLING IN THE GAPS.** An important contract interpretation issue arises when there is a gap in a contract, and the court must decide whether to let the contract fail or to instead fill in the gap and allow the contract to be enforced as judicially-revised.

The original Restatement of Contracts § 32 said: “An offer must be so definite in its terms, or require such definite terms in the acceptance, that the promises and performances to be rendered by each party are reasonably certain.” The Comment went on to explain that “[t]he law cannot subject a person to a contractual duty or give another a contractual right unless the character thereof is fixed by the agreement of the parties.”

The UCC took a different view. UCC § 2-204(3) provides:

Even though one or more terms are left open a contract for sale does not fail for indefiniteness if the parties have intended to make a contract and there is a reasonably certain basis for giving an appropriate remedy.

The Restatement (Second) of Contracts

(1981) concurs:

#### § 204 Supplying An Omitted Essential Term

When the parties to a bargain sufficiently defined to be a contract have not agreed with respect to a term which is essential to a determination of their rights and duties, a term which is reasonable in the circumstances is supplied by the court.

The Restatement (Second) of Contracts § 204, comment b provides:

The parties to an agreement may entirely fail to foresee the situation which later arises and gives rise to a dispute; they then have no expectations with respect to that situation, and a search for their meaning with respect to it is fruitless. Or they may have expectations but fail to manifest them, either because the expectation rests on an assumption which is unconscious or only partly conscious, or because the situation seems to be unimportant or unlikely, or because the discussion of it might be unpleasant or might produce delay or impasse.

The Restatement (Second) of Contracts § 204, comment d provides:

The process of supplying an omitted term has sometimes been disguised as a literal or a purposive reading of contract language directed to a situation other than the situation that arises. Sometimes it is said that the search is for the term the parties would have agreed to if the question had been brought to their attention. Both the

meaning of the words used and the probability that a particular term would have been used if the question had been raised may be factors in determining what term is reasonable in the circumstances. But where there is in fact no agreement, the court should supply a term which comports with community standards of fairness and policy rather than analyze a hypothetical model of the bargaining process.

Restatement (Second) of Contracts § 226, comment c, provides:

When the parties have omitted a term that is essential to a determination of their rights and duties, the court may supply a term which is reasonable in the circumstances.

Gap-filling has become a way of life in modern contract law. Posner describes gap-filling as an effort “to determine how the parties would have resolved the issue that has arisen had they foreseen it when they negotiated their contract.” R. Posner, at 1587. Posner offers four approaches to gap-filling: (1) try to determine what the parties would have intended had they agreed on the missing term; (2) pick the economically efficient solution; (3) apply some tie-breaking rules like *contra proferentum*; (4) stick with the four corners, in which event the contract may well fail (as in *Raffles v. Wichelhaus*, the “Peerless case,”) discussed at III.BB. below.

**O. RULES VS. STANDARDS.** The original Restatement of Contracts tended toward the statement of rules, while the Restatement (Second) of Contracts tends toward the statement of standards. Richard Posner noted:

A rule is clear by virtue of being exact. But its exactness makes it maladapted to unforeseen situations, creating pressure for recognizing exceptions, which will often reduce clarity. A standard is flexible and therefore adaptable to a variety of contexts, but the price of flexibility is vagueness.

R. Posner, at 1587.

**P. COURSE OF DEALING.** The UCC § 1-303(b) defines “course of dealing”:

A course of dealing is a sequence of previous conduct between the parties to a particular transaction which is fairly to be regarded as establishing a common basis of understanding for interpreting their expressions and other conduct.

The course of dealing comes third in UCC section 1-303(e)'s hierarchy of contract interpretative tools, behind express terms and course of performance but ahead of usage of trade.

**Q. COURSE OF PERFORMANCE.** The UCC § 1-303(a) defines “course of performance” as:

A “course of performance” is a sequence of conduct between the parties to a particular transaction that exists if: (1) the agreement of the parties with respect to the transaction involves repeated occasions for performance by a party; and (2) the other party, with knowledge of the nature of the performance and opportunity for objection to it, accepts the performance or acquiesces in it without

objection.

**R. USAGE OF TRADE.** The UCC § 1-303(c) defines “a usage of trade”:

A usage of trade is any practice or method of dealing having such regularity of observance in a place, vocation or trade as to justify an expectation that it will be observed with respect to the transaction in question. The existence and scope of such a usage are to be proved as facts. If it is established that such a usage is embodied in a written trade code or similar writing the interpretation of the writing is for the court.

**S. STATUTE OF FRAUDS.** The English Parliament adopted the first statute of frauds in 1677. As with the modern American equivalents, the statute required that certain types of contracts must be evidenced by a signed writing to be enforceable. In the United States, the statute of frauds was the sole significant incursion by legislatures into the law of contracting, until the adoption in some states of the 1906 Uniform Sales Act, which eventually led to the comprehensive Uniform Commercial Code of 1951.

**T. PAROL EVIDENCE RULE.** Under the parol evidence rule, if the parties to a written agreement have a contract that is complete or “integrated,” then evidence concerning negotiations leading up to the agreement that would contradict the terms of the agreement is not admissible. R. Posner, at 1602. The parol evidence rule overlaps the four-corners rule, because both exclude evidence of prior or contemporaneous negotiations offered to contradict the agreement. However, the four-corners rule also prohibits evidence of prior or contemporaneous negotiations offered to

supplement or help to explain the agreement, and the four-corners rule also precludes consideration of subsequent events that might reflect the meaning of the agreement, while the parol evidence rule does not apply to extrinsic evidence that post-dates the agreement. Rowley, at 295.

The parol evidence rule does not bar evidence of fraud, mutual mistake, non-payment of consideration, or scrivener’s error. Rowley, at 269-284. Additionally, the trend is to say that the parol evidence rule does not exclude extrinsic evidence offered to show that the agreement has a latent ambiguity when applied to the facts.

[T]wo types of ambiguity can usefully be distinguished. One is internal (“intrinsic”), and is present when the agreement itself is unclear. The other is external (“extrinsic”) and is present when, although the agreement itself is a perfectly lucid and apparently complete specimen of English prose, anyone familiar with the real-world context of the agreement would wonder what it meant with reference to the particular question that has arisen. . . . So parol and other extrinsic evidence is admissible, even in a case involving a contract with an integration clause, to demonstrate that the contract is ambiguous. [citations omitted]

*Federal Deposit Ins. Corp. v. W.R. Grace & Co.*, 877 F.2d 614, 620 (7<sup>th</sup> Cir. 1989) (Posner, J.).

The parol evidence rule does not bar consideration of consistent additional terms, unless the agreement is fully integrated. *See* Rowley, at 331-32. The parol evidence rule does not preclude the court from considering extrinsic

evidence on whether that agreement was intended by the parties to be integrated. R. Posner, at 1604.

The Parol Evidence Rule has been incorporated into the UCC § 2-202:

Terms with respect to which the confirmatory memoranda of the parties agree or which are otherwise set forth in a writing intended by the parties as a final expression of their agreement with respect to such terms as are included therein may not be contradicted by evidence of any prior agreement or of a contemporaneous oral agreement but may be explained or supplemented (a) by course of performance, course of dealing, or usage of trade (Section 1-303), and (b) by evidence of consistent additional terms unless the court finds the writing to have been intended also as a complete and exclusive statement of the terms of the agreement.

UCC §§ 1.201(3), 1-303 & 2-202(a), as well as Restatement (Second) of Contracts § 203, permit course of performance, course of dealing, and usage of trade to be considered in interpreting the parties' agreement. Some writers criticize the allowing of this evidence despite the parol evidence rule as being arbitrary. Professor Eric Posner disagrees, saying that these particular factors can be proved by objective evidence and disinterested witnesses, while the parties' after-the-fact statements of their subjective intent cannot. Eric Posner, *The Parol Evidence Rule, the Plain Meaning Rule, and the Principles of Contractual Interpretation*, 146 U. Pa. L. Rev. 533, 558-59 (1998).

The Restatement (Second) of Contracts § 204,

Comment e, discusses the application of the parol evidence rule to contracts with omitted terms:

The fact that an essential term is omitted may indicate that the agreement is not integrated or that there is partial rather than complete integration. In such cases the omitted term may be supplied by prior negotiations or a prior agreement. See § 216. But omission of a term does not show conclusively that integration was not complete and a completely integrated agreement, if binding, discharges prior agreements within its scope. See § 213. Where there is complete integration and interpretation of the writing discloses a failure to agree on an essential term, evidence of prior negotiations or agreements is not admissible to supply the omitted term, but such evidence may be admissible, if relevant, on the question of what is reasonable in the circumstances.

The parol evidence rule does not bar proof of a subsequent agreement that is supported by separate consideration and meets the other requirements to be valid contract. Rowley, at 253-54.

A liberal approach to the parol evidence rule is reflected in a famous opinion written by Chief Justice Roger J. Traynor of the California Supreme Court, in which the court ruled that "[t]he test of admissibility of extrinsic evidence to explain the meaning of a written instrument is not whether it appears to the court to be plain and unambiguous on its face, but whether the offered evidence is relevant to prove a meaning to which the language of the instrument is reasonably susceptible." *Pacific Gas & Elec. Co. v. G. W. Thomas Drayage &*



*Rigging Co.*, 69 Cal.2d 33, 442 P.2d 641 (Cal. 1968). Justice Traynor continued:

Although extrinsic evidence is not admissible to add to, detract from, or vary the terms of a written contract, these terms must first be determined before it can be decided whether or not extrinsic evidence is being offered for a prohibited purpose. 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. That possibility is not limited to contracts whose terms have acquired a particular meaning by trade usage, but exists whenever the parties' understanding of the words used may have differed from the judge's understanding.

Accordingly, rational interpretation requires at least a preliminary consideration of all credible evidence offered to prove the intention of the parties. . . . Such evidence includes testimony as to the 'circumstances surrounding the making of the agreement \* \* \* including the object, nature and subject matter of the writing \* \* \*' so that the court can 'place itself in the same situation in which the parties found themselves at the time of contracting.' . . . If the court decides,\*\*\* after considering this evidence, that the language of a contract, in the light of all the circumstances, is 'fairly susceptible of either one of the two interpretations contended for \* \* \*' . . . extrinsic evidence relevant to prove either of such meanings is admissible. [footnotes and citations omitted]

*Id.* at 644-46.

Professor Corbin expressed his view of the parol evidence rule in strong terms:

The cardinal rule with which all interpretation begins is that its purpose is to ascertain the intention of the parties. The criticized [parol evidence] rule, if actually applied, excludes proof of their actual intention. It is universally agreed that it is the first duty of the court to put itself in the position of the parties at the time the contract was made; it is wholly impossible to do this without being informed by extrinsic evidence of the circumstances surrounding the making of the contract.

Arthur L. Corbin, *The Interpretation of Words and the Parol Evidence Rule*, 50 Cornell L.Q. 161, 162 (1964).

If a written and signed agreement has been lost or destroyed, such an agreement may be proved by parol evidence. Rowley, at 285.

**U. MERGER CLAUSE.** A "merger clause," sometimes called an "integration clause" or an "entire agreement clause," declares the agreement to be the complete and final agreement of the parties, merging all prior preliminary agreements and discussions. The clause is a statement that the contract is an "integrated contract" which bolsters the application of the parol evidence rule. R. Posner, at 1600 n. 46.

**V. SUBSEQUENT ORAL MODIFICATION.** "The parol evidence rule does not bar extrinsic evidence regarding subsequent oral modification of a prior written agreement." Rowley, at 300. Drafting lawyers attempt to

avoid the rule about subsequent oral modifications by including a “no oral modification clause” in their contracts.

**W. SCRIVENER’S ERROR.** A scrivener’s error, or *lapsus linguae*, is an accidental deviation from the parties’ agreement made in drafting the writing. “In contract law, a scrivener’s error, like a mutual mistake, occurs when the intention of the parties is identical at the time of the transaction but the written agreement does not express that intention because of that error; this permits a court acting in equity to reform an agreement.” WILLISTON ON CONTRACTS § 70:93.

The rule is well-settled that a court is not permitted to rewrite a document or add terms not included by the parties. . . . A scrivener’s error presents an exception to this general rule, because as the United States Court of Appeals for the Seventh Circuit has observed, scrivener’s errors “are difficult to prevent, and ... no useful social purpose is served by enforcing ... mistaken term[s]. . . . Our description of scrivener’s errors in *Wellmore Coal* parallels that of the Illinois Court of Appeals, which defined such errors as those evidenced in the writing that can be proven without parol evidence. . . . Scrivener’s errors tend to occur singularly; they are not ‘continuous, ongoing, and repeated.’

*Westgate at Williamsburg Condominium Ass’n, Inc. v. Philip Richardson Co., Inc.*, 270 Va. 566, 621 S.E.2d 114, 118 (Va. 2005), citing *S.T.S. Transport Service, Inc. v. Volvo White Truck Corp.*, 766 F.2d 1089, 1093 (7th Cir. 1985) (“A merely mathematical or clerical error occurs when some term is either one-tenth or ten times as large as it should be;

when a term is added in the wrong column; when it is added rather than subtracted; when it is overlooked”).

**X. DEFAULT TERMS PROVIDED BY LAW.** Article 2 of the UCC and other statutory schemes often provide default terms that will apply, unless the agreement specifies to the contrary. The practice is not unique to sales contracts; the Uniform Partnership Act is another example of such a default statute. Where the default provisions are based on prevailing commercial practices, they can reduce the cost of contracting, since parties can simply invoke the defaults by reference or even leave the agreement blank in certain respects in reliance on the law providing the missing terms.

**Y. FORM CONTRACTS AND “BOILER-PLATE.”** In 1971, David Slawson estimated that nearly all contracts were presented by one party to another using a standard form. W. David Slawson, *Standard Form Contracts and Democratic Control of Lawmaking Power*, 84 Harv. L. Rev. 529, 529 (1971). It is widely believed that form contracts are seldom read by the non-drafting party. See Andrew Robertson, *The Limits of Voluntariness in Contract*, 29 Melbourne Univ. L. Rev. (2005). <<http://www.austlii.edu.au/au/journals/MULR/2005/5.html>>.

Form contracts “contain standard clauses designed to resolve contingencies that may arise in the course of performance.” R. Posner, at 1585. Some argue that form agreements in consumer transactions tend to be one-sided because they are drafted by sellers or industry organizations and are biased toward the seller or provider of services. R. Posner, at 1585. Forms that are drafted by a neutral organization, however, tend to be fairer. Examples would be the State Bar of

Texas' Real Estate Forms Manual, and the Texas Family Law Practice Manual (drafted by the Family Law Section of the State Bar of Texas), which are neutral, reduce negotiation and drafting costs, and anticipate the most likely problems with performance, thereby reducing the chance and cost of litigation.

Given the proliferation of forms in consumer transactions, one has to reevaluate the "meeting of the minds" concept of agreements, and even the importance of the subjective intent of the parties. As anyone who has purchased a house or a car on credit can attest, buyers seldom read all the documents, or all of the fine print, before they sign "on the dotted line," and if they were to read it only lawyer-consumers would understand all the "legal-ese." It is more reasonable to say that, in a form-dominated industry, the buyer agrees to be bound by whatever is in the paperwork. *See Kim*, at 544. Buyers do this not because they understand the terms, but rather because all lenders require this paperwork, and you either sign it or you don't get financing. In this instance, a seller-oriented approach or an objective approach to interpreting the contract are the only ones that are viable.

Richard Posner notes that the ease of copying language using word processors has encouraged lawyers to borrow "boilerplate" from earlier contracts in drafting new ones. This can cause problems where the clauses transposed to the new agreement "may make an imperfect fit with the other clauses in the contract, generating ambiguities." R. Posner, at 1587.

**Z. HIERARCHY OF CONSIDERATIONS.** Although some jurisdictions have relaxed the strict hierarchy of rules in interpreting a contract, the traditional hierarchy is: (1) express terms, (2) course of performance,

(3) course of dealing, (4) trade usages, (5) default rules, (6) general standards of reasonableness. Eyal Zamir, *The Inverted Hierarchy of Contract Interpretation and Supplementation*, 97 Colum. L. Rev. 1710, 1710 (1997) ("Zamir"). Testimony from the parties about what they intended is not part of the traditional hierarchy.

UCC § 1-303(e) provides a hierarchy of aids to interpretation:

Except as otherwise provided in subsection (f), the express terms of an agreement and any applicable course of performance, course of dealing, or usage of trade must be construed whenever reasonable as consistent with each other. If such a construction is unreasonable: (1) express terms prevail over course of performance, course of dealing, and usage of trade; (2) course of performance prevails over course of dealing and usage of trade; and (3) course of dealing prevails over usage of trade.

The Restatement (Second) of Contracts (1981) offered this hierarchy:

§ 203. Standards of Preference In Interpretation

In the interpretation of a promise or agreement or a term thereof, the following standards of preference are generally applicable:

(a) an interpretation which gives a reasonable, lawful, and effective meaning to all the terms is preferred to an interpretation which leaves a part unreasonable, unlawful, or of no effect;

(b) express terms are given greater weight than course of performance, course of dealing, and usage of trade, course of performance is given greater weight than course of dealing or usage of trade, and course of dealing is given greater weight than usage of trade;

(c) specific terms and exact terms are given greater weight than general language;

(d) separately negotiated or added terms are given greater weight than standardized terms or other terms not separately negotiated.

Section 206 of the Restatement (Second) of Contracts continues the presumption against the drafting party.

Most approaches to contract interpretation recognize the primary importance of the express words of the agreement.

## **AA. SECONDARY RULES OF CONSTRUCTION.**

**1. Noscitur a Sociis (Take Words in Their Immediate Context).** “Noscitur a Sociis” is a Latin maxim which, translated into English, means “a word is known by the company it keeps.” *Fiess v. State Farm Lloyds*, 202 S.W.3d 744, 750 (Tex. 2006), citing *Gustafson v. Alloyd Co.*, 513 U.S. 561, 575, 115 S.Ct. 1061, 131 L.Ed.2d 1 (1995) (“This rule we rely upon to avoid ascribing to one word a meaning so broad that it is inconsistent with its accompanying words”).

**2. Eiusdem Generis.** The Latin phrase “eiusdem generis” means “[o]f the same kind, class, or nature. In the construction of laws, wills and other instruments, the 'eiusdem

generis rule' is, that where general words follow an enumeration of persons or things, by words of a particular and specific meaning, such general words are not to be construed in their widest extent, but are to be held as applying only to persons or things of the same general kind or class as those specifically mentioned.” BLACK'S LAW DICTIONARY 464 (5th ed. 1979). A student article gathered the following citations:

Courts should apply the doctrine only to ambiguous instruments; an unambiguous instrument needs no aid in construction. See *Cole v. McDonald*, 236 Miss. 168, 187, 109 So. 2d 628, 637 (1959) (eiusdem generis not applicable where manifest intention of parties is evident); *Anderson & Kerr Drilling Co. v. Bruhlmeier*, 134 Tex. 574, 582, 136 S.W.2d 800, 804-05 (1940) (eiusdem generis merely rule of construction to be used as 'an aid to interpretation when . . . intention is not otherwise apparent'); *Burdette v. Bruen*, 118 W. Va. 624, 628-29, 191 S.E. 360, 361-62 (1937) (eiusdem generis cannot be invoked 'where the language under consideration is clear and unambiguous as to what is intended'). But see *Wulf v. Shultz*, 211 Kan. 724, 508 P.2d 896 (1973) (eiusdem generis applied to concededly unambiguous instrument).

*Note, Interpretation of 'Other Minerals' in a Grant or Reservation of a Mineral Interest*, 71 Cornell L. Rev. 618, 621 (1986).

**3. Expressio Unius est Exclusio Alterius.** Yet another Latin maxim, meaning “the express mention of one thing excludes all others.” “[W]hen an enumeration of specific things is not followed by some more general

word or phrase, then things of the same kind or species as those specifically enumerated are deemed to be excluded. Thus, for example, “[w]here only one exception is mentioned in a contract, the rule of *expressio unius est exclusio alterius* applies and exceptions not mentioned cannot be engrafted upon it.” Rowley, at 155.

#### **4. The Specific Prevails Over the General.**

If a specific provision of an agreement conflicts with a general provision, the specific controls over the general, or qualifies the meaning of the general provision, unless the parties clearly manifest a contrary intent. Rowley, at 156.

#### **5. The Earlier Prevails Over the Later.**

Where two provisions cannot otherwise be reconciled, the term stated earlier prevails over the later term. The rule is reversed when construing a will. Rowley, at 162-63.

#### **6. Handwritten Over Typed and Typed Over Preprinted.**

Handwritten provisions are favored over typed, and typed provisions are favored over pre-printed provisions, unless the parties clearly manifest a contrary intent. Rowley, at 159.

#### **7. Words Prevail Over Numbers or Symbols.**

“It is true that where words and figures are used to express the same number, and they do not agree, the words must prevail. That is because people are more liable to mistake in writing figures than words.” *Gran v. Spangenberg*, 54 N.W. 933, 934 (Minn. 1893).

#### **8. Contra Proferentem.**

A Latin maxim saying to construe the contract against the drafter. “Originally, the doctrine was labeled *verba chartarum fortius accipiuntur contra proferentem*.” 3 Arthur L. Corbin, CORBIN

ON CONTRACTS § 559, at 262 (1960). One possible justification is that the drafting party can be seen “at fault” for the vagueness or ambiguity. An economic perspective says that “[t]his principle reflects an assumption that the drafter can more cheaply ensure that the contract is reflected in the writing than the other party can.” E. Posner, at 558.

#### **9. Presumption Favoring Arbitration.**

In *AT & T Technologies, Inc. v. Communications Workers of America*, 475 U.S. 643, 106 S.Ct. 1415 (U.S. 1986), the Supreme Court said that “it has been established that where the contract contains an arbitration clause, there is a presumption of arbitrability in the sense that “[a]n order to arbitrate the particular grievance should not be denied unless it may be said with positive assurance that the arbitration clause is not susceptible of an interpretation that covers the asserted dispute. Doubts should be resolved in favor of coverage.”

#### **BB. THE “PEERLESS” CASE.**

The “Peerless case” is *Raffles v. Wichelhaus*, 2 H. & C. 906, 159 Eng. Rep. 375 (Ex. 1864). It is a famous case, and still talked about. A report of the decision is attached to the end of this article. In *Raffles*, the plaintiff entered into a contract to sell 125 bales of Indian cotton to the defendant. The contract specified that the cotton would be arriving in Liverpool on the ship Peerless from Bombay (“to arrive ex Peerless from Bombay”). Unbeknownst to the parties, there were two ships named Peerless arriving from Bombay, one departing in October and another in December. The defendant claimed that he understood the contract to mean cotton on the October ship while the plaintiff claimed that contract was for the arrival of the December ship. In December, when the later ship arrived in England, the plaintiff tried to deliver the cotton but the defendant refused to accept it. The plaintiff

sued for breach of contract. The court ruled that, although courts will strive to find a reasonable interpretation in order to preserve the agreement whenever possible, the court was unable to determine which ship named Peerless was intended in the contract. As a result, there was no “consensus ad idem,” and the two parties did not agree to the same thing, so there was no binding contract. The defendant won.

In this case, the court essentially found that there was no “meeting of the minds.” Stated another way, the plaintiff’s subjective intent was not the same as the defendant’s subjective intent.

While the case report doesn’t relate the surrounding circumstances, one suspects that if the price of cotton had dropped after the time of contracting, the defendant likely committed an opportunistic breach. Otherwise the defendant would have complained when the first Peerless arrived and no cotton was delivered by the plaintiff to the defendant.

**IV. CONTRACT INTERPRETATION IN TEXAS.** Texas courts have essentially ignored the new theories advanced in law review articles over the last 50 years challenging the traditional approach to contract interpretation. For a good overview of Texas law on contract interpretation see Glasser & Keith A. Rowley, *On Parol: The Construction and Interpretation of Written Agreements and the Role of Extrinsic Evidence in Contract Litigation*, 49 Bay. L. Rev 657 (1997) (“Glasser & Rowley”).

**A. PRIMARY CONCERN.** “When construing a contract, the court’s primary concern is to give effect to the written expression of the parties’ intent.” *Forbau v. Aetna Life Ins. Co.*, 876 S.W.2d 132, 133 (Tex. 1994). Notice the

focus on the *written expression* rather than the parties true intent. “Even if the court could discern the actual intent, it is not the actual intent of the parties that governs, but the actual intent of the parties as expressed in the instrument as a whole, ‘without reference to matters of mere form, relative position of descriptions, technicalities, or arbitrary rules.’” *Luckel v. White*, 819 S.W.2d 459, 462, 463 (Tex. 1991).

## **B. RULES OF CONSTRUCTION GENERALLY.**

“Courts try to solve disputes over the meaning of contracts by giving them the meaning the parties intended them to have. This is as it should be. But what meaning the parties to a contract intended it to have is often unclear. Once a dispute arises over meaning, it can hardly be expected that the parties will agree on what meaning was intended. It is for this reason that the courts have built up a system of rules of interpretation and construction to arrive at meaning, ignoring testimony of subjective intent.

‘Intention of the parties’ is often guesswork at best. Sometimes the true intention of one or even of both parties may be defeated, as when the rule is applied of giving a contract the meaning its plain, clear language implies, irrespective of what the parties may claim it was intended to mean. So, while use of rules of interpretation and construction may not always result in ascertaining the true intention of parties in using particular language in a contract, their use yet must be better than pure guesswork in most cases else they would never have been

evolved.” *Southland Royalty Co. v. Pan Am. Petroleum Corp.*, 378 S.W.2d 50, 58 (Tex. 1964) (Calvert, C.J., concurring).

“If, after the pertinent rules of construction are applied, the contract can be given a definite or certain legal meaning, it is unambiguous and we construe it as a matter of law.” *Frost Nat. Bank v. L & F Distributors, Ltd.*, 165 S.W.3d 310, 312 (Tex. 2005).

“While these general rules of construction apply when we construe ambiguous contracts or contracts that are reasonably susceptible to more than one interpretation, we hold that the contract language at issue is unambiguous and that MHR did not breach the contract.” *Lopez v. Munoz, Hockema & Reed, L.L.P.*, 22 S.W.3d 857, 860 (Tex. 2000).

### C. WHEN CONSIDERING ONLY THE AGREEMENT ITSELF.

**1. Fully Integrated, Partially Integrated, and Unintegrated.** “Under the parol evidence rule, if the parties have integrated their agreement into a single written memorial, all prior negotiations and agreements with regard to the same subject matter are excluded from consideration, whether they were oral or written” *Baroid Equip., Inc. v. Odeco Drilling, Inc.*, 184 S.W.3d 1, 13 (Tex. App.–Houston [1<sup>st</sup> Dist.] 2005, pet. denied). “When a contract is a final and complete expression of all the terms regarding that agreement, but not a final and complete expression of all the terms agreed upon between the parties, it is considered a partially integrated contract. See generally David R. Dow, Et Al., Texas Practice: Contract Law § 8.3 (2005). With respect to a partially integrated contract, parol evidence is admissible to supplement or explain the contract, but is not admissible to contradict it.”

*Lowe v. Lowe*, 2006 WL 3239852 (Tex App.--Beaumont 2006, no pet.) (memorandum opinion).

**2. Four Corners Rule.** “The primary duty of a court when construing such a deed is to ascertain the intent of the parties from all of the language in the deed by a fundamental rule of construction known as the ‘four corners’ rule. . . . *Luckel v. White*, 819 S.W.2d 459, 462, 463 (Tex. 1991).

**3. Multiple Contemporaneous Documents Construed as One.** “It is a generally accepted rule of contracts that ‘Where several instruments, executed contemporaneously or at different times, pertain to the same transaction, they will be read together although they do not expressly refer to each other.’” *Board of Ins. Com'rs v. Great Southern Life Ins. Co.*, 150 Tex. 258, 239 S.W.2d 803, 809 (Tex. 1951). “[C]ourts are to give effect to all provisions of a contract, whether a contract is comprised of one, or more than one, document.” *City of Galveston v. Galveston Mun. Police Ass'n*, 57 S.W.3d 532, 538 (Tex. App.--Houston [14 Dist.] 2001, no pet.).

**4. Clear Mistakes.** “Where it is clear that a word has been written into an instrument inadvertently, and it is clearly inconsistent with, and repugnant to the meaning of the parties, as shown by the whole instrument, it will be treated as surplusage and rejected altogether.” *Trinity Portland Cement Co. v. Lion Bonding & Surety Co.*, 229 S.W. 483, 485 (Tex. Comm'n App. 1921, judgment adopted).

**5. Scrivener’s Error.** The rule of scrivener’s error is not a rule of construction, but it is a rule that permits the court to ignore or correct a portion of the written agreement that is obviously a drafting error. “[T]he fact that an

error was caused by a scrivener's failure to embody the true agreement of the parties in a written instrument is a proper ground for reformation." *Hatch v. Williams*, 110 S.W.3d 516, 522 (Tex. App.--Waco 2003, no pet.).

The following Texas case shows a liberal view of what constitutes a scrivener's error. The doctrine was applied by the court of appeals to reform a contract even though the jury found there was no mutual mistake.

The employment contract that Lightner actually signed failed to include a page that contained provisions addressing the restrictions placed on Lightner by his non-compete agreement with LMG. . . . An earlier unsigned draft of the document that included the omitted provisions was reviewed by Lightner's attorney. When the final document was prepared for signatures, one of the pages was included twice and an apparent gap in the text from one of the pages to the next indicated a skipped page. Even so, all the pages were numbered consecutively. LMG claims the page was omitted from the final document by an inadvertent mistake, that Lightner knew of the non-compete agreement and its terms, and that he even accepted \$100,000 in exchange for it.

\* \* \*

The jury found the omission of the page was not a mutual mistake, and the trial court thereupon refused to enforce the non-compete agreement. LMG challenges this jury finding claiming that mutual mistake was established as a matter of law and that

the finding should be disregarded.

We see the question as being whether the parties had a mutual understanding and intent that Lightner was to be bound by a non-compete agreement when he signed the employment contract with LMG. That question can be resolved in the affirmative simply by considering Lightner's testimony and by examining the document Lightner actually signed.

Lightner testified he was aware his employment agreement included a covenant not to compete, but he disclaimed any interest in it and denied knowing its terms. He said "It was not an important issue for me in signing [the agreement]." Moreover, the document Lightner signed clearly contains a promise not to compete against LMG for two years after termination. And the agreement expressly acknowledges that he was to be paid \$100,000 "[f]or and in consideration of [Lightner's] agreement to the terms and conditions of the covenant not to compete."

Lightner says he was "completely unaware" of the omitted provisions, which he says destroys any mutual understanding and intent that would support an agreement. We disagree. The evidence conclusively establishes Lightner's intent to be bound by the covenant not to compete. Lightner's claim not to know all the terms of the covenant does not avoid his responsibilities under the agreement he made. See *Roland v. McCullough*, 561 S.W.2d 207, 213 (Tex.Civ.App.--San Antonio 1978, writ ref'd n.r.e.) ("A



contract may not be avoided on the ground of mistake of fact where it appears that ignorance of the facts was the result of carelessness, indifference, or inattention”).

“Reformation is a proper remedy when the parties have reached a definite and explicit agreement, understood in the same sense by both, but, by their mutual or common mistake, the written contract fails to express this agreement.” . . . Because it is clear the parties had a non-compete agreement, but it is unclear from the signed document what all the terms of the agreement were, the matter must be remanded to the trial court to reform the written contract to conform to the terms of the agreement.

*Laredo Medical Group v. Lightner*, 153 S.W.3d 70, 74 (Tex. App.--San Antonio 2004, pet. denied).

**6. Plain Meaning Rule.** “We give terms their plain, ordinary, and generally accepted meaning unless the instrument shows that the parties used them in a technical or different sense.” *Heritage Res., Inc. v. NationsBank*, 939 S.W.2d 118, 121 (Tex. 1996). “Language used by parties in a contract should be accorded its plain, grammatical meaning unless it definitely appears that the intention of the parties would thereby be defeated.” *Lyons v. Montgomery*, 701 S.W.2d 641, 643 (Tex. 1985).

**7. Construe Contract as a Whole.** “This court is bound to read all parts of a contract together to ascertain the agreement of the parties. . . . The contract must be considered as a whole. . . . Moreover, each part of the contract should be given effect.” *Forbau v.*

*Aetna Life Ins. Co.*, 876 S.W.2d 132, 133 (Tex. 1994). “In construing an unambiguous oil and gas lease our task is to ascertain the parties' intentions as expressed in the lease. . . . To achieve this goal, we examine the entire document and consider each part with every other part so that the effect and meaning of one part on any other part may be determined. . . . We presume that the parties to a contract intend every clause to have some effect.” *Heritage Resources, Inc. v. NationsBank*, 939 S.W.2d 118, 121 (Tex. 1996). “No one phrase, sentence, or section [of a contract] should be isolated from its setting and considered apart from the other provisions.” *Guardian Trust Co. v. Bauereisen*, 132 Tex. 396, 121 S.W.2d 579, 583 (1938).

**8. Noscitur a Sociis (Take Words in Their Immediate Context).** A Latin maxim which, translated into English, means “a word is known by the company it keeps.” *Fiess v. State Farm Lloyds*, 202 S.W.3d 744, 750 (Tex. 2006).

**9. Expressio Unius est Exclusio Alterius.** “The maxim, that ‘the express mention of one thing implies the exclusion of another,’ is ordinarily used to control, limit, or restrain the otherwise implied effect of an instrument, and not to ‘annex incidents to written contracts in matters with respect to which they are silent.’” *Morrow v. Morgan*, 48 Tex. 304 \*3 (Tex. 1877). “The maxim *expressio unius est exclusio alterius*, meaning that the naming of one thing excludes another, though not conclusive, is applicable to these facts.” *CKB & Assocs., Inc. v. Moore McCormack Petroleum, Inc.*, 734 S.W.2d 653, 655 (Tex. 1987). “[I]n construing the agreement we must adhere to the maxim that ‘the expression of one thing is the exclusion of another thing.’” *Phillips Petroleum Co. v. Gillman*, 593 S.W.2d 152, 154 (Tex. Civ. App.--Amarillo 1980, writ

ref'd n.r.e.).

**10. Ejusden Generis.** “[W]hen words of a general nature are used in connection with the designation of particular objects or classes of persons or things, the meaning of the general words will be restricted to the particular designation.” *Hilco Elec. Coop. v. Midlothian Butane Gas Co.*, 111 S.W.3d 75, 81 (Tex. 2003). *Dynamic Pub. & Distributing L.L.C. v. Unitec Indus. Center Property Owners Ass'n, Inc.*, 167 S.W.3d 341 (Tex. App.--San Antonio 2005, no pet.) (“The principle of ejusdem generis . . . applies only when a contract is ambiguous”).

**11. Specific Terms Prevail Over General Terms.** “Another [secondary rule of construction] is the rule which gives effect to an earlier over a later provision.” *Southland Royalty Co. v. Pan Am. Petroleum Corp.*, 378 S.W.2d 50, 578 (Tex. 1964). “In a contract, a specific term controls over a more general one.” *Shell v. Austin Rehearsal Complex, Inc.*, 1998 WL 476728 \* 12 (Tex. App.--Austin 1998, no pet.). “[T]he contract in question appears on the surface to be ambiguous; however, we believe the apparent ambiguity may be resolved by the application of a well-settled rule of construction, to wit: that if general terms appear in a contract, they will be overcome and controlled by specific language dealing with the same subject.” *City of San Antonio v. Heath & Stich, Inc.*, 567 S.W.2d 56, 60 (Tex. Civ. App.--Waco 1978, writ ref'd n.r.e.).

**12. Earlier Terms Prevail Over Later Terms (But not in Wills).** “[P]rovisions stated earlier in an agreement are favored over subsequent provisions.” *Wells Fargo Bank, Minnesota, N.A. v. North Cent. Plaza I, L.L.P.*, 194 S.W.3d 723 (Tex. App.--Dallas 2006, pet. denied). However, several cases

have held that, in interpreting a will, “if there is an irreconcilable conflict in an earlier and a later clause, the earlier clause must give way to the later one, which prevails as the latest expression of the testator's intention on that particular subject.” *Kaufhold v. McIver*, 682 S.W.2d 660, 666 (Tex. App.--Houston [1st Dist.] 1984, writ ref'd n.r.e.); *Morriss v. Pickett*, 503 S.W.2d 344 (Tex. Civ. App.--San Antonio 1973, writ ref'd n.r.e.). See *Dougherty v. Humphrey*, 424 S.W.2d 617, 20 (Tex. 1968) (“The court of civil appeals applied the rule that when there is a conflict among provisions in a will, the last clause in the will controls. That rule is only applicable when it clearly appears that the clauses conflict and can not be reconciled.”).

**13. Handwritten Over Typed and Typed Over Preprinted.** “[T]here are other secondary rules of construction for resolving apparent conflicts . . . . One is the rule which gives effect to written or typewritten provisions over printed provisions.” *Southland Royalty Co. v. Pan Am. Petroleum Corp.*, 378 S.W.2d 50, 578 (Tex. 1964).

**14. Words Prevail Over Numbers or Symbols.** “When there is a variance between unambiguous written words and figures the written words control. . . .” *Guthrie v. Nat'l Homes Corp.*, 394 S.W.2d 494, 496 (Tex. 1965).

**15. “Notwithstanding Anything Else” Clause.** “The expression ‘anything in this lease to the contrary notwithstanding,’ when used in the final section of a written contract, has priority over any contrary provision of the contract directed to the same question.” See *N.M. Uranium, Inc. v. Moser*, 587 S.W.2d 809, 814 (Tex. Civ. App.--Corpus Christi 1979, writ ref'd n.r.e.). “When parties use the clause ‘notwithstanding anything to the con-

trary contained herein' in a paragraph of their contract, they contemplate the possibility that other parts of their contract may conflict with that paragraph, and they agree that this paragraph must be given effect regardless of any contrary provisions of the contract." *Helmerich v. Payne Int'l Drilling Co. v. Swift Energy Co.*, 180 S.W.3d 635, 643 (Tex. App.--Houston [14th Dist.] 2005, pet. denied).

**16. Surrounding Circumstances.** "In determining whether a contract is ambiguous, we look to the contract as a whole, in light of the circumstances present when the contract was executed. . . . These circumstances include the commonly understood meaning in the industry of a specialized term, which may be proven by extrinsic evidence such as expert testimony or reference material." *XCO Production Co. v. Jamison*, 194 S.W.3d 622 , 627-28 (Tex. App.--Houston [14<sup>th</sup> Dist.] 2006, pet. denied).

**17. Utilitarian Standpoint.** "We construe contracts 'from a utilitarian standpoint bearing in mind the particular business activity sought to be served' and 'will avoid when possible and proper a construction which is unreasonable, inequitable, and oppressive.' *Frost Nat. Bank v. L & F Distributors, Ltd.*, 165 S.W.3d 310, 312 (Tex. 2005).

**18. Construction Must Be "Reasonable."** "Courts will avoid when possible and proper a construction which is unreasonable, inequitable, and oppressive." *Reilly v. Rangers Mgmt., Inc.*, 727 S.W.2d 527, 530 (Tex. 1987). "We construe a contract by determining how the "reasonable person" would have used and understood its language, considering the circumstances surrounding the contract's negotiation and keeping in mind the purposes intended to be accomplished by the parties when entering into the contract." *7979 Airport Garage, L.L.C. v. Dollar Rent A Car Systems,*

*Inc.*, 2007 WL 1732223 (Tex. App.--Houston [14 Dist.] 2007, n.p.h.).

**19. Use Rules of Grammar.** "Courts are required to follow elemental rules of grammar for a reasonable application of the legal rules of construction." *General Financial Services, Inc. v. Practice Place, Inc.*, 897 S.W.2d 516, 522 (Tex. App.--Fort Worth 1995, no pet.).

**20. Exceptions.** "The ordinary purpose of an exception is to take something out of the contract which would otherwise have been included in it. . . . When the meaning of an exception is reasonably certain, it must be given effect unless wholly repugnant to the provision intended to be limited by it." *Lyons v. Montgomery*, 701 S.W.2d 641, 643 (Tex. 1985).

**21. Contra Proferentem (Construe Against the Drafter).** "Under the doctrine, an ambiguous contract will be interpreted against its author." *Evergreen Nat. Indem. Co. v. Tan It All, Inc.*, 111 S.W.3d 669, 677 (Tex. App.--Austin 2003, no pet.). "In Texas, a writing is generally construed most strictly against its author and in such a manner as to reach a reasonable result consistent with the apparent intent of the parties. . . ." *Temple-Eastex Inc. v. Addison Bank*, 672 S.W.2d 793, 798 (Tex. 1984). "[T]he doctrine of contra proferentem is applied only when construing an ambiguous contract." *Lewis v. Vitol, S.A.*, 2006 WL 1767138 (Tex. App.--Houston [1 Dist.] 2006, no pet.). "[A] contract generally is construed against its drafter only as a last resort under Texas law— i.e., after the application of ordinary rules of construction leave a reasonable doubt as to its interpretation. " *Forest Oil Corp. v. Strata Energy*, 929 F.2d 1039, 1043-44 (5th Cir. 1991). *Accord, Evergreen Nat. Indem. Co.*, at 676 ("The doctrine of contra proferentem is a device of last resort

employed by courts when construing ambiguous contractual provisions”).

**22. Things to Avoid.** There are things for the court to avoid in construing an agreement.

**a. Don’t Render Clauses Meaningless.** “In the interpretation of contracts the primary concern of courts is to ascertain and to give effect to the intentions of the parties as expressed in the instrument. . . . To achieve this object the Court will examine and consider the entire instrument so that none of the provisions will be rendered meaningless.” *R & P Enters. v. LaGuarta, Gavrel & Kirk, Inc.*, 596 S.W.2d 517, 518-19 (Tex. 1980).

**b. Validity Preferred Over Invalidity.** “If, to our minds, the language of the deed is reasonably susceptible of a construction which would identify any definite interest in the land in suit, we should give it that construction, for it is a rule universally recognized that if an instrument admits of two constructions, one of which would make it valid and the other invalid, the former must prevail.” *Dahlberg v. Holden*, 150 Tex. 179, 238 S.W.2d 699, 702 (Tex. 1951).

**c. Presumption Against Illegality.** “While of course courts have no right to depart from the terms in which the contract is expressed to make legal what the parties have made unlawful, nevertheless when the contract by its terms, construed as a whole, is doubtful, or even susceptible of more than one reasonable construction, the court will adopt the construction which comports with legality. It is presumed that in contracting parties intend to observe and obey the law.” *Walker v. Temple Trust Co.*, 124 Tex. 575, 80 S.W.2d 935, 936-37 (1935). *Accord, Smart v. Tower Land & Inv. Co.*, 597 S.W.2d 333, 340 (Tex. 1980).

**d. Avoid Forfeitures.** “[C]ourts will not declare a forfeiture, unless they are compelled to do so, by language which will admit of but one construction, and that construction is such as compels a forfeiture.” *Automobile Ins. Co. v. Teague*, 37 S.W.2d 151, 153 (Tex. Comm’n App. 1931, judgment adopted).

**e. Avoid Implied Terms.** “[W]hen parties reduce their agreements to writing, the written instrument is presumed to embody their entire contract, and the court should not read into the instrument additional provisions unless this be necessary in order to effectuate the intention of the parties as disclosed by the contract as a whole.” *Danciger Oil & Ref. Co. v. Powell*, 154 S.W.2d 632, 635 (Tex. 1941).

**23. Special Contracts.** Certain types of contracts have special interpretive rules.

**a. Arbitration Clauses.** “Because of the strong policy favoring arbitration, ‘[a]n order to arbitrate should not be denied unless it can be said with positive assurance that the arbitration clause is not susceptible of an interpretation that covers the asserted dispute.’ . . . Thus, ‘[a]ny doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration.’” *Williams Industries, Inc. v. Earth Development Systems Corp.*, 110 S.W.3d 131, 137 (Tex. App.--Houston [1 Dist.] 2003, no pet.) [citations omitted].

**b. Deeds.** “[I]t is recognized that ordinarily a deed will be construed most strongly against the grantor. This canon of construction is not applied by the courts where the intention of the parties is clearly expressed and the instrument is unambiguous.” *Arnold v. Ashbel Smith Land Company*, 307 S.W.2d 818, 824 (Tex. Civ. App.--Houston 1957, writ ref’d).

“Double M. urges us to consider canons that

have been developed for interpreting deeds and reservations. For example, courts have held that deeds should be construed to convey the greatest estate possible and that reservations should be construed against the grantor. These canons, however, do not apply when the deed is unambiguous.” *Stewman Ranch, Inc. v. Double M. Ranch, Ltd.*, 192 S.W.3d 808, 811 (Tex. App.--Eastland 2006, pet. denied). See Bruce M. Kramer, *The Sisyphean Task of Interpreting Mineral Deeds and Leases: An Encyclopedia of Canons of Construction*, 24 Tex. Tech L. Rev. 1, 110-11 (1993).

**c. Guarantees.** “A guarantor is entitled to have his agreement strictly construed so that it is limited to his undertakings, and it will not be extended by construction or implication.” *Reece v. First State Bank of Denton*, 566 S.W.2d 296, 297 (Tex. 1978). “Where uncertainty exists as to the meaning of a contract of guaranty, its terms should be given a construction which is most favorable to the guarantor.” *Coker v. Coker*, 650 S.W.2d 391, 394 n. 1 (Tex. 1983).

**d. Insurance Policies.** “Whether a contract, like an insurance policy, is ambiguous is a legal question decided by examining the entire contract in light of the circumstances present when the parties entered the contract. . . . [I]f a policy is subject to more than one reasonable interpretation, we must adopt the construction most favorable to the insured when we resolve the uncertainty.” *State Farm Fire & Cas. Co. v. Vaughan*, 968 S.W.2d 931, 933 (Tex. 1998). “[T]he interpretation of insurance contracts is governed by the same rules of construction applicable to other written contracts.” *State Farm Life Ins. Co. v. Beaton*, 907 S.W.2d 430, 433 (Tex. 1995).

When construing a contract, courts

must strive to give effect to the written expression of the parties' intent. *Id.* (citations omitted). To do so, they must read all parts of a contract together. *Id.* (citations omitted). Indeed, courts must be particularly wary of isolating from its surroundings or considering apart from other provisions a single phrase, sentence, or section of a contract. See *id.* at 133-34 (citations omitted). Only if an insurance policy remains ambiguous despite these canons of interpretation should courts construe its language against the insurer in a manner that favors coverage.

*State Farm Life Ins. Co. v. Beaton*, 907 S.W.2d 430, 433 (Tex. 1995). “[I]f a policy is subject to more than one reasonable interpretation, we must adopt the construction most favorable to the insured when we resolve the uncertainty.” *State Farm Fire & Cas. Co. v. Vaughan*, 968 S.W.2d 931, 933 (Tex. 1998).

#### **D. WHEN CONSIDERING THINGS OUTSIDE THE AGREEMENT.**

**1. Statute of Frauds.** The Texas statute of frauds is set out in Tex. Bus. & Com. Code ch. 26. The statute provides that certain types of contractual obligations are not enforceable “unless the promise or agreement, or a memorandum of it, is (1) in writing; and (2) signed by the person to be charged with the promise or agreement or by someone lawfully authorized to sign for him.” Tex. Bus. Comm. Code § 26.01. Section 26.02 applies the requirement to loans over \$50,000.00. The Texas Legislature has also adopted a “statute of conveyances” which provides that a conveyance of an interest in real estate, to be enforced, must be “in writing and must be sub-

scribed and delivered by the conveyor or by the conveyor's agent authorized in writing.” Tex. Prop. Code § 5.021. When an alleged modification of an agreement encompasses a matter required by the statute of frauds to be in writing, the modification is unenforceable unless it is in writing. *Barnett v. Legacy Bank of Texas*, 2003 WL 22358578 (Tex. App.--Eastland 2003, rev. denied) (memorandum opinion).

**2. Parol Evidence Rule.** "The parol evidence rule is not a rule of evidence at all, but a rule of substantive law. . . . When parties have concluded a valid integrated agreement with respect to a particular subject matter, the rule precludes the enforcement of inconsistent prior or contemporaneous agreements. . . . On the other hand, the rule does not preclude enforcement of prior or contemporaneous agreements which are collateral to an integrated agreement and which are not inconsistent with and do not vary or contradict the express or implied terms or obligations thereof.” *Hubacek v. Ennis State Bank*, 317 S.W.2d 30, 31 (Tex. 1958) (citations omitted).

“The Court may read a written document in the light of surrounding circumstances, which can be proved, in order to arrive at the true meaning and intention of the parties as expressed in the words used, but will not hear parol evidence of language or words other than those used by the parties themselves in the writing. No other words are to be added to or subtracted from the written instrument.” *Self v. King*, 28 Tex. 552 (1866).

“Where the terms of the contract are plain and unambiguous the construction given it by the contracting parties is ordinarily immaterial and, in the absence of fraud, accident or mistake, parol evidence is not admissible to vary its terms.” *Richardson v. Hart*, 185 S.W.2d

563, 564 (Tex. 1945).

“The details which merely explain or clarify the essential terms appearing in the instrument may ordinarily be shown by parol.” *Wilson v. Fisher*, S188 S.W.2d 150, 152 (Tex. 1945).

“Extrinsic evidence may, indeed, be admissible to give the words of a contract a meaning consistent with that to which they are reasonably susceptible, i.e., to ‘interpret’ contractual terms. If the contract language is not fairly susceptible of more than one legal meaning or construction, however, extrinsic evidence is inadmissible to contradict or vary the meaning of the explicit language of the parties' written agreement.” *National Union Fire Ins. v. CBI Indus., Inc.*, 907 S.W.2d 517, 521 (Tex. 1995).

“McDade urges that the contract was latently ambiguous because it believed that the Friendswood exception only allowed Friendswood to lease space it already owned to ABS. . . . McDade's interpretation, however, is parol evidence, and parol evidence of intent cannot be admitted for the purpose of creating an ambiguity . . . . Only after a contract is found to be ambiguous may parol evidence be admitted for the purpose of ascertaining the true intentions of the parties expressed in the contract.” *Friendswood Development Co. v. McDade & Co.*, 926 S.W.2d 280, 283 (Tex. 1996).

Tex. Bus. & Comm. Code § 26.02 (c) & (d) contain a form of the parol evidence rule that applies to loans for more than \$50,000.00. The statute provides:

(c) The rights and obligations of the parties to an agreement subject to Subsection (b) of this section shall be determined solely from the written

loan agreement, and any prior oral agreements between the parties are superseded by and merged into the loan agreement.

(d) An agreement subject to Subsection (b) of this section may not be varied by any oral agreements or discussions that occur before or contemporaneously [FN1]with the execution of the agreement.

However, subsections (e) and (f) require that the lender give a prescribed notice to the borrower before the loan agreement is signed, or else the rule will not be applied.

Parol evidence may be introduced to show that a promissory note is not enforceable because the special purpose for, or condition upon, which it was delivered did not occur. *Akin v. Dahl*, 661 S.W.2d 914, 916 (Tex.1983). “A ‘condition precedent’ is a condition that ‘postpones the effective date of the instrument until the happening of a contingency. . . . Parol evidence is always competent to show the nonexistence of a contract or the conditions upon which it may become effective.’” *Borg-Warner Acceptance Corp. v. Jesse Vinson Imports, Inc.*, 1991 WL 4848 \*2 (Tex. App.--Houston [14 Dist.] 1991, writ denied) (not for publication)[citations omitted].

“The parol evidence rule excludes only prior and contemporaneous negotiations. It does not apply to subsequent agreements entered into by the parties.” *Garcia v. Karam*, 154 Tex. 240, 276 S.W.2d 255, 258 (Tex. 1955); *accord, Katerndahl v. State Farm Fire and Cas. Co.*, 961 S.W.2d 518, 523-24 (Tex. App.--San Antonio 1997, no pet.).

“[I]n the absence of fraud, accident, or mutual

mistake, the parol or extrinsic evidence rule is particularly applicable where the written contract contains a recital that it contains the “entire agreement between the parties,” or a similarly worded merger provision.” *Weinacht v. Phillips Coal Co.*, 673 S.W.2d 677, 679 (Tex. App.--Dallas 1984, no writ).

**3. Surrounding Circumstances.** “A question relating to the construction of an indemnity contract is presented. We are to take the wording of the instrument, consider the same in the light of the surrounding circumstances, and apply the pertinent rules of construction thereto and thus settle the meaning of the contract.” *Spence & Howe Const. Co. v. Gulf Oil Corp.*, 365 S.W.2d 631, 632 (Tex. 1963).

“Both parties offered evidence of the course of dealings between the parties and the circumstances surrounding the execution of the 1971 (Osceola) purchase order contract, including the customs and usages in the tank construction design, fabrication, and erection business and the sufficiency of the autopositive print for use in designing the Osceola vessel. This evidence was not in violation of the parol evidence rule. Even though the 1971 purchase order agreement was not ambiguous, the court was entitled to consider the surrounding facts and circumstances, not to vary or add to the contract, but to learn the intention with which the words were used.” *Gorbett Bros. Steel Co., Inc. v. Anderson, Clayton & Co.*, 533 S.W.2d 413, 418 (Tex. Civ. App.--Houston [1st Dist.] 1976, no writ).

Parol evidence is admissible to show a latent ambiguity in an agreement. See paragraph IV.E.2 below.

**4. Course of Performance.** Tex. Bus. & Comm. Code § 1.303 says that “the express

terms of an agreement and any applicable course of performance, course of dealing, or usage of trade must be construed whenever reasonable as consistent with each other.” So, in sale-of-merchandise transactions the court must look at course of performance in the process of interpreting the express terms of an agreement. However, in *East Montgomery County Municipal Utility District No. 1 v. Roman Forest Consolidated Municipal Utility District*, 620 S.W.2d 110, 112 (Tex. 1981), the court said: “The conduct of the parties is only relevant after the court has determined (as a matter of law) that the contract is ambiguous.”

**5. Course of Dealing.** *International Therapeutics, Inc. v. McGraw-Edison Co.*, 721 F.2d 488, 491 (5<sup>th</sup> Cir. 1983):

A course of dealing is a sequence of previous conduct between the parties to a particular transaction which is fairly to be regarded as establishing a common basis of understanding for interpreting their expressions and other conduct. The emphasis is on a sequence of events; a single transaction cannot constitute a course of dealing.

**6. Usages of Trade.** “Extrinsic evidence may, indeed, be admissible to give the words of a contract a meaning consistent with that to which they are reasonably susceptible, i.e., to ‘interpret’ contractual terms. FN6 If the contract language is not fairly susceptible of more than one legal meaning or construction, however, extrinsic evidence is inadmissible to contradict or vary the meaning of the explicit language of the parties’ written agreement.” *Nat’l Union Fire Ins. Co. v. CBI Indus. Inc.*, 907 S.W.2d 517, 521 (Tex. 1995). “FN6. In

cases involving ‘trade usage’ evidence, for example, the meaning to which a certain term or phrase is most reasonably susceptible is the one which so regularly observed in place, vocation, trade, or industry so ‘as to justify an expectation that it will be observed with respect to a particular agreement.’ Restatement (2d) of Contracts § 222(1). See also Tex. Bus. & Com. Code § 1.205(b).” *Id.*

## E. AMBIGUITY.

**1. Definition of Ambiguity.** “A contract is ambiguous when its meaning is uncertain and doubtful or is reasonably susceptible to more than one interpretation.” *Heritage Resources, Inc. v. NationsBank*, 939 S.W.2d 118, 121 (Tex. 1996); *Coker v. Coker*, 650 S.W.2d 391, 393 (Tex. 1983). “A contract is not ambiguous if it can be given a certain or definite legal meaning or interpretation.” *Lopez v. Munoz, Hockema & Reed, L.L.P.*, 22 S.W.3d 857, 860 (Tex. 2000). “If a written instrument is so worded that a court may properly give it a certain or definite legal meaning or interpretation, it is not ambiguous. On the other hand, a contract is ambiguous only when the application of the applicable rules of interpretation to the instrument leave it genuinely uncertain which one of the two meanings is the proper meaning.” *R & P Enterprises v. LaGuarta, Gavrel & Kirk, Inc.*, 596 S.W.2d 517, 519 (Tex. 1980).

“An ambiguity does not arise simply because the parties advance conflicting interpretations of the contract. . . . For an ambiguity to exist, both interpretations must be *reasonable*.” *Columbia Gas Trans. Corp. v. New Ulm Gas, Ltd.*, 940 S.W.2d 587, 589 (Tex. 1996).

**2. Patent Vs. Latent Ambiguity.** “An ambiguity in a contract may be said to be ‘patent’ or ‘latent.’ A patent ambiguity is evident on



the face of the contract. . . . A latent ambiguity arises when a contract which is unambiguous on its face is applied to the subject matter with which it deals and an ambiguity appears by reason of some collateral matter. FN4 . . . If a latent ambiguity arises from this application, parol evidence is admissible for the purpose of ascertaining the true intention of the parties as expressed in the agreement.” *Nat’l Union Fire Ins. Co. v. CBI Indus. Inc.*, 907 S.W.2d 517, 520 (Tex. 1995). “FN4. For example, if a contract called for goods to be delivered to ‘the green house on Pecan Street,’ and there were in fact two green houses on the street, it would be latently ambiguous.” *Id.*

**3. Question of Law Vs. Question of Fact.** “The question of whether a contract is ambiguous is one of law for the court.” *Heritage Resources, Inc. v. NationsBank*, 939 S.W.2d 118, 121 (Tex. 1996). “This Court may conclude a contract is ambiguous, even though the parties do not so contend.” *EOG Resources, Inc. v. Wagner & Brown, Ltd.*, 202 S.W.3d 338, 344 (Tex. App.--Corpus Christi 2006, pet. denied).

**4. What is Considered?** If after applying the established rules of interpretation, a written instrument remains reasonably susceptible to more than one meaning, extraneous evidence is admissible to determine the true meaning of the instrument.” *R & P Enterprises v. LaGuerta, Gavrel & Kirk, Inc.*, 596 S.W.2d 517, 519 (Tex. 1980). “The ambiguity must become evident when the contract is read in context of the surrounding circumstances, not after parol evidence of intent is admitted to create an ambiguity.” *Nat’l Union Fire Ins. Co. v. CBI Indus. Inc.*, 907 S.W.2d 517, 521 (Tex. 1995).

**F. GAP-FILLING.** “The parol evidence rule provides that, in the absence of fraud,

accident, or mistake, extrinsic evidence is not admissible to vary, add to, or contradict the terms of a written instrument that is facially complete and unambiguous. 36 Tex.Jur.3d Evidence § 315 (1984). But, if the instrument is incomplete on its face, extrinsic evidence may be admitted to show the part that is missing, provided the evidence does not conflict with the written provisions.” *Martin v. Ford*, 853 S.W.2d 680, 681-82 (Tex. App.--Texarkana 1993, writ den’d). *Accord, First Victoria Nat. Bank v. Briones*, 788 S.W.2d 632 (Tex. App.--Corpus Christi 1990, writ ref’d n.r.e.).

**V. SUMMARY JUDGMENT.** Cases can be found that say interpreting a contract is a question of law, while others say that it is a question of fact. Professor Corbin has been widely quoted for saying that “[t]he question of interpretation of language and conduct--the question of what is the meaning that should be given by a court to the words of a contract, is a question of fact, not a question of law.” 3 A. Corbin, CORBIN ON CONTRACTS § 554, at 219 (1960). This is in keeping with Corbin’s contextual approach to contract interpretation. But Corbin goes on to say: “if the evidence is so clear that no reasonable man would determine the issue before the court in any way but one,” then the issue is one that is properly for the judge to determine. *Id.* § 554, at 222. *Accord, St. Joseph Professional Bldg. Corp. v. American Nat. Ins. Co.*, 511 S.W.2d 578, 581 (Tex. Civ. App.--1974, writ ref’d n.r.e.) (“If it could be said the commitment was ambiguous, then there are two extrinsic factors which support a construction favoring tenant occupancy. As these factors are undisputed, construction would remain a matter for the court”).

But Corbin’s perspective is that context evidence must always be considered. And many

of the cases that quote Corbin involve agreements which the court found to be ambiguous. Few would disagree with the view that extrinsic evidence becomes admissible, and jury's role arises, once an agreement is found to be ambiguous. The more controversial proposition is whether extrinsic evidence should be considered on the question of how to interpret an unambiguous agreement, and if so then what happens if the evidence is conflicting? Does the jury resolve the conflicts and the court uses the verdict as a basis for interpreting the agreement, or does the jury interpret the agreement itself?

Corbin notwithstanding, the Texas Supreme Court has made it clear that the "[i]nterpretation of a contract becomes a fact issue to be resolved by extrinsic evidence only when application of pertinent rules of construction leaves a genuine uncertainty as to which of two meanings is proper." *Harris v. Rowe*, 593 S.W.2d 303, 306 (Tex. 1979); see *Coker v. Coker*, 650 S.W.2d 391, 394 (Tex. 1983) ("When a contract contains an ambiguity, the granting of a motion for summary judgment is improper because the interpretation of the instrument becomes a fact issue"). The Texas Supreme Court is saying that extrinsic evidence is not admissible to interpret an unambiguous agreement. So, a jury issue can arise in Texas only for ambiguous agreements or when there is a gap.

"When a contract is reasonably susceptible to more than one meaning, extraneous evidence is admissible to determine the true meaning of the instrument. . . . Summary judgment in such a case is improper, as the question of the true meaning of the contract becomes one of fact for the jury." *North Central Oil Corp. v. Louisiana Land and Exploration Co.*, 22 S.W.3d 572, 581 (Tex. App.--Houston [1 Dist.] 2000, pet denied). See *e.g. Smith v.*

*Prudential Prop. and Cas. Ins. Co.*, 10 S.W.3d 846, 850 (Ark. 2000). "The construction and legal effect of written contracts are matters to be determined by the court, not by the jury, except when the meaning of the language depends upon disputed extrinsic evidence."

## VI. THE ROLE OF THE JURY IN CONTRACT INTERPRETATION.

A study by the National Center for State Courts showed that contract disputes constituted 16.4% of state civil jury trials in 1996 as compared to tort cases which constituted 82.6% of state jury trials in 1996. *Caseload Highlights: Examining the Work of the State Courts*, 2001. A February 2005 report 63% of trials were tort. Among the contract cases, excluding debt collection suits, slightly more were tried to a jury than to the court.

<[http://www.ncsconline.org/D\\_Research/csp/Highlights/Vol11No1.pdf](http://www.ncsconline.org/D_Research/csp/Highlights/Vol11No1.pdf)>. The small percent of contract disputes may result from the fact that a contractual relationship, unlike a tortious relationship, is consensual to begin with, and contracting parties who wish to maintain ongoing business relationships and their reputations may be more inclined to renegotiate contract terms when problems develop. See Nottage, at 15 (regarding Stewart Macaulay's empirical studies on contract law in actual practice). Also, contract litigants may be bargaining away their right to a jury trial or agreeing to arbitrate. Richard Posner noted that contracting parties are sometimes leery of juries determining their contract disputes. At the time of contracting they can agree to binding arbitration or they can agree to waive a jury if a trial occurs. R. Posner, at 1595. They can also use a merger clause in the contract, as a way to invoke the parol evidence rule in an effort to steer away from factual disputes about the nature of the parties' agreement.

Statements are legion that the interpretation of a written contract raises a question of law for the judge (and for the appellate court). I will begin by demonstrating that this proposition is problematic from the perspective of generally prevailing standard for distinguishing fact and law issues.

William C. Whitford, *The Role of the Jury (and the Fact/Law Distinction) In the Interpretation of Written Contracts*, 2001 Wis. L. Rev. 931 (2001). (“Whitford”). The article is a “must read” if you are grappling with a summary judgment involving contract interpretation, or trying to fashion a jury charge involving contract interpretation.

Restatement (Second) of Contracts § 212, comments d and e, say this about contract interpretations and juries:

d. “*Question of law.*” Analytically, what meaning is attached to a word or other symbol by one or more people is a question of fact. But general usage as to the meaning of words in the English language is commonly a proper subject for judicial notice without the aid of evidence extrinsic to the writing. Historically, moreover, partly perhaps because of the fact that jurors were often illiterate, questions of interpretation of written documents have been treated as questions of law in the sense that they are decided by the trial judge rather than by the jury. Likewise, since an appellate court is commonly in as good a position to decide such questions as the trial judge, they have been treated as questions of law for purposes of appellate review. Such treatment has the effect of limiting the power of the trier of fact to exercise a

dispensing power in the guise of a finding of fact, and thus contributes to the stability and predictability of contractual relations. In cases of standardized contracts such as insurance policies, it also provides a method of assuring that like cases will be decided alike.

e. *Evaluation of extrinsic evidence.* Even though an agreement is not integrated, or even though the meaning of an integrated agreement depends on extrinsic evidence, a question of interpretation is not left to the trier of fact where the evidence is so clear that no reasonable person would determine the issue in any way but one. But if the issue depends on evidence outside the writing, and the possible inferences are conflicting, the choice is for the trier of fact.

UCC Section 209(2) provides that the question of whether there is an integrated agreement is for the court to determine before attempting interpretation and before considering the parol evidence rule. *See* Rowley, at 335.

The question arises in a gap-filling case whether the judge or jury fills the gap. The Restatement (Second) of Contracts does not say. Richard E. Speidel, *Restatement Second: Omitted Terms and Contract Method*, 67 Cornell L.Rev. 785, 804 (1982). It seems to be accepted that the terms and meaning of an oral agreement, or of a written agreement that has been lost, are for the jury.

The U.S. Supreme Court said, as a matter of federal procedure: “Although the construction of written instruments is one for the court, where the case turns upon the proper

conclusions to be drawn from a series of letters, particularly of a commercial character, taken in connection with other facts and circumstances, it is one which is properly referred to a jury.” *Rankin v. Fidelity Insurance, Trust & Safe Deposit Co.*, 189 U.S. 242, 252-253, 23 S.Ct. 553, 557, 47 L.Ed. 792 (1903).

The question arises as to just what to submit to the jury. Many years ago, the Texas Supreme Court said:

When the effect of the writing does not depend entirely upon the construction or meaning of its terms, but upon extrinsic facts and circumstances, then it becomes the duty of the court to submit for the consideration of the jury the instrument, together with the attending facts and circumstances adduced in evidence, with such instructions upon the legal effect of the instrument as would meet the various phases presented by the extrinsic evidence.

*Taylor v. McNutt*, 58 Tex. 71 (Tex. 1882). Thus, the language in *Taylor v. McNutt*, suggests that the jury will interpret the agreement, after the judge gives them the appropriate rules of construction to use.

The Pattern Jury Charges PJC 101.2 has the court asking the jury whether the defendant breached the contract. If there is a dispute regarding the meaning of the agreement, and the agreement is not ambiguous, then the meaning of the contract is determined by the judge and the jury is to be advised of the court’s interpretation in instructions. The commentary to PJC 101.2 says:

**Interpretation.** Construction of an

unambiguous term is an issue for the court. If appropriate, an instruction should be included giving the jury the correct interpretation of that term. See PJC 101.7. If the court determines that a particular provision is ambiguous, an instruction on resolving that ambiguity should be included. See PJC 101.8.

Texas Pattern Jury Charges (Business, Consumer, Insurance, Employment) p. 31. The Pattern Jury Charges, PJC 101.7, observes:

**Court’s construction should be included in charge.** If the construction of a provision of the agreement is in dispute and the court resolves the dispute by interpreting the provision according to the rules of construction, the court should include that interpretation in submitting PJC 101.2.

The Pattern Jury Charges, PJC 101.8, addresses an ambiguous provision of an agreement, suggesting the following jury instruction.

It is your duty to interpret the following language of the agreement:

[Insert ambiguous language.]

You must decide its meaning by determining the intent of the parties at the time of the agreement. Consider all the facts and circumstances surrounding the making of the agreement, the interpretation placed on the agreement by the parties, and the conduct of the parties.

Presumably the jury is given a choice between the parties’ two inconsistent interpretations.

PJC 101.9, in its comment, states that “Texas law is not clear on whether trade custom is merely evidentiary and not appropriate for jury instruction or whether it may in fact form the basis for a proper instruction.” PJC 101.9 at 40. The comment suggests that such a question “could inquire whether a particular custom or usage existed and, if it existed, whether the parties intended that it would affect a contract term” *Id.* This approach suggests that the jury would be asked to resolve the specific question of whether custom or usage should be used by the court in interpreting the agreement, and if so, then perhaps the judge takes that verdict and plugs the result into the rest of the interpretive effort to arrive at the meaning of the agreement.

Note that a dispute can arise as to whether an agreement is integrated. One writer suggests that the question of whether a writing is integrated, and, if so, fully integrated, are questions of law for the court. Rowley, at 335, n. 904 (citing among other things U.C.C. § 2-202 cmt. 3). “[W]e hold that it is a question of fact in this case whether the terms agreed to and embodied in the September 2 and October 19, 1983 writings were intended to be the final expressions of the contract or were only preliminary negotiations which the parties did not intend to have legal significance until execution of the contemplated legal documentation. This question was properly submitted to and answered by the jury in fulfillment of its fact finding responsibilities. In some cases, of course, the court may decide, as a matter of law, that there existed no immediate intent to be bound. This case, however, is not such a case.” *Foreca, S.A. v. GRD Development Co., Inc.*, 758 S.W.2d 744, 746 (Tex. 1988).

Professor Whitford has pointed out that a determined litigant can circumvent the four-corners rule and parol evidence rule by raising

jury issues through the assertion of claims for fraud, mutual mistake, waiver, and the like. Whitford, at 941-42.

**VII. REVIEW ON APPEAL.** “When a contract is not ambiguous, the construction of the written instrument is a question of law for the court . . . . We review the trial court's legal conclusions de novo.” *MCI Telecommunications Corp. v. Texas Utilities Elec. Co.*, 995 S.W.2d 647, 650-51 (Tex. 1999). “The interpretation of an unambiguous document is a question of law. We review the trial court's decision de novo. . . . We perform that review without considering parol evidence . . . . We consider the entire document under the ‘four corners’ rule. . . . To determine the parties' intention, we look only at what the parties actually stated in the deed, not what they allegedly meant.” *Stewman Ranch, Inc. v. Double M. Ranch, Ltd.*, 192 S.W.3d 808, 810 (Tex. App.--Eastland 2006, pet. denied). “Whether a contract is ambiguous is a question of law for the court. . . . We review the trial court's legal conclusions de novo. . . . We determine whether the contract is ambiguous by looking at the contract as a whole in light of the circumstances present when the parties entered the contract.” *Kennedy Ship & Repair, L.P. v. Pham*, 210 S.W.3d 11, 22 (Tex. App.--Houston [14th Dist.] 2006, no pet.). “Interpretation of a contract is a matter of law, as is the determination that a contract is ambiguous, and both are reviewed de novo.” *Camden Iron & Metal, Inc. v. Krafsur (In re Newell Indus., Inc.)*, 336 F.3d 446, 448 (5th Cir. 2003) (applying Texas law).

“We review parol evidence questions de novo, as questions of law.” *Haden v. David J. Sacks, P.C.*, 222 S.W.3d 580, 592 (Tex. App.--Houston [1st Dist.] 2007, pet. pending).

On the federal side, the rule is a little differ-

ent. In *Palmer v. Fuqua*, 641 F.2d 1146, 1154 n. 15 (5<sup>th</sup> Cir. 1981), the Fifth Circuit, applying Texas law but federal procedure was faced with the question of whether to review the trial court's interpretation of an agreement as a factual determination to be reviewed under the clearly erroneous rule, or as a conclusion of law freely reviewable by the appellate court. The Court noted:

It is clear that the interpretation of the legal effect of a contract is a question of law for the court to decide. . . . The question whether the Ritchie lease falls within the phrase "area of interest owned by this Partnership," however, might more accurately be characterized as a question of fact. . . . Yet even when dealing with the interpretation of the meaning of a contract, "if the evidence is so clear that no reasonable man would determine the issue before the court in any way but one," the issue is one that is properly for the judge to determine. . . . Thus, the meaning of a contract, when the contract is not ambiguous, is oftentimes characterized as a question of law. [Citations omitted]

**VIII. CONCLUSION.** Although much has been written about the right and wrong ways to go about interpreting contracts, Texas law on interpreting contracts has not changed greatly in 100 years. When interpreting an agreement, whether in summary judgment, at trial, or on appeal, lawyers should know the rules of interpretation to invoke. Lawyers feeling constrained by these rules may use alternate approaches, like finding a patent or latent ambiguity, or fraud in the inducement, or invoking equity to reform the agreement, to put the facts before the fact finder in hopes of overcoming the words of the contract.

## IX. FURTHER READING.

- Randy E. Barnett, *The Sound of Silence: Default Rules and Contractual Consent*, 78 Va. L. Rev. 821 (1992).
- Larry A. DiMatteo, *Reason and Context: A Dual Track Theory of Interpretation*, 109 Penn. State L. Rev. 397 (2004).
- E. Allan Farnsworth, *The Interpretation of International contracts and the Use of Preambles*, Int'l Business Law J. No. 3-4, 271-279 (2002), on line at: <<http://cisgw3.law.pace.edu/cisg/bilbio/farnsworth.html>>.
- Avery Wiener Katz, *The Economics of Form and Substance in Contract Interpretation*, 104 Colum. L. Rev. 496 (2004).
- Adam Kramer, *Common Sense Principles of Contract Interpretation*, 23(2) Oxford J. Of Legal Studies 173 (2003) (a British perspective), on line at: <<http://www.3vb.com/pgs-articles/ak-Interpretation-as-published.shtml>>.
- Mark L. Movsesian, *Rediscovering Williston*, 62 Wash. & Lee L. Rev. 207 (2005).
- Vincent Nelson, *The Interpretation Of Contracts: The Rules Re-Written For Modern Times*, (2004) (detailing English law's movement away from literalism to purposive interpretation of contracts), available on line at: <[http://www.39essex.com/document/s/VN\\_seminar\\_Contracts\\_handout\\_310304\\_FINAL.pdf](http://www.39essex.com/document/s/VN_seminar_Contracts_handout_310304_FINAL.pdf)>.

- Robert E. Scott & George G. Triantis, *Anticipating Litigation in Contract Design*, 115 Yale L.J. 814 (2006).
- George G. Triantis, *The Efficiency of Vague Contract Terms: A Response to the Schwartz-Scott Theory of U.C.C. Article 2*, 62 La. L. Rev. 1065 (2002).
- Zipporah Batshaw Wiseman, *The Limits of Vision: Karl Llewellyn and the Merchant Rules*, 100 Harv. L. Rev. 465 (1987).
- Bruno Zeller, *Determining the Contractual Intent of Parties Under the CISG and Common Law—A Comparative Analysis*, 4 European J. Of Law Reform No. 4 629 (2002), available on line at:  
<<http://cisgw3.law.pace.edu/cisg/biblio/zeller8.html>>.

## X. THE "PEERLESS" CASE.

RAFFLES v. WICHELHAUS (1864)

Court of the Exchequer

2 Hurl. & C. 906

Declaration. For that it was agreed between the plaintiff and the defendants, to wit, at Liverpool, that the plaintiff should sell to the defendants, and the defendants buy of the plaintiff, certain goods, to wit, 125 bales of Surat cotton, guaranteed middling fair merchant's dhollorah, to arrive ex Peerless from Bombay; and that the cotton should be taken from the quay, and that the defendants would pay the plaintiff for the same at a certain rate, to wit, at the rate of 17.25 d. per pound, within a certain time then agreed upon after the arrival of said goods in England. Averments: that the said goods did arrive by said ship from Bombay to England, to wit, at Liverpool, and the plaintiff was then and there ready and willing and offered to deliver that said goods to the defendants, etc. Breach: that the defendants refused to accept the said goods or pay the plaintiff for them.

Plea. That the said ship mentioned in the said agreement was meant and intended by the defendant to be the ship called the Peerless, which sailed from Bombay, to wit, in October; and that the plaintiff was not ready and willing, and did not offer to deliver to the defendants any bales of cotton which arrived by the last-mentioned ship, but instead thereof was only ready and willing, and offered to deliver to the defendants 125 bales of Surat cotton which arrived by another and different ship, which was also called the Peerless, and which sailed from Bombay, to wit, in December.

Demurrer, and joinder therein. Milward, in support of the demurrer. The contract was for the sale of a number of bales of cotton of a particular description, which the plaintiff was ready to deliver. It is immaterial by what ship the cotton was to arrive, so that it was a ship called the Peerless. The words, "to arrive ex Peerless," only mean that if the vessel is lost on the voyage, the contract is to be at an end. [Pollock, C.B. It would be a question for the jury whether both parties meant the same ship to be called the Peerless.] That would be so if the contract was for the sale of a ship called the Peerless; but it is for the sale of cotton on board a ship of that name. [Pollock, C.B. The defendant only bought that cotton which was to arrive by a particular ship. It may as well be said, that if there is a contract for the purchase of certain goods in a warehouse A., that is satisfied by the delivery of goods of the same description in warehouse B.] In that case there would be goods in both warehouses; here, it does not appear that the plaintiff had any goods on board the other Peerless. [Martin, B. It is imposing on the defendant a different contract from that which he entered into. Pollock, C.B. It is like a contract for the purchase of wine coming from a particular estate in Spain or France, where there are two estates of the same name.] The defendant has no right to contradict,



by parole evidence, a written contract good upon the face of it. He does not impute misrepresentation or fraud, but only says he fancied the ship a different one. Intention is of no avail, unless stated at the time of contract. [Pollock, C.B. One vessel sailed in October, the other in December.] The time of sailing is no part of the contract.

Mellish (Cohen with him), in support of the plea. There is nothing on the face of the contract to show that any particular ship called the Peerless was meant; but the moment it appears that two ships called the Peerless were about to sail from Bombay there is a latent ambiguity, and parole evidence may be given for the purpose of showing that the defendant meant one Peerless and the plaintiff another. That being so, there was no consensus ad item, and therefore no binding contract. He was then stopped by the Court.

Per Curiam. Judgment for the defendants.