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Although trade and its defining terms lie at the very core of contract law, perceptions of the state's involvement in the exchange process remain peculiarly incomplete. Everyone understands that the state supplies the fundamental property-defining rules for pre-trade endowments. For instance, governmentally provided rules of tort, nuisance, and civil rights establish basic boundaries of what initially belongs to an individual and, hence, what he has to offer in exchange. When an exchange subsequently takes place, however, the parties themselves assume an important part of the burden of communicating what rights are being given and received. Although the state's general rules of contract provide a set of standard gap-filling assumptions or implied terms, almost every agreement requires the parties to provide some additional individualized content. At one level, the private and state-supplied terms of an executory contract represent an attempted interparty *communication* of the substantive entitlements intended to be exchanged. Since, however, the

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terms communicate evidence of the exchange's content to the state as well, they also constitute the principal legal *definition* of the rights reallocation. Unfortunately, this definitional process requires parties to employ inherently error-prone signals—the "formulations" of their agreement.[1] If the chosen combination of privately and publicly supplied terms results in an inappropriate formulation, a party may suffer a costly surprise when the contract is legally enforced. The disappointed party will frequently contend that the content of the contract, as ultimately interpreted, does not accurately describe the original intent or expectation.

Many such complaints about the misformulation or misinterpretation of an agreement are rooted in tensions between implied and express terms and between standard and unconventional forms of expression. To the extent that these tensions have been understood at all, the major attempt to harmonize them relies on what we term the Expanded Choice postulate.[2] The postulate maintains that implied terms expand contractors' choices by providing standardized and widely suitable "preformulations,"[3] thus eliminating the cost of negotiating every detail of the proposed arrangement. This Expanded Choice thesis implicitly presumes a neutral policy toward individualized agreements: atypical parties lose nothing, since they remain unrestrained from designing customized provisions to replace the state-supplied terms.[4]

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1. To formulate is "to reduce or to express in or as if in a formula; put into a systematized statement or expression." WEBSTER'S THIRD NEW INTERNATIONAL DICTIONARY 894 (1976).

2. A form of the Expanded Choice postulate has long been recognized as a normative principle in theoretical welfare economics. *See* Lancaster, *Welfare Propositions in Terms of Consistency and Expanded Choice*, 68 ECON. J. 464 (1959).

3. The terminology of "preformulated" versus "particularized" contractual provisions follows our earlier discussion in Goetz & Scott, *The Mitigation Prineiple: Toward a General Theory of Contractual Obligation*, 69 VA. L. REV. 967, 971 (1983).

4. *See infra* text accompanying notes 9-10. Candor requires us to admit that we bear a large responsibility for the perhaps overly uncritical formalization of the Expanded Choice postulate. *See, e.g.*, Goetz & Scott, *supra* note 3, at 971; Goetz & Scott, *Principles of Relational Contraets*, 67 VA. L. REV. 1089, 1089-90 (1981) [hereinafter cited as Goetz & Scott, *Relational Contracts*]; Goetz & Scott, *Liquidated Damages, Penalties, and the Just Compensation Principle: Some Notes on an Enforcement Model and a Theory of Efficient Breach*, 77 COLUM. L. REV. 554, 588 n.87 (1977). However, a number of other scholars must share the responsibility for the current popularity of the postulate as a normative criterion. *See, e.g.*, A. SCHWARTZ & R. SCOTT, COMMERCIAL TRANSACTIONS: PRINCIPLES AND POLICIES 19-23 (1982); Baird & Weisberg, *Rules, Standards, and the Battle of the Forms: A Reassessment of § 2-207*, 68 VA. L. REV. 1217, 1249-52 (1982); Jackson, *"Anticipatory Repudiation" and the Temporal Element of Contract Law: An Economic Inquiry into Contract Damages in Cases of Prospective Nonperformance*, 31 STAN. L. REV. 69 (1978); Jackson & Kronman, *Secured Financing and Priorities Among Creditors*, 88 YALE L.J. 1143 (1979). Professor Kronman has even attempted to justify the postulate in Kantian terms rather than on purely utilitarian grounds. *See* Kronman, *Wealth Maximization as a Normative Principle*, 9 J. LEGAL STUD. 227 (1980). *But see* A. SCHWARTZ & R. SCOTT, *supra*, at 21 n.11. The only challenge to the almost universal acceptance of the underlying assumption of neutrality that supports the Expanded Choice postulate appears *id.* at 335-37.

Despite the seductive persuasiveness of the Expanded Choice postulate, its reassurances are marred by unacknowledged incongruities. For example, the courts' tendency to treat state-created rules as presumptively fair often leads to judicial disapproval of efforts to vary standard implied terms by agreement.[5] Indeed, as the system for implying terms into contracts becomes more highly refined, the opting-out burden of those who prefer a different allocation of risks grows weightier.[6] Furthermore, conflicting applications of the parol evidence and plain-meaning rules betray widespread judicial uncertainty over the proper method of interpreting agreements that intermingle express and implied terms.[7] These and other related problems have exposed a central question that remains unresolved: To what extent do implied and express terms, and standardized and individualized forms of agreement, function in antagonistic rather than complementary ways? This issue can be illuminated by focusing attention on the environment in which contractual formulations evolve.

Part I of this Article develops a conceptual analysis of the interaction between private and state-supplied contractual formulations. Our framework departs from the conventional view that state-supplied contract clauses are means merely of reducing negotiating and other resource costs; it focuses instead on the value of implied terms as widely useful, predefined signals that reduce the incidence of certain identifiable types of formulation errors. From this perspective, privately provided express terms constitute more refined attempts to reduce the definitional errors resulting from inappropriate formulations. We show how such express signals are, paradoxically, so vulnerable to misinterpretation that they may actually increase error. Contracting parties, therefore, must rely on the state's standardization of express and implied terms in order more safely to combine implied and express terms in their agreements. This error-reduction conceptualization clarifies the ways in which formulation errors occur, how private parties and courts react to them, and how the state can and does influence the formulation of private contract terms.

Part II examines the theoretical implications of this analysis for the Expanded Choice postulate. We argne that the very benefits of the state's efforts to imply and standardize widely useful terms create hith-

5. *See, e.g.*, Hayward v. Postma, 31 Mich. App. 720, 724, 188 N.W.2d 31, 33 (1971) (parties must use clear and unequivocal language to shift liability for risk of loss from seller to buyer); Caudle v. Sherrard Motors Co., 525 S.W.2d 238, 240 (Tex. Civ. App. 1975) (same); *see also* Davis v. Small Business Inv. Co., 535 S.W.2d 740, 744 (Tex. Civ. App. 1976) (contractual provision purporting to allocate to debtor the burden of "all" expenses incurred in preserving collateral not an agreement "otherwise" sufficient to vary the terms of U.C.C. § 9-207(2)(a)).

6. *See infra* notes 14, 19, & text accompanying notes 74-77.

7. *See infra* text accompanying notes 118-27.

erto overlooked barriers to innovative forms of contractual agreement. As more complex and refined terms are implied from the patterned behavior of contracting parties, variation by express agreement becomes more difficult and costly than is commonly realized. Similarly, expanding the set of standard terms and clauses retards the evolution of new, "emergent" formulations. These barriers to innovation restrain the development of alternative contractual formulations and favor highly reliable but possibly ill-fitting language, thereby imposing added costs on innovative relationships.

We consider the normative implications of our analysis for contractual interpretation in Part III. The error-reduction framework demonstrates that the prevailing judicial approach to ex post interpretation has far-reaching feedback effects on the operation of the ex ante contractual signalling system. Moreover, an examination of recent cases challenges the conventional premise that methods of contractual interpretation have evolved over the past half-century from an extreme focus on narrow "plain meaning" to the opposite pole of liberal contextual construction. Surprisingly, the cases reveal a continuing struggle between "textualist" and "contextualist" interpretive methodologies. Depending upon which methodology they favor, courts and commentators view the purpose of contract interpretation as a determination either of what the contracting parties subjectively intended or of what the contract itself objectively means. We argue that this struggle between methodological extremes reflects a failure to understand and accommodate the respective roles of implied and express terms in contractual formulations. Properly understood, the tensions between these competing methodologies can be alleviated through interpretive principles designed explicitly to facilitate improvements in contractual formulation. Finally, we suggest modifications in the interpretive process to better accommodate the complex and demanding formulations required by specialized modern contractual relationships.

I
AN ANALYSIS OF THE INTERACTIONS BETWEEN IMPLIED AND EXPRESS FORMULATIONS

What the law calls a "contract" starts out as a communication: an exchange of promises between the parties. As we have emphasized elsewhere, a key function of any promise is to provide information about a future happening.[8] The content of that information, in turn, has a critical impact both on promissory reliance and on any subsequent interpre-

8. Goetz & Scott, *Enforcing Promises: An Examination of the Basis of Contract*, 89 YALE L.J. 1261, 1266-70 (1980).

tation of the contract by the state. Thus, a failure adequately to communicate the content of a promise or to define the rights being exchanged threatens "reliability," the central concern of the contractual process.

The analysis developed below will identify a variety of conceptually distinct errors which reduce the reliability of contractual formulations as instruments of communication and definition. Both the actions of the state in promoting the development of standard formulations and those of private parties in crafting express terms can then be recognized as efforts to describe more accurately the rights being exchanged, in order to reduce the risk of particular types of formulation error. Unfortunately, the antagonistic relationship between the processes of generalization and particularization makes it difficult to reduce one type of error without aggravating another type.

A. The Costs of Contractual Formulation

1. The Risk of Formulation Error

This paper assumes that the parties are able to negotiate to a subjective understanding about the combinations of underlying substantive rights that form the basis for mutually beneficial trade. What remains is an instrumental problem, that of formulating contractual terms that mirror the desired exchange. Conventional analysis tends to regard the costs of formulating contracts too narrowly, as including only "transaction costs": those resource-oriented costs of time, effort, and expertise expended in the negotiation and drafting of agreements. But the formulations of the agreement must also serve an evidentiary function, i.e., must communicate the content of the agreement to nonparties, particularly courts. Consequently, the formulation process entails risk above and beyond the resource costs of drafting the agreement. To understand the formulation problem adequately, therefore, we must adopt a wider perspective on costs, one that incorporates the "error costs" resulting both from unexploited opportunities and from unintended resort to state interpretations of disputed contracts. Contractual formulations are, after all, *instruments* designed to achieve particular purposes. More complex and finely calibrated instruments generally offer improved results. Unfortunately, intricate, special-purpose instruments may also invite disaster if put to unintended uses, or if the instruments themselves have been inadequately designed and tested.

The risk of formulation error is thus a real cost of contracting which, especially for certain classes of transactions, may be quite substantial.[9] There are a number of ways parties might respond to this risk

9. The aggregate costs of contracting thus include not only the direct or out-of-pocket costs of

in the absence of any assistance from the state. For instance, they could invest resources to craft their contractual language with greater care and expertise, so that unintended effects are minimized. Alternatively, they might simply avoid transactions whose complexity makes adequate formulation of performance obligations particularly difficult. Similarly, parties could adopt relatively safe contractual formulations, even when riskier ones would better fit their objectives. And, of course, parties could simply choose to suffer the risks of formulation error when the available alternatives are not cost-effective.

Contemporary contract law provides two mechanisms that, singly or in combination, are thought to enable contracting parties to reduce formulation error beyond what the methods described above permit. First, the law supplies standardized and widely suitable risk allocations which enable parties to take an implied formulation "off the rack," thus eliminating certain types of costs and errors arising from individualized specification of terms. Second, atypical parties are invited to formulate express provisions that redesign or replace ill-fitting implied rules. Thus, state-supplied terms provide parties with time-tested, relatively safe provisions that minimize the risk of unintended effects. The danger that state-supplied terms may fit the agreement imprecisely and distort its meaning can be reduced by exercising the option to specify more precise—but frequently riskier—express terms.

The Expanded Choice postulate asserts that these two mechanisms function harmoniously: state-supplied formulations facilitate typical transactions while making atypical ones no more difficult. But two key suppositions underlie this notion of Expanded Choice: (1) that state-supplied terms are mere facilitators, specifying terms that the parties could formulate themselves if unrestrained by time and effort costs; (2) that the availability of state-supplied terms is neutral in that it raises no barriers beyond the existing resource costs to the use of alternative terms by atypical parties. In order to test the validity of these suppositions, imagine that parties engaged in contract negotiations can at minimal resource cost bargain over and draft any possible set of express formulations upon which they may ultimately agree. Under these conditions, can the parties put together combinations of implied and express provisions in a way that fully captures their subjective understanding? We begin our analysis of this question by identifying some considerations that affect the choice of contractual formulations.

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negotiation, drafting, and the like, but also the effects of "error": the social costs that arise when the contractual provision fails to resolve correctly an anticipated contingency. Furthermore, contracting parties can be expected to invest in precautionary measures, such as alternative formulations, up to the point where such precautionary expenditures equal the expected cost of formulation error.

2. *The Communication and Definition Functions of Contracts*

To the extent that the law permits parties to choose from an array of alternative formulations, it also allows the parties to make mistakes in those choices. In visualizing exactly how things can go wrong, it is helpful to view contracts essentially as collections of conditional instructions. Contractual terms first *communicate* to the parties what consequences are to occur if certain conditions are met and then, when those conditions become actualities, *define* for the state the appropriate consequences. Payments, delivery of goods, recourse to remedies, etc., are all examples of consequences triggered by what are supposed to be well-defined linkages to precipitating events or contingencies. If a particular set of contingencies materializes, then the outcome should be predictable. This is, of course, a formal way of capturing what the law regards as the intent of the parties about the performance that is to follow when certain conditions are met. If the instructions that make up contracts were ideally formulated, then the only uncertainty associated with contractual results would concern the probability of the contingencies themselves and not the execution of the instructions. The agreement would then be a legally defined and mutually communicated assignment of risks contingent on future events. Such a complete contingent contract[10] is the ideal of contractual "reliability."

By contrast, formulation error is revealed when the occurrence of a contingency produces surprising (and unintended) consequences, suggesting that the instructions embedded in the contract are defective.[11] These defects, in turn, may be failures of either the communication or definition function of the contractual formulation. Whether the contract is properly communicative depends critically on subjective perceptions of the parties. While these subjective understandings are dispositive for the overwhelming majority of contracts, the state's definitional powers may override the communicative content in that fraction of contracts submitted to external adjudication.

3. *A Typology of Formulation Error*

The first step in discussing responses to the risk of formulation error is to understand precisely how the types of errors differ. For instance, certain formulations are said to be "ambignous," "indefinite," or the

10. The perfectly contingent contract is a paradigm in which parties in a bargaining situation are presumed able, at reasonable cost, to allocate explicitly the risks that future contingencies may cause one or the other to regret having entered into an executory agreement. Its polar opposite is the "relational" contract, in which one or more future contingencies are peculiarly intricate or uncertain, thus preventing accurate allocation of risks at the time of contracting. *See generally* Goetz & Scott, *Relational Contracts*, *supra* note 4, at 1089-92.

11. Formulation error is revealed only when a disappointed party contends that a subsequent interpretation of the contract deviates from the original expectation.

product of "mistake." While such labels generally describe what can go wrong, they are themselves imprecise. By building on the notions of communicative and definitive functions just discussed, we can clarify the different ways in which contractual signals may be defective. A more careful typology of errors suggests that both the state and private parties are responding to a number of conceptually distinct problems of contract formulation.

a. Administrative Error

Perhaps the simplest form of formulation error is the accidental or mechanical failure that results in omission or distortion of a clearly intended formulation. For example, a written contract may be inaccurately transcribed by inadvertent omission of a clause or key words, or misstatement of a price or date. Little elaboration is necessary about such "administrative error." Administrative errors are usually easily recognizable although, alas, not always detected in time.[12]

Any contractual device that simplifies the operations required to express a formulation also reduces the risk of administrative error. Hence, a preprinted standard-form contract is advantageous in that the scope for administrative errors is minimized. Better yet are preformulated terms, which are never subject to purely administrative error: they are either implied terms that need not be printed or legally conventionalized contractual terms of art that may be expressly invoked by the parties. Both are concise alternatives to wordy and error-prone individualized formulations.

b. Ambiguity

The term "ambiguous" is loosely applied to describe a variety of formulation difficulties. Our intention is to use the term more narrowly, to focus on the precision of contractual terms. When a single instruction has more than one possible meaning, the same set of factual conditions may generate alternate sets of prescribed consequences.[13] When un-

12. Ordinarily, the "mistake" that produces an administrative error is readily recognizable, i.e., "mutual." Thus, either party is entitled to have the written agreement reformed to express the original intention, so long as third parties are not "unfairly affected." *See, e.g.*, RESTATEMENT OF CONTRACTS § 504 illustration 1 (1932). The same result would occur under the Second Restatement as well. *See* RESTATEMENT (SECOND) OF CONTRACTS § 157 (1979). The reformation remedy is granted only after proof of a discrepancy between the parties' understanding and their written expressions of it. Furthermore, the courts are reluctant to "make a new contract" for the parties, and thus require that the discrepancy be established by clear and convincing evidence. *See, e.g.*, Progressive Mut. Ins. Co. v. Taylor, 35 Mich. App. 633, 193 N.W.2d 54 (1971); Ross v. Food Specialties, 6 N.Y.2d 336, 160 N.E.2d 618, 189 N.Y.S.2d 857 (1959).

13. Courts often do not distinguish between "vague" and "ambiguous" terms. A typical judicial definition of ambiguity includes, for example, any term or word that is "capable of more than one sensible and reasonable interpretation or has no definite significance," Ross Bros. Constr. Co. v.

resolvable controversies arise over the meaning of "ambiguous" contractual language, the parties must resort to an external dispute-resolution mechanism with its own criteria for interpretation.[14]

Ambiguity in contractual instructions is normally unintended, i.e., it is surprising to the parties involved. In most instances, had the possibility of the dispute-triggering conditions been pointed out in advance, the parties could have reformulated the terms so as to remove the ambiguity—and would have preferred so to rectify the error. Focus on the unintentional case has perhaps obscured the analysis of situations in which the parties *deliberately* use vague or "indeterminate" formulations.[15]

State *ex rel* Transp. Comm'n, Highway Div., 59 Or. App. 374, 650 P.2d 1080 (1982). More narrowly, however, a word is vague to the extent that it can apply to a wide spectrum of referents, or to referents that cluster around a modal "best instance," or to somewhat different referents in different people. *See, e.g.*, Frigaliment Importing Co. v. B.N.S. Int'l Sales Corp., 190 F. Supp. 116 (S.D.N.Y. 1960) ("chicken" is stewing chicken, as seller contends, rather than the broiler or fryer chicken); Highley v. Phillips, 176 Md. 463, 5 A.2d 824 (1939) (provision for removal of "all the dirt" on a tract included sand from a stratum of subsoil). Linguistically, ambiguity requires at least two distinct, usually inconsistent meanings. *See, e.g.*, Petroleum Fin. Corp. v. Cockburn, 241 F.2d 312 (5th Cir. 1957) (telegram lacking punctuation that would ordinarily be supplied in a letter permits differing readings); Raffles v. Wichelhaus, 159 Eng. Rep. 375 (1864) (the celebrated case of two ships named "Peerless," sailing from Bombay several months apart). Most language is vague in the sense that the set of objects to which a word applies is rarely delineated with absolute precision, but true syntactic ambiguity occurs only infrequently. This distinction is sometimes expressed in terms of "latent ambiguity" (the Peerless case) and "patent ambiguity" (uncertainty of meaning or vagueness). *See, e.g.*, W. ANSON, PRINCIPLES OF THE LAW OF CONTRACT 150 (18th ed. 1939); D. McDONNELL & J. MOORE, KERR ON FRAUD AND MISTAKE 171 (7th ed. 1952). Professor Young suggested substituting "equivocation" for patent ambiguity since it "was not yet burdened with legal signification." Young, *Equivocation in the Making of Agreements*, 64 COLUM. L. REV. 619, 626-34 (1964). Regardless of the label used, the distinction is relevant to our separate discussion, in the text below, of "indeterminate" instructions. *See infra* text accompanying notes 151-60.

14. Courts do perform this function, but their use of interpretive criteria is problematic. For instance, uncertainty persists over the relative weight to be given the "plain meaning" of the parties' express language and various types of contextual evidence that qualify or alter the "ordinary" meaning of the express terms. Hence, parties face some uncertainty about the applicable criteria for resolving ambiguity. *Compare In re* Soper's Estate, 196 Minn. 60, 264 N.W. 427 (1935) (extrinsic evidence admissible to show that the word "wife" did not refer to deceased's legal wife but to woman with whom he was living at death), *with* Dixon, Odom & Co. v. Sledge, 59 N.C. App. 280, 296 S.E.2d 512 (1982) (extrinsic evidence not admissible to establish that "former client" in separation agreement did not include a client who had previously left the firm before approaching the withdrawing partner). The sources of (and solutions for) this current confusion over interpretive criteria are analyzed in Part III below. *See also infra* note 19 and accompanying text.

15. *See infra* text accompanying notes 151-60. Terms may deliberately be left ambiguous or imprecise as a "lesser of evils" expedient. In relational contexts, for example, parties may agree to use "best efforts" or behave "reasonably" or act in "good faith" because they are incapable of anticipating—much less resolving—all future contingencies. Here, what is being called for is not interpretation of the particular terms, but equitable "filling in of the blanks" in light of conditions that were difficult to anticipate or describe in advance. *See, e.g.*, C. STEVENSON, ETHICS AND LANGUAGE 208 (1944) ("[O]ne of the chief functions of [imprecise] words is that they can be adapted to this or that specific purpose, as occasion requires."). This "adapter" need not, of course, be a court of law. An arbitrator may offer specialized expertise or more sensible dispute-resolution criteria than a state-supplied judge. Properly speaking, of course, such indeterminate instructions should be described as deliberately "vague" rather than "ambiguous." *See supra* note 13.

c. Incompleteness

When a contract fails to provide for a contingency, unintended results may occur. This "incompleteness error" typically occurs when the parties inadvertently overlook a potentially important, but low probability contingency.[16] Incompleteness errors in contracts are analogous to "bugs" in computer software: the program functions correctly until it encounters an unanticipated combination of operational conditions. The sudden popularity of CB radios in the mid-1970s, for instance, revealed a "bug" in many automobile insurance policies. Expensive and vulnerable add-on automotive equipment, such as stereo players, had been excluded from coverage, but the policy language did not anticipate CB units. Insurance companies were forced to cover the unforeseen risk until the "bug" could be fixed at the next cycle of policy renewals. Note that contractual instructions, although incomplete, may nonetheless specify a perfectly well-defined and clear result for each contingency, as in the example of the insurance companies who were bound to pay for stolen CB equipment. If the possibility of some contingency was not foreseen at the formulation stage, however, the resulting assignment of consequences will nonetheless be unintended and surprise at least one of the parties.

Incompleteness is not inevitable even when the express instructions of the parties fail to allow for a particular contingency. Parties implicitly incorporate the standard rules of contract law into their agreement. Indeed, a key purpose of state-supplied terms is to save parties from the necessity of formulating a complete set of express conditions for contingencies that may be difficult to anticipate, or are at least easily overlooked. Thus, many of the general rules of contract, such as those of impossibility and excuse, impose constructive conditions that reduce incompleteness risks.[17] These supplementary rules of contract do not re-

16. Errors caused by incomplete instructions are frequently manifested by a claimed excuse from a contractual obligation because of mistake of fact or impracticability. For example, *compare* RESTATEMENT (SECOND) OF CONTRACTS § 152 (1979) (When Mistake of Both Parties Makes a Contract Voidable), *with id.* § 266 (Existing Impracticability or Frustration). Illustrative cases include Mishara Constr. Co. v. Transit-Mixed Concrete Corp., 365 Mass. 122, 310 N.E.2d 363 (1974) (failure to provide for labor dispute); Krell v. Henry, [1903] 2 K.B. 740 (failure to provide for the illness of King Edward VII); Howell v. Coupland, [1876] 1 Q.B.D. 258 (failure to provide for crop failure). In general, courts will complete the instructions with a preformulated legal norm whenever the contingency in question was reasonably foreseeable.

17. *See generally* Young, *supra* note 13. The standard gap-filling or supplementary role of contract rules is well established in the common law. Holmes, for example, offers the illustration of the lecturer who agrees to speak without mentioning the time: "One of the parties thinks that the promise will be construed to mean at once, within a week. The other thinks that it means when he is ready." Holmes resolved this "incompleteness" problem by affirming the contract, the lecturer to appear in a reasonable time. Holmes, *The Path of the Law*, 10 HARV. L. REV. 457, 464 (1897).

move all incompleteness, however; they are necessarily generalized formulations that do not purport to address every set of circumstances.

d. Inconsistency

Inconsistency errors occur when a contract contains separate instructions that arguably compel conflicting results for the same set of conditions. Whereas incompleteness errors are the result of underproviding contractual instructions, inconsistent terms are a result of overprovision. In one illustrative case, for example, inconsistency existed between the alleged understandings that unloading and storage charges were to be paid by the buyer and an "F.A.S." term which normally indicates that the seller pays.[18] Although the courts and parties may attempt to resolve the apparent logical contradiction by asserting ambiguity, that label is frequently a misnomer. Especially when the conflict is between express and implied terms, framing the problem as one of inconsistency is more helpful at raising the underlying issues, which involve competing priorities or hierarchies of rules rather than "meanings" of terms.[19]

e. Interpretation Error

When their own communication errors cause the parties to understand their agreement in diverse ways, the state's subsequent defining of the disputed terms will necessarily conflict with at least one party's intent. In addition to such errors precipitated by the parties themselves, the state may in effect superimpose new and thus "erroneous" instructions on an original formulation that was well understood between the parties but disputed for strategic motives. Such errors will occur when the court either enforces terms that were almost certainly not contemplated by either party or refuses to enforce terms that were. Cases that have implied a warranty of habitability into residential leases are frequently cited as examples of the former variety of error,[20] while cases that have refused to acknowledge the enforceability of requirements and

18. Brunswick Box Co. v. Coutinho, Caro & Co., 617 F.2d 355 (4th Cir. 1980) (evidence of course of performance admissible to vary standard meaning of F.A.S. term in written contract).

19. Disputes over arguably inconsistent terms often center on the appropriate interpretation of Uniform Commercial Code sections 1-205(4) and 2-202, which address apparent conflicts between express terms and usages of trade, courses of dealing, and other context evidence. Although both provisions purport to favor express terms in cases of conflict, the cases betray substantial variance. *E.g., compare* Columbia Nitrogen Corp. v. Royster Co., 451 F.2d 3 (4th Cir. 1971) (usage controls), *with* Southern Concrete Servs. Inc. v. Mableton Contractors, Inc., 407 F. Supp. 581 (N.D. Ga. 1975) (express term controls), *aff'd*, 569 F.2d 1154 (5th Cir. 1978). For a discussion of the relationship between express terms and the contractual context, see Kirst, *Usage of Trade and Course of Dealing: Subversion of the U.C.C. Theory*, 1977 U. ILL. L.F. 811.

20. *See* Pugh v. Holmes, 253 Pa. Super. 76, 384 A.2d 1234 (1978), *aff'd*, 486 Pa. 272, 405 A.2d 897 (1979).

best-efforts contracts are illustrations of the latter.[21]

Some instances of imposed error reflect deliberate substitutions of the state's will for that of the parties. More frequently, however, the state creates "interpretation error" by inadvertently failing to extract the "correct" meaning from the signals that the parties have given. Indeed, the inherent fallibility of the interpretive process generates an irreducible risk of error. In recent years, courts have vacillated between an extreme interpretive focus on narrow "plain meaning" and the opposite norm of loose contextual construction.[22] Regardless of the mode of contractual interpretation adopted by the state, ex post interventions that seek to accommodate both express and implied formulations threaten instead to redefine dramatically the nature of the bargain.[23]

f. Ill-Fitting Formulations

The brief descriptions of the foregoing categories may already have suggested that there will frequently be practical tradeoffs among the different categories of formulation error. Indeed, if the desired substantive exchange of the parties is sufficiently difficult to formulate, and the residual risk of error sufficiently high, one risk-reducing strategy is to rely on "ill-fitting" formulations that admittedly do not produce the desired exchange. Thus, parties may adapt to a risky environment by using safe but inexact formulations.[24] When this occurs, the potential gains from trade are not fully exploited.

We can now state concisely the central premise of our conceptual framework: We assume that contracting parties attempt to minimize the aggregate costs of coping with the various types of formulation errors described above.[25] In selecting suitable instruments to accomplish this objective, the contractors face two pivotal choices: first, whether to rely on implied or express formulations; and second, whether to accept standardized formulations or attempt to design unconventional alternatives. Unfortunately, as the following sections will show, these formulation

21. *See, e.g.*, Joliet Bottling Co. v. Joliet Citizens' Brewing Co., 254 Ill. 215, 98 N.E. 263 (1912); Bay v. Bedwell, 21 S.W.2d 203, 205 (Mo. Ct. App. 1929).

22. *See infra* text accompanying notes 118-27.

23. *See infra* cases cited in note 78 and accompanying discussion.

24. A classic example of the use of ill-fitting formulations is the adoption of admittedly overbroad warranty disclaimers by many sellers of computer software. In a published letter to a trade magazine, the president of Signature Software Systems acknowledged that the firm in fact was willing to—and de facto did—guarantee the efficacy of its programs to users, but nevertheless used a particular broad-based warranty disclaimer and licensing form because it had been previously litigated by another firm and thus definitively interpreted by a court. Otten, *Warranty Pirates*, BYTE, Mar. 1983, at 22 (letter to editors). This phenomenon is elaborated *infra* in text accompanying note 83.

25. Of course, aggregate costs include the resource costs of drafting, negotiation, and the like. We contend, however, that these costs are relatively insignificant in comparison to the costs of error.

mechanisms affect the different types of errors in potentially conflicting ways.

B. The Function of Implied Formulations

1. The Expanding Sources of Implied Terms

Until recently, the state had a relatively restrained role in developing contractual formulations. The traditional common law interpretive approach, as reflected in the parol evidence and plain-meaning rules, focused intensively on the written agreement.[26] If the writing appeared to be a complete (integrated) expression of the parties' intent, the common law parol evidence rule barred introduction of extrinsic evidence to contradict or supplement the written terms. The rule thus fixed the integrated document as the sole subject for interpretation.[27] Only the limited set of judicially or legislatively recognized rules of contract law would be automatically incorporated into the agreement, and only such of them as were not preempted by the express terms.[28] In addition, the traditional plain-meaning rule barred parties from using extrinsic evidence to aid interpretation: if the document appeared clear and unambiguous in its terms, its meaning was to be determined from the four corners of the instrument, without resort to extrinsic evidence.[29]

The common law rules thus strained mightily to avoid confronting many of the sources of formulation error just described, relying on the

26. *See* Farnsworth, *Disputes over Omission in Contracts*, 68 COLUM. L. REV. 860, 862-64 (1968); *see also* Henrietta Mills, Inc. v. Commissioner, 52 F.2d 931, 934 (4th Cir. 1931) ("The courts will not write contracts for the parties to them nor construe them other than in accordance with the plain and literal meaning of the language used."). As we discuss *infra* in Part III, this traditional view continues to have loyal adherents. *See, e.g.*, Columbia Broadcasting Sys. v. Capital Cities Communications, Inc., 301 Pa. Super. 557, 570, 448 A.2d 48, 54 (1982) ("[N]o extrinsic evidence may be introduced in an attempt actually to alter, amend, add to, or detract from the terms of the contract as written.").

27. *See, e.g.*, Mitchill v. Lath, 247 N.Y. 377, 381, 160 N.E. 646, 647 (1928) (in order for evidence of a prior oral agreement to be admissible, "an inspection of the written contract, read in the light of surrounding circumstances must not indicate that the writing appears 'to contain the engagements of the parties' "); RESTATEMENT OF CONTRACTS § 237 (1932) (Parol Evidence Rule); *see also* Board of Trade v. Swiss Credit Bank, 597 F.2d 146, 148 (9th Cir. 1979) (ambiguity is necessary to admission of usage evidence). This case is but one example of the continuing influence of the traditional common law approach. *See infra* text accompanying notes 123-25.

28. *See, e.g.*, Smith v. Abel, 211 Or. 571, 593, 316 P.2d 793, 803-04 (1957) ("While custom (if sufficiently shown) might be used to interpret an ambiguous term of the contract, it could not be used to make a contract or to add to or contradict the terms of the contract.").

29. *See* McBaine, *The Rule Against Disturbing Plain Meaning of Writings*, 31 CALIF. L. REV. 145 (1943). As we discuss below, despite the endorsement of expansive resort to context in the Code and Second Restatement, the plain-meaning rule continues to be invoked by many courts in order to bar the use of extrinsic evidence in interpretation. This tension over appropriate methods of interpretation symptomizes the continuing failure to appreciate the dynamics of contractual formulation. *See* cases cited *infra* in notes 123-25 and accompanying text.

maxim "the courts do not make a contract for the parties."[30] At least as evidenced by the language of their written formulations, however, parties frequently seemed to make very bad contracts for themselves. Pressure mounted steadily to imply informal understandings and usages into contracts.[31] The dam, which had begun to leak earlier in the twentieth century, finally burst with the adoption of the Uniform Commercial Code, the triumph of a dramatically changed, activist approach that has come to permeate other aspects of contract law as well.[32]

The Code, now joined by the Second Restatement of Contracts, effectively reverses the common law presumption that the parties' writing and the official law of contract are the definitive elements of the agreement. Evidence derived from experience and practice can now trigger the incorporation of additional, implied terms. The Code, for example, explicitly recognizes that the content of an agreement includes trade usages, prior dealings and the parties' experience in the performance of the contract.[33] Indeed, the parol evidence rule under the Code and the Second Restatement admits inferences from trade usage, prior dealings, and performance even if the express terms of the contract seem perfectly clear and are apparently "integrated."[34] Once proven, privately generated implied terms are accorded essentially the same status as state-supplied official formulations and must be explicitly preempted if they are not to apply.[35]

The Code thus implies as a state-supplied term any prevailing commercial practice in any recoguizable class of transactions; the prevalent contractual patterns in a trade environment automatically become im-

30. *See, e.g.*, Agnew v. Lacey Co-Ply, 33 Wash. App. 283, 288, 654 P.2d 712, 715 (1982) ("A court may not create a contract for the parties which they did not make themselves.").

31. *See* Levie, *Trade Usage and Custom Under the Common Law and the Uniform Commercial Code*, 40 N.Y.U. L. REV. 1101, 1102-04 (1965).

32. *See, e.g.*, RESTATEMENT (SECOND) OF CONTRACTS § 204 (1979) (Supplying an Omitted Essential Term); *id.* § 221 (Usage Supplementing an Agreement); *id.* § 222 (Usages of Trade); *id.* § 223 (Course of Dealing).

33. " 'Agreement' means the bargain of the parties in fact as found in their language or by implieation 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)." U.C.C. § 1-201(3) (1978).

34. Comments to the Code state that:

> This section definitely rejects . . . the requirement that a condition preeedent to the admissibility of [evidence of course of dealing, usage of trade or course of performance] is an original determination by the court that the language used is ambiguous. [§ 2-202(a)] makes admissible evidence of course of dealing, usage of trade and course of performance to explain or supplement the terms of any writing stating the agreement of the parties in order that the true understanding of the parties . . . may be reached.

U.C.C. § 2-202 comments 1, 2 (1978). *See also* RESTATEMENT (SECOND) OF CONTRACTS § 220 comment d, § 222 comment b, § 223 comment b (1979).

35. "Such writings are to be read on the assumption that the course of prior dealings between the parties and the usages of trade were taken for granted when the document was phrased. Unless carefully negated they have become an element of the meaning of the words used." U.C.C. § 2-202 comment 2 (1978).

plied formulations.[36] Similarly, devices now exist for creating implied formulations that are individualized to the parties. A course of dealing between the parties,[37] for example, establishes "a common basis of understanding for interpreting their expressions and other conduct."[38] A course of conduct after or under the agreement has similar significance.[39] An inference drawn either from a course of dealing or from performance under the present contract trumps an inconsistent trade usage.[40] The primacy of the more individualized implied terms is based on the assumption that the parties themselves know best what they meant by their contractual formulations, and that their actions before and under the agreement are the best indication of their meaning.

The process of implying terms from more narrowly focused experiences places a significant stress on the state's interpretive process. Whereas the court generally infers alleged industry-wide trade practices

36. The Code identifies the sources of unofficial (i.e., privately created) supplementary norms in some detail. *See, e.g.*, U.C.C. § 1-205(2) (1978) ("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.").

Assuming that such usages can be shown to exist, what is the "jurisdiction" of these unofficial preformulations? Under pre-Code law, a trade usage did not apply to a party who was not a member of the trade unless he actually knew of it or the other party could reasonably believe he knew of it. White and Summers observe that

> [t]his view has been carried forward by § 1-205(3). . . . [U]sage of trade is only binding on members of the trade involved or persons who know or should know about it. Persons who should be aware of a trade usage doubtless include those who regularly deal with members of the relevant trade, and also members of a second trade who commonly deal with members of the relevant trade (for example, farmers should know something of farm equipment selling).

J. WHITE & R. SUMMERS, HANDBOOK OF THE LAW UNDER THE UNIFORM COMMERCIAL CODE § 12-7, at 457 (2d ed. 1980).

But the same commentators also note that requirements for proving a usage are "far less stringent" than were the old common law requirements for custom. A usage of trade need not be well-known, let alone universal, if it is sufficiently regular that the factfinder can draw an inference that the parties would expect it to be observed. *Id.* § 3-3, at 103; *see also* RESTATEMENT OF CONTRACTS § 247 comment b (1932); 5 S. WILLISTON, A TREATISE ON THE LAW OF CONTRACTS § 661, at 113-18 (3d ed. 1961); Warren, *Trade Usage and Parties in the Trade: An Economic Rationale for an Inflexible Rule*, 42 U. PITT. L. REV. 515, 574-75 (1981).

37. A course of dealing is "a sequence of previous conduct between the parties to a particular transaction." U.C.C. § 1-205(1) (1978).

38. *Id.*; *see also* RESTATEMENT (SECOND) OF CONTRACTS § 223(1) (1979) (same language). Unless "carefully negated," the course of prior dealings between the parties becomes a fully operative element of the parties' agreement. U.C.C. § 2-202 comment 2 (1978); *see also* RESTATEMENT (SECOND) OF CONTRACTS § 223(2) comment b (1979) (same). Indeed, course of dealing is attributed greater weight than usage of trade, since dealings evidence arrangements between the two parties to the contract. U.C.C. § 1-205(4) (1978); *see also* RESTATEMENT (SECOND) OF CONTRACTS § 203(b) (1979) (same). The relevance of individualized context was, of course, recognized prior to the Code and Second Restatement. *See, e.g.*, 3 A. CORBIN, CORBIN ON CONTRACTS §§ 555-556 (1963); 5 S. WILLISTON, *supra* note 36, § 660.

39. U.C.C. § 1-205 comment 2 (1978).

40. U.C.C. § 2-208(2) & comment 1 (1978); *see also* RESTATEMENT (SECOND) OF CONTRACTS § 203(b) (1979) (same).

from a considerable mass of behavioral data, the alleged patterns in the behavior of particular parties may be derived from a quite limited number of occurrences. The number of observations may be so small that an observer would have difficulty distinguishing valid inferenees from spurious ones. Courts experience grave difficulty determining the degree of repetition necessary to establish a "course" of conduct.[41] Similarly, it may be difficult to determine whetlier a particular act sheds light on the *ex ante* meaning of the agreement or merely represents an *ex post* waiver of a term of the agreement. The finder of fact must engage in an error-prone inquiry whether the acts were ambiguous and, if not, whether they constitute a course of performance or waivers—unpatterned instances from wliich no inferences can be drawn.[42]

A number of courts have recognized informal commercial practices in the course of interpreting disputed contracts. However, the tide of expansive implication lias not swept away the restrained approach of the common-law tradition. The two systems, continuing in an uneasy coexistence, provide an opportunity to study how changes in the supply of implied terms affect the risks of formulation errors.

2. *The Effects of Expanding the Supply of Implied Terms*

a. *Customs and Usages: Reducing Error from Ill-Fitting Formulations*

Many provisions of executory contracts are commonly implied from standard state-supplied rules of contract, such as the rules specifying the detail and standard of performance, the remedies for nonperformanee, or the unforeseen contingencies which will excuse furtlier obligation. These standard rules are designed for general application; they are often incongruent with the shifting needs of various classes of specialized eontractors.[43] Because they evolve slowly, official rules necessarily lag behind the emergence of new conditions, resulting in increasingly ill-fitting formulations. By implying a variety of terms derived from the general com-

41. Although the Code requires more than a single instance ("A single occasion of conduct does not fall within the language of this section"), it supplies no furtlier guidance on liow many acts are needed. U.C.C. § 2-208 comment 4 (1978).

42. While the Code does express a preference for the waiver interpretation, tliis preference operates only if the interpretation is doubtful. If this problem arises, "tlie preference is in favor of 'waiver' whenever such construction, plus the application of the provisions on the reinstatement of riglits waived . . . is needed to preserve the flexible character of commercial contracts and to prevent surprise or other hardship." *Id.* comment 3 (1978).

43. To be sure, when the state perceives the needs of such contractors as sufficiently important, it may adopt special purpose rules for particular subsets of transactions. For example, for tlie cases of personal services, sales, government contracts, and construction projects, the state lias provided specialized rules that supplement or replace the standard formulations. But tlie judicial and legislative processes by which such special-purpose rules evolve tend to be relatively slow and to operate only for fairly general subsets of transactions.

mercial environment, the state expands the supply of widely useful, standard forms of agreement. These include, for example, trade usages regarding the existence of warranties,[44] commonly accepted quality tolerances,[45] and circumstances under which price and quantity terms that appear to be fixed are in fact subject to some variation.[46] These "customary" formulations serve as general standards for particular sets of transactions, thus reducing the error caused by reliance on ill-fitting official formulations.

Custom and usages are, in effect, an additional set of general patterns, reflecting a collective wisdom and experience about certain specialized understandings. These patterns are "prototypes" in both of the traditional senses of that word: more importantly as archetypes, models or patterns; but also as temporal precursors to possible formal legal "recognition."[47] Patterns that gain acceptance within a particular market or sub-market will ultimately emerge as additions to the array of state-supplied terms. Legal recognition will occur, for instance, when a court holds a relevant trade practice to be a controlling factor in an interpreta-

44. A typical example is the obligation to provide pedigree papers in contracts for sale of purebred animals. Under § 2-314(3) of the Code, such a usage or course of dealing concerning the standard of quality of goods sold creates an implied warranty that supplements the "official" implied warranty of merchantability. Just as with legislatively supplied terms, such a warranty automatically becomes part of the contract unless properly disclaimed. U.C.C. § 2-314 comment 3 (1978).

45. *See, e.g.*, Ambassador Steel Co. v. Ewald Steel Co., 33 Mich. App. 495, 190 N.W.2d 275 (1971) (trade usage that "commercial quality" steel requires a carbon content between 1010 and 1020).

46. *See, e.g.*, Columbia Nitrogen Corp. v. Royster Co., 451 F.2d 3 (4th Cir. 1971) (usage and course of dealing admitted to show that express price and quantity terms were not exact, but projections to be adjusted according to market forces). *But cf.* Southern Concrete Servs., Inc. v. Mableton Contractors, Inc., 407 F. Supp. 581 (N.D. Ga. 1975) (evidence of trade usage to modify quantity term in integrated writing excluded by court under parol evidence rule), *aff'd*, 569 F.2d 1154 (5th Cir. 1978).

47. Unlike legal rules that are implied unless specifically countermanded, private prototypes must be incorporated, formally or informally, into the agreement by the parties. Formal incorporation occurs when parties make a particular pattern an express part of their writing. Informal prototypes are mere tacit understandings and are not explicitly expressed. An important feature of such informally adopted contractual patterns is that they normally lack legal enforceability unless the state provides a recognition mechanism. Of course, lack of legal enforceability does not necessarily prevent informal terms from heavily influencing their commercial environments. In fact, the primacy of such informal norms gives currency to the widely held view that the express terms of a commercial contract "don't matter," since the parties appear constrained almost entirely by custom and usage. An alternative characterization of such contracts is that the express terms are merely relatively insignificant in comparison to those implied. "Ordinary" contractors in such markets can reasonably begin each transaction with the assurance that the mere indication of intention to create a legal relationship will trigger the imposition of standards common to the industry or trade.

Professor MacCauley is the most notable champion of the view that commercial relationships are largely governed by "social," as distinct from "legal" norms. *See* MacCauley, *Non-Contractual Relations in Business: A Preliminary Study*, 28 AM. SOC. REV. 55 (1963); *see also* Klein & Leffler, *The Role of Market Forces in Assuring Contractual Performance*, 89 J. POL. ECON. 615 (1981). We would argue, of course, that the distinction is largely illusory. The unofficial or other context-generated understandings might be legally enforceable, implied terms.

tion dispute. Thereafter, the trade usage will constitute an implied term for all transactions within the relevant category.[48] This evolutionary process produces an expanding supply of mature, customary formulations that individual parties could not replicate merely by the expenditure of additional time and effort. For most parties, such implied terms are not only *cheaper*, but they are also *better* than do-it-yourself ones.

The expanded menu of customary implied terms thus allows more parties to choose contractual formulations that closely fit their ideal transactional relationship. Furthermore, despite the distinctive benefits of customary formnlations, there are several reasons why private contracting parties wonld be hesitant to develop such formulations themselves. First, parties who develop innovative forms bear significant, exogenous, legal risks. Since the legal system retains ultimate power over interpretation and enforcement, parties cannot be certain what effect will be given to any formulation until it is tested.[49] Second, the process of contractual formulation is subject to inherent endogenous hazards that emerge and undergo correction only over time. Accumulated experiences are therefore very important in shaping customary contractual prototypes.

Formulations that survive this quasi-Darwinian evolutionary process become mature conventions whose risks and performance characteristics are known. A new or emerging formulation is risky because it has not been sufficiently tested for various types of formulation errors. A celebrated example of the hazards of immature conventions is *Frigaliment Importing Co. v. B.M.S. International Sales Corp.*[50] That case in-

48. Importing usages and dealings into a contract provides a means of giving recognized legal status to sets of privately provided, special-purpose formulations having limited "jurisdiction." Courts are directed to infer these rules from the patterned behavior of types of traders and of individual parties. Whatever its practical difficulties, this inquiry falls within the traditional realm of judicial factfinding. A different problem arises once a usage has been established. Thereafter, its underlying rationale—and therefore its proper application to any particular set of circumstances—may be misunderstood.

It is well-settled that application of the official rules of contract to the particular facts of a case is a "matter of law" to be undertaken by the judge. This includes the application of basic prineiples of interpretation to the evidence as well. *See, e.g.*, Ross Bros. Constr. Co. v. State *ex rel* Transp. Comm'n, Highway Div., 59 Or. App. 374, 650 P.2d 1080 (1982) (threshold determination of ambiguity remains a legal question for the court). The rationale for this rule is plain. The correct application of black-letter law is a matter of some sophistication, requiring knowledge of the underlying purposes of the rules and their manner of interaction. Traditionally, therefore, many matters of rule application were withheld from the jury.

Little attention has been paid, however, to the problem of construing unofficial rules. The Code dictates that "[i]f it is established that . . . a usage is embodied in a written trade code or similar writing the interpretation of the writing is for the court." U.C.C. § 1-205(2) (1978). Exactly who may construe an *unwritten* trade usage or other "unofficial" norm is, however, an open question.

49. It is this interpretive risk that provides the key link between the development of contractual formulations and contractual interpretation.

50. 190 F. Supp. 116 (S.D.N.Y. 1960).

volved an apparently straightforward attempt to formulate a contract for several hundred thousand pounds of chicken using a combination of express terms and emerging trade patterns. Although some of the defining patterns used were mature, and therefore reliable, the tentative status of others rendered the precise definition of "chicken" uncertain.[51] As *Frigaliment* illustrates, the production of well-validated, mature formulations is a costly, error-prone process.

b. *Courses of Dealing and Performance: Reducing Incompleteness Error*

In addition to incorporating broadly based contextual patterns, the state may also import into the legal agreement particularized experiences, such as courses of dealing or performance. This additional aspect of the implication process reduces those formulation errors caused by recourse to express contractual signals. Implying particularized terms avoids the administrative errors and the ambiguities in expression that frequently result when understandings are reduced to express terms. Moreover, a course of dealing or performance also reduces what we have described as incompleteness error. Many low-probability contingencies are unlikely to be addressed expressly in typical executory contracts. These events are too uncertain, and their interaction too complex, for individual bargainers to provide for them by express contractual terms. But repeated experience with low-probability events tends to reveal patterns of behavior between the parties. When the transactions between parties involve repeated occasions for performance, courts can look to these highly focused experiences as a source of implied terms in subsequent interpretive disputes between the same parties. By increasing the supply of party-specific terms, the state thus promotes reductions in incompleteness risks.

3. *Underlying Tensions in the Implication Process*

The various aspects of the implication process are not wholly complementary. Indeed, there is an inherent tension between the expansive incorporation of the particularized contractual context and the evolution of customary formulations that are widely useful for many contractors. The incorporation of party-specific context may reduce the risk of incompleteness error, but it also retards the adaptive evolution of the custom

51. There exist well-established categories of chickens such as "broilers," "roasters," "fryers," and "stewing chicken." The problem was whether the generic word "chicken" was used in the agreement to embrace all of these categories, as the seller contended, or, as the buyer argued, to exclude stewing chicken, which it referred to as "fowl." Reference to usage—common trade understandings as well as courses of dealing and performance between the parties—was insufficient to satisfy the buyer's burden of proof.

and usage formulations that would otherwise emerge as prevalent contractual norms. In order for a customary formulation to evolve, it must become widely acceptable as a standard form of agreement. Highly specified and particularized formulations, implied from the narrowly focused evidence of courses of performance and dealing, undercut the appeal of general-purpose formulations designed for broad categories of transactions. Since parties will have less frequent recourse to widely used prototypes if the implication process becomes more particularized, the recognition of customary terms having general efficacy will necessarily decline.

Conversely, an expanded supply of customary terms tends to undermine the reliability of the more specialized implied terms derived from courses of dealing and performance. The risk of interpretation error increases if the decisionmaker must rationalize individualized terms with customary contractual norms. This interpretive tension results in inconsistencies between contractual signals and thus generates offsetting costs.

The precise empirical effects of expanding the implication process remain uncertain. But when the state attempts to minimize the costs of formulation error by providing contractors with a complete array of implied terms, there is a tradeoff between different types of error as the implication process is extended to include both generalized and particularized experiences. Customary terms reduce the distortion from ill-fitting formulations but expose parties to incompleteness risks. Conversely, more particularized terms will reduce incompleteness error but at the cost of a reduced supply of mature, customary formulations. To be sure, there are initial gains in error reduction generated by a wider array of implied terms. But the generalized/particularized tradeoff suggests that, beyond a point, further state intervention is unlikely to yield cost-effective reductions in formulation error. Since the various types of error are sensitive to different, potentially conflicting influences, there is a practical limitation on the capacity of implied terms to reduce error costs.

Assume that contracting parties have incorporated the optimal combination of particularized and customary implied terms. In a world without resource constraints, can they effect any further reductions in aggregate error? The Expanded Choice postulate suggests an affirmative answer in theory: parties can alter the state-supplied structure by negotiating additional express terms. They will do so whenever the offsetting effects of implication threaten to limit the benefits of using implied terms. We shall argue, however, that combining express and implied terms raises a number of formidable practical difficulties.

C. The Function of Express Formulations

Given the inability of even the most elaborate state implication of

terms fully to eliminate formulation error, the freedom to disclaim or supplement any state-supplied term seems to offer contracting parties an attractive option. An express agreement enables the parties to signal some combination of supplements or replacements for the implied terms that the law would otherwise impute to the contract. Unhappily, this additional signalling or communication necessarily involves verbal or written symbols that are susceptible to misinterpretation.

1. Express Options: Supplementing and Trumping

Express formulations offer two distinct options for using particularized instructions to enhance a framework of implied terms. The first of these enables one to augment or *supplement* the implied terms ("opting in"). Some supplementary terms are indispensable for each transaction, if only to indicate price, identify goods, or supply similar rudimentary detail. Additionally, supplementary terms may add to and refine the state-supplied terms, explicitly allocating whatever risks of intervening contingencies are incompletely signalled by the array of implied terms. Since supplementary terms address the risks of incomplete agreement, their defining characteristic is that they are not inconsistent with the underlying structure of the state-supplied terms. By contrast, parties sometimes desire to countermand or *trump* one or more of the preformulated provisions ("opting out").[52] The ability to trump implied terms enables contracting parties to restructure the implied bargain when necessary to avoid an ill-fitting formulation.

In principle, therefore, the combination of express supplements and trumps offers contractors a further opportunity to select between generalized and particularized forms, and so reduce errors caused by both incomplete and ill-fitting terms. In exercising one or the other option, however, parties must clearly signal whether they intend merely to enrich the state-supplied terms or desire a result other than that normally inferred from the transactional context. Otherwise, the resulting ambiguity could actually increase formulation error, frustrating the very purpose behind introducing express terms.[53]

2. Invocations

What mechanisms assist parties who seek to differentiate supplementary terms from trumping expressions? We noted earlier that legal recognition—the acknowledgement by a court that a mode of agreement

52. *See, e.g.*, Amoco Prod. Co. v. Texaco, Inc., 415 So. 2d 1003 (La. Ct. App. 1982) (express agreement that defendant would pay delay penalty of 200% of total construction costs trumps context evidence that penalty would be limited to 200% of defendant's 25% share of such costs).

53. The interpretive tension between trumping expressions and the implication of context is further discussed *infra* in text accompanying notes 134-49.

has become prevalent—can trigger the metamorphosis of an emerging formulation into a state-implied norm that parties can countermand only by a clear disavowal. A similar logic applies to the interpretation of terms that have a customary meaning whenever used, even if their use is not so customary as to warrant automatic inclusion as implied terms. Thus, the legal recognition of certain talismanic words and phrases greatly facilitates the process of trumping. Definitional recognition does not change the optional character of these terms. However, it does confer upon them the status of "invocations,"[54] terms that, once deliberately called upon, have a legally circumscribed meaning that will be heavily—perhaps even irrebuttably—presumed. For instance, the Code recognizes a series of preformulated expressions that can be invoked by parties in appropriate circumstances; such expressions as "F.O.B.,"[55] "F.A.S.,"[56] "C.I.F.,"[57] and "as is,"[58] carry predefined legal meanings that permit the parties to escape the contextual interpretation that might otherwise apply.[59] A similar interest in permitting escape from particular contexts motivated "INCOTERMS," the international rules for the interpretation of trade terms.[60] It also motivated the standard form corporate

54. While the term "invocation" has several common meanings, we use it here in the following sense: "the act of calling upon or referring to something, as a concept, document, etc., for support and justification in a particular circumstance." THE RANDOM HOUSE DICTIONARY OF THE ENGLISH LANGUAGE 749 (1969).

An early and clear example of such a mechanism was the common law seal. A sealed promise was enforceable despite evidence of factors such as fraud or duress. *See* Barbour, *The History of Contract in Early English Equity*, in 4 OXFORD STUDIES IN SOCIAL AND LEGAL HISTORY 89 (P. Vinogradoff ed. 1914).

55. *See* U.C.C. § 2-319(1) & comment 1 (1978).

56. *See* U.C.C. § 2-319(2) (1978).

57. *See* U.C.C. § 2-320(1) & comments 1 & 2 (1978).

58. *See* U.C.C. § 2-316(3)(a) & comment 7 (1978). The Code regards "as is," "as they stand" and "with all faults" as synonymous invocations signalling that the buyer takes the entire risk as to the quality of the goods.

59. The meanings given to the Code's predefined invocations are subject to contrary agreement by particular parties. *See supra* notes 55-58. This raises a troublesome question: can a course of dealing or performance establish such a contrary agreement, or may the meaning of the invocation be varied only by a further express understanding? *Compare* National Heater Co. v. Corrigan Co. Mechanical Contractors, 482 F.2d 87 (8th Cir. 1973) (express term "delivered" in purchase order trumped the usual meaning of "F.O.B. point of shipment" in acknowledgement) *with* Steuber Co. v. Hercules, Inc., 646 F.2d 1093 (5th Cir. 1981) (the normal meaning of CIF, that buyer bears risk of unloading goods, can be modified by course of performance and oral agreement that seller would bear unloading risks), *and* Brunswick Box Co. v. Coutinho, Caro & Co., 617 F.2d 355 (4th Cir. 1980) (course of performance trumps F.A.S. term in written agreement). We suggest normative principles of interpretation to resolve this issue *infra* in Part III.

60. *See* INTERNATIONAL COMMERCE COMM'N, INCOTERMS (1980). Each of the fourteen INCOTERMS attempts to set forth a number of substantive rules, including, most importantly, the point at which risk of loss passes from the seller to the buyer. Most of these rules were well-known and widely used terms of international trade before their formal codification by the International Chamber of Commerce. See also the more domestic *Revised American Foreign Trade Definitions*, in 1 A. LOWENFELD, INTERNATIONAL PRIVATE TRADE 151 (1981).

indenture.[61]

Invocations, then, can serve as legally unambiguous contractual signals. Many of the problems we discuss below are fundamentally rooted in signal misinterpretation and thus suggest that the number and variety of invocations is somehow inadequate. The inadequacy of the stock of invocations is vividly demonstrated by the problems that parties encounter in accurately communicating any revision in the implied, state-supplied terms.

3. *The Danger of Attempting Improvements Through Express Terms*

From the perspective just outlined, implied and express terms function, respectively, as a foundation and a set of building blocks for contractual agreements. Ideally, contracting parties can then select the combinations of implied and express provisions that minimize the aggregate costs of formulation error. The Expanded Choice postulate thus presents the alluring vision of a legal system that offers an array of widely useful terms for reducing formulation error and further invites the optional use of atypical terms not on the prearranged menu.

Unfortunately, however, parties must communicate express terms through the inherently imperfect mediation of words, actions, and other manifestations that admit of varying interpretations.[62] As arbiter of disputed interpretations, the state determines the meaning of whatever signals the parties exchange. While the state presumably knows what it means by the formulations it implies into every contract, it does not know the intended meaning of terms chosen by the parties. Thus, privately formulated express terms are always subject to an additional dimension of interpretation error. This heightened exposure to

61. *See* Broad v. Rockwell Int'l Corp., 642 F.2d 929, 943 (5th Cir.) ("A large degree of uniformity in the language of debenture indentures is essential to the effective functioning of the financial markets: uniformity of the indentures that govern competing debenture issues is what makes it possible meaningfully to compare one debenture issue with another . . . ."), *cert. denied*, 454 U.S. 965 (1981). *See generally* AMERICAN BAR FOUND., COMMENTARIES ON INDENTURES (1971).

The federal courts seem generally to recognize that such standard form indenture provisions are "not the consequence of the relationships of particular borrowers and lenders and do not depend upon particularized intentions of the parties to an indenture." Sharon Steel Corp. v. Chase Manhattan Bank, 691 F.2d 1039, 1048 (2d Cir. 1982), *cert. denied*, 460 U.S. 1012 (1983); *see also* Smith & Warner, *On Financial Contracting: An Analysis of Bond Covenants*, 7 J. FIN. ECON. 117 (1979).

62. *See infra* text accompanying notes 118-26. The contingent character of interpretation has been widely noted in contemporary literary, philosophical and, most recently, legal scholarship. For a valuable review of the arguments and the literature, see S. FISH, IS THERE A TEXT IN THIS CLASS? (1980); Abraham, *Statutory Interpretation and Literary Theory: Some Common Concerns of An Unlikely Pair*, 32 RUTGERS L. REV. 676 (1979); Peller, *The Metaphysics of American Legal Thought* (1984) (forthcoming in the *California Law Review*). Those with a taste for a more in-depth treatment can profit by reading J. CULLER, ON DECONSTRUCTION: THEORY AND CRITICISM AFTER STRUCTURALISM (1983) and J. DERRIDA, POSITIONS (A. Bass trans. 1981).

interpretation error may thwart the parties' effort to improve their agreement by employing a combination of nonstandardized supplements and trumps.

A particularly striking illustration of this additional risk of interpretation error is suggested by the common law maxim of construction *expressio unius exclusio alterius* (specific references exclude others similar in kind). This maxim illustrates the mine field to be traversed in any attempt to supplement an implied instruction with express terms. A court may instead construe an express term to exclude or negate otherwise applicable implied terms. The contractor therefore faces the risk that an express term designed as a *supplement* will instead be interpreted as a *trump*. Recent disputes over escalation clauses in long-term contracts illustrate this phenomenon. Parties frequently respond to inflation risks by agreeing to express escalation clauses. Typically, these clauses describe the costs to be escalated, the indices by which cost changes are to be measured, and the limits within which fluctuations may occur. Such clauses generally protect sellers against price increases, but may cause grave difficulties when unforeseen events expose defects in the escalator provisions. In such cases, courts commonly interpret the contract narrowly, rejecting the seller's argument that the occurrence of unforeseeable circumstances should trigger the usual implied condition excusing performance. In one illustrative case, the court rejected the seller's claim of excuse, stating:

> It is clear that . . . the contract contemplated that foreseeable cost increases would be passed on to the buyer. However, the existence of a *specific* provision which put a ceiling on contract price increases resulting from a rise in [costs] impels the conclusion that the parties intended that the risk of a substantial and unforeseen rise in [costs] would be borne by the seller. . . .[63]

The converse error may occur as well—terms intended as trumps may be interpreted as supplements. Courts typically interpret express terms by looking to precisely the same commercial and legal context they use to determine the applicable implied terms. While evidence of contractual context is frequently useful in clarifying meaning, courts may misuse it in deciding that, no matter what the express terms seem to say, the apparent meaning is unreasonably peculiar in the circumstances of the transaction.[64] Giving the contextual patterns interpretive priority

63. Publicker Indus., Inc. v. Union Carbide Corp., 17 U.C.C. Rep. Serv. (Callaghan) 989, 992 (E.D. Pa. 1975) (emphasis added); *see also* Missouri Pub. Serv. Co. v. Peabody Coal Co., 583 S.W.2d 721, 728 (Mo. Ct. App.) (seller's claim for excuse denied because seller "agreed to the use of the Industrial Commodities Index"), *cert. denied*, 444 U.S. 865 (1979). *But see* Aluminum Co. of Am. v. Essex Group, Inc., 499 F. Supp. 53 (W.D. Pa. 1980) (court equitably adjusted prices following failure of agreed-upon indexing system).

64. *See, e.g.*, Brunswick Box Co. v. Coutinho, Caro & Co., 617 F.2d 355 (4th Cir. 1980)

over the express instructions can subvert attempts to redesign ill-fitting formulations.

If the law too willingly treats the words used to communicate contractual instructions as elastic and highly context-relative, the instruments used to signify trumps become blunt and uncertain. For example, interpretive rules typically direct courts to construe express and implied terms "wherever reasonable as consistent with each other."[65] The presumption is limited by its corollary: usages and experience which cannot reasonably be reconciled with the express terms of a contract should be held not binding.[66] A realistic reading of the case law, however, casts doubt on the practical dependability of this principle.[67] Indeed, there is almost always some contextual argument upon which seemingly inconsistent terms can be rationalized.[68] In practice, therefore, the presumption of consistency places a considerable burden on parties who desire to opt out of the legally implied terms by trumping them with contrary express provisions. Although parties commonly offer context evidence to show that a word in a contract has a nonstandard meaning, they may also offer it to defeat an intended trump. Much of the apparent confusion in the courts about the proper role of context evidence results from failure to recognize this tension between two goals of the formulation process: clarification of ambiguous meaning through contextual evidence and the ability to opt out of implications that the context might otherwise suggest.

In sum, the additional risk of error inherent in interpreting express signals challenges the proposition that parties can successfully blend im-

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(course of performance and surrounding context suggest that standard meaning of F.A.S. term might not be applicable); Columbia Nitrogen Corp. v. Royster Co., 451 F.2d 3 (4th Cir. 1971) (course of dealing and usage of trade, if admitted in evidence, demonstrate that express price and quantity terms in written contract were only "fair estimates"); Modine Mfg. Co. v. North E. Indep. School Dist., 503 S.W.2d 833, 837-38 (Tex. Civ. App. 1973) (trade usage admissible to show that express term "capacities shall not be less than indicated" should be interpreted as permitting "reasonable variations in cooling capacity").

65. U.C.C. § 1-205(4) (1978); *see also* RESTATEMENT (SECOND) OF CONTRACTS § 203(b) comment d (1979); Corbin, *The Interpretation of Words and the Parol Evidence Rule*, 50 CORNELL L.Q. 161, 188-89 (1965).

66. U.C.C. § 2-208(2) provides that:

> [t]he express terms of the agreement and any such course of performance, as well as any course of dealing and usage of trade, shall be construed whenever reasonable as consistent with each other; but when such construction is unreasonable, express terms shall control course of performance and course of performance shall control both course of dealing and usage of trade (Section 1-205).

67. White and Summers assert that usage and dealings "may not only supplement or qualify express terms, but in appropriate circumstances, may even override express terms." J. WHITE & R. SUMMERS, *supra* note 36, § 3-3, at 98. "[T]he provision that express terms control inconsistent course of dealing and [usages and performance evidence] really cannot be taken at face value." *Id.* at 101.

68. For decisions rationalizing text and context under the Code, see cases cited *supra* in note 64. For a review of courts adhering to the common law view, see cases cited *supra* in note 124.

plied and express terms. The interpreter may err in deciding whether an individualized express term in apparent conflict with a standard implied term is an attempt to trump or merely an inartful supplement of a standard provision. To the extent this makes it significantly more difficult for parties to neutralize ill-fitting implied terms through recourse to express trumps, atypical parties lose the practical power to break out of contextual norms. Yet, ironically, a court that mistakenly reads express supplements as sweeping exclusions of implied terms may chill attempts to articulate incomplete formulations through express provisions. Even if resource costs are negligible, contractors will be reluctant to draft express formulations unless such efforts are likely to reduce rather than exacerbate error costs. Such assurance can only come through the standardization of implied and express terms—a process that both expands and constrains formulation choices.

D. The Function of Standardization

1. The Benefits of Preformulation

Standardized terms—or preformulations—exist both in implied form and as express invocations. Providing a menu of instructions from which parties can choose greatly simplifies and reduces the cost of contracting. It is important to realize, however, that the improvement generated by standardization goes far beyond a mere saving of the additional resource costs that would be incurred if parties had to articulate completely the individualized terms for each contract. The typology of formulation error outlined earlier[69] highlights the variety of ways in which parties can misformulate a contract. Furthermore, the signalling instruments used to reduce such error are themselves imperfect and potentially defective. Preformulations bring to bear a collective wisdom and experience that parties are unable to generate individually.

The unique benefits of standardization derive from the process by which formulations mature and are recognized by the state as having consistent meaning. A principal effect of this evolutionary process is the "testing" of combinations of express and implied formulations for dangerous but latent defects. Combinations of formulations are unlikely to be carefully pretested by individual contractors; testing involves substantial risks, and private developers of successful contractual arrangements cannot capture much of the benefit that will accrue to subsequent users. The state's recognition of the evolutionary trial and error process functions as a regulatory scheme designed to promote these "public goods." Analogously, the Food and Drug Administration tests drugs well beyond the level of precautions that an individual would adopt for any particular

69. *See supra* pp. 267-73.

product, in recognition of the public benefits of guarding against low-probability but high-impact defects. Contractual instructions may also contain latent design defects that cannot be avoided simply by encouraging individuals to undertake more careful precautions in the contracting process. Over time, however, the consequences of standard formulations are observable in a wide range of transactions, permitting the identification and removal of errors of ambiguity, inconsistency, or incompleteness. Thus, mature preformulations become validated by accumulated experience and are therefore safer than new, innovative formulations. We can best support this claim by elaborating the several benefits of preformulation.

a. Labeling

Preformulated terms provide a uniform, and therefore intelligible, system of communication.[70] This "labeling" function is analogous to governmental provision of regulated standards of weights, measures, and generic product names, and offers contractors similar communicative advantages. Labeling serves a number of purposes. A contractor who invests resources to understand fully the effects of a particular preformulated term can apply his knowledge to understand subsequent provisions cast in the same form.[71] In addition, if all parties who wish to communicate essentially the same intent embody it in a standard formulation, contractors can more accurately compare the risks of error inherent in different combinations of terms.[72]

b. Diversification

Preformulation also contributes to the evolutionary enrichment of the supply of customary forms through the identification, selection and announcement of specific experiences that can be generalized to particular classes of transactions. By constantly expanding the stock of preformulated terms—both express and implied—the state provides private parties with more "off-the-rack" choices and thus offers a "better

70. What we call "labeling" is analogous to what Fuller described as the "channeling" function of legal formality. Fuller, *Consideration and Form*, 41 COLUM. L. REV. 799, 801-03 (1941). *See generally* Schwartz & Wilde, *Imperfect Information in Markets for Contract Terms: The Examples of Warranties and Security Interests*, 69 VA. L. REV. 1387 (1983).

71. "The use of standardized language can result in a better and quicker understanding of those provisions and a substantial saving of time . . . for . . . all others who must . . . refer to the indenture . . . ." Sharon Steel Corp. v. Chase Manhattan Bank, 691 F.2d 1039, 1048 (2d Cir. 1982) (quoting AMERICAN BAR FOUND., *supra* note 61, at 3), *cert. denied*, 460 U.S. 1012 (1983).

72. *See, e.g.*, Broad v. Rockwell Int'l Corp., 642 F.2d 929, 943 (5th Cir.) ("[U]niformity of the indentures that govern competing debenture issues is what makes it possible meaningfully to compare one debenture issue with another . . . without being misled by peculiarities in the underlying instruments."), *cert. denied*, 454 U.S. 965 (1981); *see also* Schwartz & Wilde, *supra* note 70, at 1459-61.

fit" for those predisposed to purchase a standard cut and size. Diversified formulations reduce errors that result when parties employ ill-fitting terms because of a reluctance to craft more carefully tooled provisions on their own. Thus, by generalizing its implication of terms for particular parties, the state renders more accessible to individual contractors the lessons derived from the pooled experiences of others similarly situated.

c. Reliability

A final but critically important benefit of standardized formulations is the reliability that results from the process of "recognition." A term is recognized when it is identified through adjudication or statutory interpretation and blessed with an official meaning. Informal or "unofficial" customary terms may be well-tested and clearly communicative between parties to the transaction and nonetheless be subject to the prospect of misinterpretation by the state. This risk jeopardizes efforts to use express supplements and trumps to reduce aggregate formulation error. Contract interpretation therefore serves to determine and announce relatively reliable definitions of contractual formulations that are protected by official acceptance.

2. The Deterioration of Recognized Preformulations

We have described an evolutionary process in which useful contractual patterns develop, are tested, and ultimately achieve legal recognition. The most mature forms are the implied term and the express invocation. Unfortunately, the life span of these preformulations, especially the express terms, can be needlessly short.

In addition to ordinary risks of obsolescence, the repetitious use of express terms generates two special problems, *rote use* and *encrustation*. Each of these is a feature of what is commonly called "boilerplate." Over time, some formulations get used by rote so consistently that they lose their meaning.[73] Rote usage may develop as a species of contractual overkill, as in forms that designate already enforceable agreements as "signed and sealed." Thereafter, the usage is continued because the parties see no reason to eliminate a term they view as costless and thus incur a risk, however small, of jeopardizing the predefined meaning of their agreement. Such rote usage imposes a hidden cost on those relatively few parties who use the preformulation operationally. In the "signed and sealed" example, their mechanism for requesting enforcement of an

73. Ordinary social relations are similarly replete with phrases that have lost their literal meaning through rote usage. The person who asks "How are you?" usually does not mean to inquire about your health. Similarly, "Have a nice day," an unusual expression of friendliness a few years ago, has now lost most of its meaning and has become almost a ritual salutation for personnel in many retail establishments.

otherwise unenforceable promise is now corrupted by the fact that the seal has become meaningless boilerplate.

Formulations are also subject to what we term encrustation, an overlaying of legal jargon to the point that the intelligibility of the language deteriorates significantly. Such boilerplate weakens the communicative properties of preformulations, reducing their reliability as signals of what the parties really intend.

The tension between particularized and generalized formulations is thus subject to a further complication: while standardization aids parties in combining express and implied terms, it also contains self-destructive characteristics that erode the usefulness of existing preformulations. This problem, combined with our argument below that standardization also impedes experimentation with innovative formulations, raises serious questions concerning the claims of the Expanded Choice postulate.

II
THEORETICAL IMPLICATIONS: REEXAMINING THE ASSUMPTION OF EXPANDED CHOICE

The discussion in Part I exposes a latent dilemma in the state's role in contractual formulation. The state's provision of standardized contractual signals reduces many errors that inhere in contractual instructions. However, these same benefits create a relative disadvantage to innovative instructions that depart from conventional forms. The absolute benefit of innovation stays the same, while the absolute benefit of preformulated terms increases. The enhanced status of state-supplied terms has the perverse effect of reducing contractors' incentives to innovate. Over time, the state-supplied preformulations will themselves fail to evolve because the flow of innovative formulations, express and implied, will dwindle. The raw material from which preformulations emerge consists of the expressions and experiences of individual bargainers confronting new and challenging contractual problems. If that trial-and-error experience is diminished because parties turn to convenient standardized terms offered by the state, the evolutionary process itself stagnates.

The Expanded Choice postulate seems to suggest that this relative disadvantage is the only disincentive to unconventional agreements: the superiority of preformulated over innovative terms is merely a natural incident of expanded choice. But focusing exclusively on the natural benefits of standardized terms ignores two further barriers that hinder innovation in contractual formulations: the burden of escaping from the old forms and the difficulty of coordinating a move to new ones.

A. Institutional Bias Against Unconventional Expression

Judicial contract interpretation is the medium through which the state integrates privately developed prototypes into the system of publicly supplied terms. The evolution of these widely useful preformulations is facilitated by the use of interpretation theories that use context evidence liberally to supplement both the express terms of an agreement and the state-supplied legal rules. This objective, however, clashes with the demands of a second interpretive function: facilitating the formulation of individualized agreements. As noted above, substantial antagonism exists between these goals, especially in efforts to distinguish between supplementing and trumping options. Contracting parties must be able to escape the preexisting formulations before they can attempt innovative agreements. This requires not only that the parties be able expressly to trump the conventional implied terms, but that the state correctly interpret their efforts. The state's institutional support for implied terms renders both conditions more problematic.

Increased standardization ideally enables contracting parties to minimize aggregate formulation error by more successfully combining express and implied terms. Nonetheless, a highly developed process for implying standardized terms to contracts may result in an institutional bias unless there are parallel enhancements of the express contractual mechanisms. Any imbalance favoring the relative reliability of implied provisions increases the burden of opting-out on those who do not wish the standard terms. Recent cases demonstrate how difficult it is to use express terms to countermand ill-fitting implied preformulations.[74]

Overprotection of implied terms threatens the integrity of express trumping provisions because the interpreter will be reluctant to give express terms meanings that conflict with the apparent factual and legal context. One response is for the law to insist—through the rules of interpretation—on certain standards of artful wording.[75] The bias against express formulations will tend to diminish if key words are given well-defined meanings.[76] This means of protecting the building blocks of ex-

74. *See* Nanakuli Paving & Rock Co. v. Shell Oil Co., 664 F.2d 772 (9th Cir. 1981) (merger clause, excluding evidence of prior dealings, does not bar introduction of usage of trade to alter the price term in the contract); Legnos v. United States, 535 F.2d 857, 858 (5th Cir. 1976) (despite express term "F.O.B. vessel" in contract, international context requires that "the intention of the contracting nations, rather than definitional niceties, must be given controlling weight").

75. A principal purpose of maxims of construction is to maintain standards of wording that reduce formulation error. *E.g.*, *noscitur a sociis* (words in a series affected by others in the same series); *ejusdem generis* (a general term is limited by a specific term to which it is linked); *expressio unius est exclusio alterius* (specific references exclude others similar in kind). *See* Patterson, *The Interpretation and Construction of Contracts*, 64 COLUM. L. REV. 833, 853-54 (1964).

76. Obviously, many of the particularized components of agreements—such as the price and quantity of goods sold, or the place and terms of delivery—rely upon the "plain meaning" or dictionary interpretation of everyday language. In addition, as we discussed above, express terms often rely

press agreement would require the interpreter to restrict the weight accorded to any extrinsic evidence that vitiates the predefined or "plain" meaning of certain terms or, in the extreme case of specially-protected invocations, to ignore context entirely. Unless the supply of standardized express terms is protected and replenished by regular recodification or judicial recognition, it will become increasingly difficult for parties to escape customary implied agreements without actually increasing the risk of formulation error.

Unfortunately, the plain meaning interpretations cannot fully resolve the problem of institutional bias. Even a specially defined invocation is vulnerable to attack as mere rote usage; after sufficient abuse by rote inclusion, its predefined significance becomes debatable. If successfully attacked as mere obsolete "boilerplate," such express terms may dissolve into the very context they were initially designed to escape. Judicial interpreters must draw lines that distingnish meaningful expressions from boilerplate. As they do, the reliability of express formulations as signalling devices diminishes.

In many respects, and perhaps on balance, a more elaborate and inclusive system of implied preformulation is a positive development, because it responds to categories of formulation error that are not efficiently addressed by express terms. But attempts to cope simultaneously with the distinct formulation problems of incompleteness and poor fit may be frustrated by the inherent antagonism of their respective remedies: the evolution of implied terms and the provision of trumping expressions to signal unconventional arrangements.[77]

B. Uncoordinated Behavior: Additional Barriers to Innovation

Even assuming the parties can define contractual language so as to escape the conventional formulations, the development of innovative formulations will be impeded. A transition to new contractual formnlations frequently must overcome two distinct but interrelated problems. The first of these is willingness to incur whatever costs are necessary to identify terms with potential advantages over the status quo. Then, to the

upon "magic words"—legally defined invocations as the building blocks for a custom-tailored contract. *See supra* text accompanying notes 53-61.

77. The historical development of contract law supplies an important reason why this tension between the standardization of express and implied terms has not been fully confronted. Implication is, at bottom, a willingness of the law to "make a contract" for the parties on the basis of certain contextual evidence. Initially, the common law was hesitant to accept that task except under a relatively limited number of general-purpose norms, the "rules" of contract. Through precisely the sort of evolutionary process alluded to above, however, courts have progressively identified and carved out special-purpose implied terms for various submarkets and classes of transactions. In many cases courts have raised informal contractual prototypes to the status of recognized customary terms. The ultimate development of this trend is the Code's strong preference for inferring customary norms from context.

extent that such advantages depend on the standardization benefits discussed above, groups of contractors must coordinate their joint adoption of a standard formulation of the terms.

The limits of copyright law create an initial barrier to innovation by denying contractors substantial property rights in their formulations.[78] An inherent free-rider problem thus retards the production of innovative formulations for emerging relationships. So long as individual contractors are incapable of capturing the full benefits of their innovative expressions, new formulations will be underproduced. This produces a lag between the emergence of new potential relationships and the creation of improved formulations to exploit the potential. In the interim, contracting parties will continue to use ill-fitting terms to ensure reliable responses to the changed conditions.

The difficulty in coordinating a move to new contractual language constitutes another barrier to innovation. This problem can best be understood by way of an analogy—the development of shopping zones. Retail establishments concentrate in particular locations in order to capture the marketing benefits of concentrated customer access and the complementarity of certain activities, such as shoe stores and clothing dealers. The resultant "agglomeration" economies[79] benefit all establishments in the zone. Exogenous shocks—such as migration to the suburbs—fre-

78. The federal copyright statute offers a seemingly broad and expansive protection for all "original works of authorship." 17 U.S.C. § 102 (1982). Nonetheless, the protection of innovative contractual formulations through copyright raises two separate problems. The first question is whether a contract form or term is copyrightable at all. In Baker v. Selden, 101 U.S. 99 (1879), the Supreme Court held that blank forms to be used for recording bookkeeping entries could not be copyrighted. The court reasoned that granting a copyright monopoly on the written form would permit the holder to monopolize the idea to which the form is incident. Subsequently, however, the federal courts have held contractual instruments and other business forms copyrightable whenever the forms contained terms or explanations inseparable from the underlying plan. *See, e.g.*, Continental Casualty Co. v. Beardsley, 253 F.2d 702 (2d Cir.), *cert. denied*, 358 U.S. 816 (1958). Where, however, the uncopyrightable idea is so straightforward or so narrow that there are necessarily only a limited number of ways to express it, any particular form will be uncopyrightable. The rationale for this limitation is to prevent the idea from being monopolized. *See* Morrissey v. Proctor & Gamble Co., 379 F.2d 675 (1st Cir. 1967).

Second, even if copyright protection is available for a particular innovative contractual clause, the substantive ideas it expresses remain public goods. The federal courts have consistently held that even though particular wording of a contract has been copyrighted, others are free to embody similar contractual provisions in their own agreements and may use suitable words to express such provisions. *E.g.*, Dorsey v. Old Surety Life Ins. Co., 98 F.2d 872 (10th Cir. 1938); *cf.* American Inst. of Architects v. Fenichel, 41 F. Supp. 146 (S.D.N.Y. 1941) (statement in form book that form contracts should be used as references implied permission to use forms, and precluded infringement action for use of form printed in the book).

Trade secret rules offer no alternative protection for innovative formulations, since it is the breach of confidence by unauthorized disclosure, rather than infringement of a property right, which is the gravamen of trade secret liability. *See, e.g.*, Wilkes v. Pioneer Am. Ins. Co., 383 F. Supp. 1135 (D.S.C. 1974).

79. *See generally* W. ISARD, LOCATION AND SPACE-ECONOMY 182-88 (1956); H. NOURSE, REGIONAL ECONOMICS 85-92 (1968).

quently make obsolete the locations of existing business districts. Individual businesses, however, may be unwilling to invest in discovering a new, superior location[80] and persuading other businesses to move in numbers large enough to yield adequate agglomeration advantages in the new location. Development will depend on a private entrepreneur having the necessary incentives to purchase a suitable tract of land, organize the necessary relocation, and capture efficiency gains in the form of its ownership interest.

Unfortunately, in the case of contractual innovation, the weakness of property rights impedes any similar solution. Even if private parties could costlessly discover new, improved terms, they could not readily *coordinate* any general move to new forms by other contractors. Certain private organizations—such as trade organizations and law firms—can partially overcome the property rights problem that discourages attempts at contractual innovation. The state's monopoly on the official recognition of standard meaning will nonetheless impose on any private efforts a risk of error not borne when using the existing preformulations. The effect of the state's control over interpretation is the equivalent in the shopping center example of an entrepreneur being unable to secure in advance of investment the necessary site plan approval and zoning. In sum, the contractual equivalent of the obsolete shopping district may not be abandoned even when the analog of a better location surely exists.

This problem of uncoordinated business behavior is a classic illustration of the optimal solution for one segment of a multidimensional problem being inconsistent with the optimal solution for the whole. Standardization, which aims to relieve parties from tasks that generate formulation errors, indirectly produces a negative effect in a related dimension of the formulation process. The fact that preformulation generates short-term gains at the expense of possible long-term gains does not, of course, imply that state intervention is on balance undesirable. Evaluating this balance requires an examination of the probable effects of these barriers to innovative formulations.

C. *The Effects of Barriers to Innovative Formulations*

Our analysis has shown that barriers to innovative formulations are an inherent byproduct of state regulation of contract terms. Rather than merely providing expanded choice, the state's regulation of the formulation process results in a tradeoff between the benefits of reduced error in

80. Although the new location must be superior for all parties who relocate, it need not be ideal for any particular business. If, for instance, the optimal location for sporting goods stores is not the best location for clothing stores, the exploitation of agglomeration economies may require a compromise. Compromise may similarly be prerequisite to the adoption of conventionalized contract terms.

existing relationships and the costs of failing to exploit fully the potential gains from new relationships. The previously discussed benefits of preformulated terms must be balanced against these costs. This calculus requires an assessment of the magnitude of lost opportunities, and of the ability of market responses to mitigate the loss.

1. Lost Opportunities: The Problem of Lags

a. New Formulations for New Relationships

To the extent that there are lags in the evolution of new contractual standards, parties with emerging needs face a choice. Either they can use ill-fitting formulations that secure less than maximum trading gains, or they can incur the costs of crafting new forms of agreement that are better adapted to the evolving conditions. To illustrate the empirical relevance of this problem, we briefly discuss two specific examples: the recent emergence of commerce in low-price, mass-market computer software; and the intricate, interactive "fast track" method of construction of large buildings. In addition, we will discuss the more general historical example of requirements and best-efforts contracts and their slow acceptance by the legal community. These examples illustrate the need for innovative formulations when parties enter uncharted legal landscapes—where mature formulations such as invocations, and even prevalent trade usages, are lacking.

Technological developments such as the emergence of the microcomputer sometimes create a new contractual environment. The recently developed mass market for microcomputer software differs in important respects from the more mature market in which programs for large mainframes have been sold.[81] Mainframe software transactions typically involve large sums of money, frequently require negotiation, and employ a written contract to embody their key terms. They typically involve relatively sophisticated purchasers. This mainframe market has evolved a mature legal structure along the lines discussed above: a menu of contractual preformulations, trade practices and terms, and party expectations. In the mass market for small computer software, by contrast, many buyers are extremely ill-informed. There is little negotiation of the vendor's terms, the meaning and enforceability of certain express terms are uncertain, and there is little common understanding as to implied terms.

What purposes would express contractual preformulations for mass-market computer software transactions be designed to serve? Although

81. *See generally* J. SOMA, COMPUTER TECHNOLOGY AND THE LAW § 3.13 (1983); Brooks & Brewer, *Special Problems in the Mass Distribution of Hardware, Software, and Firmware*, 1982 U. SO. CAL. COMPUTER INST. § II.

software for small computers is relatively inexpensive, improper performance—for instance, by an accounting, inventory control, or other record-keeping program—may result in heavy losses to users. Software developers are reluctant to risk indeterminate damage liability and therefore typically wish to disclaim the customary product warranties and remedies. Since software is easily duplicated, the vendor may also wish to impose certain duties on the purchaser. For example, the purchaser may be obligated to use the program exclusively on a particular computer, and to restrict the accessibility of the product to others who may make illegal "pirated" copies.

Provisions designed to effect both of these vendor desires are frequently incorporated in a "license agreement" distributed to the consumer. Due to various marketing expedients, especially those related to high-volume mail-order sales, the buyer may not be presented with the written contract until product delivery. A widely-used technique, the "shrink wrap" package, displays the license agreement through a transparent wrapper whose unsealing will, it is stated, be deemed an acceptance of the license terms. The enforceability of such an "agreement" is, of course, open to question and is presently being addressed by legislation in several states.[82]

Beyond the unique mechanics of contract creation, any vendor who attempts to formulate original protective and restrictive clauses will bear the risks of formulation error and misinterpretation. A succinct exemplification of this problem appeared recently in a major computer magazine. A columnist's complaint about the convoluted license agreement and disclaimer attached to a software product elicited the following response from the president of the vendor company:

> Soft-Link, *as many other software vendors have done*, has merely used wording similar to that used by Digital Research. . . . Digital Research has a successful software package, has not been sued out of business, and has successfully sued against pirates, while other software companies have difficulty coming up with anything else as simple and as protective. . . .
>
> Actually, *most software houses are willing to be less restrictive in practice*, but with suits being brought for almost any reason, valid and otherwise, and with such suits being expensive to defend, . . . software houses will probably continue to use similar wording in warranties and licenses, if for no other reason than to avoid attorney fees rather than responsibility.[83]

Digital Research, the developer of the standard 8-bit operating system,

82. The computer trade publication *InfoWorld* describes a recent Louisiana statute and reports imminent legislative efforts in California, Georgia, and other states. Watt, *Louisiana Software Protection*, INFOWORLD, Sept. 3, 1984, at 13.

83. Otten, *Warranty Pirates*, BYTE, Mar. 1983, at 22 (letter to editors) (emphasis added).

had developed and implemented its licensing language early in the history of the microcomputer market. The tested character of the language apparently outweighed its imperfect fit.

Unusual economic conditions may also create new contractual regimes. Traditionally, construction contract bids were based on complete designs and specifications. In recent years, however, the combination of high interest rates and rapid cost inflation has stimulated experiments with a "fast-track" method of phased construction. Under this method, many construction tasks are initiated before overall design is complete. The economic motive for this accelerated procedure is to minimize both financing costs and inflation of labor and materials costs during the construction period.[84] This consolidation of the design and building processes is often combined with another construction innovation, the use of a "construction manager" [CM]. The CM combines certain functions traditionally performed separately by the design professional (the engineer or architect) and the contractor.[85] On one hand, the CM participates in the design process by reviewing proposed designs during development and providing recommendations about them.[86] On the other hand, he serves as a "super general contractor" by coordinating the prime contractors[87] and subcontractors, reviewing change orders, inspecting the progressing work for deficiencies, preparing and revising project budgets, and so forth.

Use of the professionally hybrid CM within the fast-track team context raises difficult legal problems.[88] At the least, it departs from the traditional owner/architect/contractor structure in which the mutual relationships and obligations have been thoroughly worked out and defined

84. The fast track process is a "method of construction by which actual construction is commenced prior to the completion of all design, planning, bidding and subcontracting stages in order to alleviate the effects of inflation." Meathe v. State Univ. Constr. Fund, 65 A.D.2d 49, 50, 410 N.Y.S.2d 702, 703 (N.Y. App. Div. 1978).

85. On this general topic, see the symposium, *Construction Management and Design-Build Fast/Track Construction*, LAW & CONTEMP. PROBS., Winter 1983, at 1.

86. AMERICAN INST. OF ARCHITECTS, GENERAL CONDITIONS OF THE CONTRACT FOR CONSTRUCTION, Doc. No. B801-1980, at § 1.1.2 (1980) ("Review designs during their development."); *id.* at § 1.1.5 ("Coordinate Contract Documents by consulting with . . . Architect regarding Drawings and Specifications as they are being prepared, and recommending alternative solutions whenever design details affect construction feasibility, cost or schedules."); ASSOCIATED GEN. CONTRACTORS, STANDARD FORM OF AGREEMENT BETWEEN OWNER AND CONSTRUCTION MANAOER, Doc. No. 8d, at § 2.1.4 (1979) ("Review the drawings and specifications as they are prepared, recommending alternative solutions.").

87. CM's are particularly appropriate for "multiprime" jobs, in which the owner contracts with a number of primes. *See generally* Gaede & Bynum, *The Multi-Prime Job*, in CONSTRUCTION BRIEFINGS (1979).

88. One writer says the situation makes it "impossible to state a general rnle or, in most jurisdictions, to even predict a result with reasonable certainty." Bynum, *Construction Management and Design-Build/Fast Track Construction from the Perspective of the General Contractor*, LAW & CONTEMP. PROBS., Winter 1983, at 25, 30.

by the law over time. Furthermore, the fast-track procedure may be unusually contentious, thus placing great practical stress on any theoretical lacunae in the formulation of the relationships. The very choice of the procedure implies an unusual concern with speed, symptomized by poorly defined job specifications and by documents whose formulations are less refined than has been customary. The procedure is thus inherently susceptible to contractual disputes. For instance, widespread use of hastily formulated provisional plans tends to bring about disputes over subsequent change orders and whether they represent true alterations in the scope of the work or are merely a finalization of the original plans.[89] In an extreme case, a contractor may argue that changes constitute such abandonment of the original contract that *quantum meruit* is the only appropriate basis of payment.[90] Other difficulties relate less to haste than to risks of incompleteness error posed by the necessary segmentation of phased construction, in which responsibilities may fall through the cracks. As one commentator has noted, "The more the construction phase of a project is broken into individual packages, the more likelihood there is that needed construction work or responsibilities will be omitted in defining the contract packages."[91] Whatever its source, an increased incidence of revisions heightens the difficulty of coordinating the schedules of subcontractors and therefore exacerbates problems of legal responsibility for delays and other costs.

In addition, fast-track projects still frequently use standard-form contract documents whose formulations were evolved in the traditional fully-designed job environment. This increases some of the inherent problems of unpredictability. These documents "rarely constitute realistic efforts to deal with the heightened exposure of both general contractor and subcontractor to the change order, extra work, and scheduling problems attendant upon a fast track project."[92] The language of particular fast-track contracts tends to be unique to the project being developed, and is frequently refined ad hoc as work progresses.[93] This situation is in stark contrast with the thorough testing, in both arbitration and the courts, of traditional construction contract terms. One reason for the lack of fast-track paradigms may simply be the lag due to free rider problems and other barriers discussed above. Professor Pratt con-

89. *See, e.g.*, City Stores Co. v. Gervais F. Favrot Co., 359 So. 2d 1031 (La. Ct. App. 1978).

90. *See* Daugherty Co. v. Kimberly-Clark Corp., 14 Cal. App. 3d 151, 92 Cal. Rptr. 120 (1971).

91. J. ADRIAN, CM: THE CONSTRUCTION MANAGEMENT PROCESS 219 (1981). A diligent contractor may find that "extra" work not expressly provided for in the plans must be performed in order to complete the job. Problems arise over the authorization of such extras.

92. Squires & Murphy, *The Impact of Fast Track Construction and Construction Management on Subcontractors*, LAW & CONTEMP. PROBS., Winter 1983, at 55, 63.

93. Coulson, *Dispute Management Under Modern Construction Systems*, LAW & CONTEMP. PROBS., Winter 1983, at 127, 132.

tends, however, that the industry has not *wanted* to develop new standard forms for fast-track construction under a construction manager. Instead, it has deliberately chosen "to keep the concepts loosely defined to permit a flexible response to the perplexing changes in the economic climate."[94] This attempt to choose flexibility at the expense of legal definition, Pratt suggests, risks a bitter result: since modern courts commonly intervene to impose standards if the parties provide none, judicial application of general interpretive norms may result in the fast-track construction industry's being held to rules quite different from those it would choose for itself.[95]

Although courts today commonly apply broad standards to give enforceable meaning to deliberately indeterminate obligations, their unwillingness to do so for many years created serious contracting problems. Contractors first employed what we now call "requirements" and "output" contracts in response to uncertain economic conditions in the mid-nineteenth century.[96] Those admittedly indeterminate agreements were widely viewed as void for lack of mutuality.[97] But refusal to enforce such agreements was not universal,[98] and by the beginning of the twentieth century, courts began to accept the view that it was better to tolerate "some indefiniteness and uncertainty in contracts [than to tell the parties] that, unless they are able accurately to foretell what nature holds in store, they cannot safely make contracts which will in some degree be dependent upon future events."[99] Although this manner of contracting was ultimately accepted, the prolonged delay in adjustment unquestionably imposed serious costs, due on one hand to lost opportunities from the continued use of ill-adapted formulations, and on the other to the interpretation errors[100] caused by the courts' refusal to enforce the parties' true agreement.

The examples we provide above are admittedly anecdotal. Nonetheless, they illustrate important problems which hinder contract formulation in new environments. They demonstrate how the barriers to innovation can outweigh any opportunity costs, thus producing lag in the development of new contractual formulations.

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94. Pratt, *Afterword: Contracts and Uncertainty*, LAW & CONTEMP. PROBS., Winter 1983, at 169, 170-71.

95. *Id.* at 171-72.

96. Havighurst & Berman, *Requirement and Output Contracts*, 27 ILL. L. REV. 1, 1 n.1 (1932), reports finding only one American case of this type before the mid-19th century.

97. *See, e.g.*, Bailey v. Austrian, 19 Minn. 535 (1873). *See generally* Lavery, *The Doctrine of* Bailey v. Austrian, 10 MINN. L. REV. 584 (1926).

98. For a list of cases finding mutuality in requirement contracts, see *id.* at 587 n.11.

99. California Prune & Apricot Growers, Inc. v. Wood & Selick, Inc., 2 F.2d 88, 90 (S.D.N.Y. 1924).

100. *See also* the cases cited *supra* in note 21.

b. Plain Language: New Formulations for Existing Relationships

A "plain-language contract" is one that results from converting a set of complex instructions originally drafted in "legalese" into a more communicative set of instructions. The legal relationships created by the new formulation are intended to be precisely the same as those under the old. Judicial interpretation of plain-language contracts should therefore be more straightforward than that of contracts expressing genuinely novel relationships. For several reasons, the experience of the "plain-language movement" provides insights into the peculiar effects of the state's role in the production of contractual formulations.[101]

If the new formulation yields precisely the same set of legal relationships as the old, what benefits are conferred by the translation process? The answer lies in the distinction between the communication and the definition functions of contracts. A perfect plain-language translation has the same legal effect as the original but is better understood by the parties. The economic benefits of plain-language formulation flow from several sources. First, it provides assurance to the parties that they understand one another. A formulation that misleads one or more of the parties may produce an unintended transaction that results in net harm rather than mutual benefit. Fear of the unknown consequences of legalistic language may induce some parties not to enter into transactions at all, although a clear expression of the same relationship would be recognized as beneficial. Second, if a contract is in fact formed, incomplete understanding may obstruct the exploitation of the rights and duties thus created. Third, even if perfect understanding is ultimately achieved, excess understanding costs result in a needless loss.

The problems raised by unclear expressions of the content of a relationship may be analogized to buying an imported stereo receiver whose directions are poorly translated—or not translated at all—from the producer's foreign language. Although many of the functions of the equipment will be apparent from its general appearance and nature, advantages and disadvantages both may remain concealed. One cryptic instruction may warn that the set will melt if plugged into the same circuit as a steam iron, while another may fail to convey that the red button on the rear activates a wonderful built-in burglar alarm. If the effect of such instructions on market acceptance is not entirely clear, consider the case of similar instructions for the assembly of furniture, or of bicycles, where the risk is of total loss if the unintelligible instructions are incorrectly followed. The lesson applies even more emphatically to transac-

101. *See generally* E. BISKIND, SIMPLIFY LEGAL WRITING (2d ed. 1975); C. FELSENFELD & A. SIEGEL, SIMPLIFIED CONSUMER CREDIT FORMS (1978); D. MELLINKOFF, THE LANGUAGE OF THE LAW (1963); Note, *New York's Plain English Law*, 8 FORDHAM URB. L.J. 451 (1980); Note, *A Model Plain Language Law*, 33 STAN. L. REV. 255 (1981).

tions—e.g., insurance, credit—where contractual language so much more fundamentally defines the product itself.

Opponents of change in "legalistic" formulations have contended that the obscurity of legal language is a necessary side effect of unambiguousness.[102] Moreover, resistance to new contractual language from within the legal profession is "no ordinary conservative fear. Lurking in the dark background is the always present, rarely voiced lawyer's fear of what will happen if he is not 'precise'—in the way that the law has always been 'precise.' "[103] For lawyers, plain and simple language has long conjured up the specter of negligence liability.[104] This practical concern helps to explain why the plain-language movement arouses more enthusiasm among legal scholars than among practitioners. Scholars advocate reforms at a conceptual level and have little involvement with either the mundane drafting difficulties of implementation or the business risks of testing the new formulation. To the extent that a mature, traditional formulation deals explicitly with many contingencies, it may indeed be more precise, even if less intelligible. Frequently, however, the precision of legal jargon derives not from its words but from their power to trigger the implication of established norms, in the form of precedents, usages, and other dispute-resolution devices. Invocations are classic examples of this phenomenon. The central challenge for innovators formulating plain-language contracts is to devise ways to call upon the existing set of norms through substitute language.

Important new plain-language formulations have nonetheless emerged in the past decade. In 1974, Sentry Insurance Company, a small Wisconsin auto insurance company, pioneered a "Plain Talk" automobile insurance policy that has since been filed in forty states and imitated by other companies.[105] In a similar project that culminated in 1975, Citibank simplified its standard form loan applications and agreements. Coming from the second largest bank in the country, this initiative attracted much attention and had considerable impact in the banking industry.[106]

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102. E. GOWERS, THE COMPLETE PLAIN WORDS 91 (1948).

103. D. MELLINKOFF, *supra* note 101, at 294.

104. Morton, *Challenge Made to Beardsley's Plea for Plain and Simple Legal Syntax*, 16 CAL. ST. B.J. 103, 105 (1941).

105. Sentry's revision responded to a nationwide opinion survey which concluded that policyholders wanted a contract that they could read and understand. *See* C. FELSENFELD & A. SIEGEL, WRITING CONTRACTS IN PLAIN ENGLISH 46 (1981). Sentry was apparently willing to accept certain legal risks in exchange for the presumed marketing advantages. Another plain-language insurance policy was involved in National Merchandise Co. v. United Serv. Auto. Ass'n, 400 So. 2d 526 (Fla. Dist. Ct. App. 1981), discussed *infra* in note 108.

106. Why and how Citibank voluntarily subjected itself to the risk that the new forms would not "hold up in court" merits further attention. Unlike Sentry Insurance, Citibank did not originally plan to exploit the potential market benefits of plain language. According to Carl Felsenfeld and

Companies that adopt and continue to use new formulations evince their perception that the marketing advantages outweigh the legal risks. It is not clear, however, to what extent these risks have yet materialized.[107] Evidence is sparse as to the impact of plain-language insurance and banking forms on interpretational disputes. Few litigated cases construe the new plain-language clauses, although out-of-court settlements and the perceived positions of parties may have been materially affected. The financial feasibility of plain-language reformulation will become clearer as additional experience accumulates.

2. *The Limits on Market Responses to Lags*

a. *The Recognition Problem*

The plain-language experience also illustrates the dangers of even the most straightforward attempts by private parties to employ unconventional or unrecognized contractual forms. An important goal of the drafter of any contractual formulation is to create a contract that a court will interpret in a predictable way. Presumably one can always translate legal jargon into language that is more easily understandable than the original. However, there is no practical assurance that a court will treat the new formulation as equivalent to the old. Contractual language is subject to ambiguity error to the extent that it lacks pre-established conventions for its interpretation. This is so whenever new terms are adopted. The problem is not the intelligibility of the new terms; rather, the change itself weakens the relevance of the existing stock of dispute-resolving conventions that the traditional language invoked. Thus, in-

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Alan Siegel, two lawyers who worked on redesign of the personal note, the simplification project "began as an exercise in design, as Citibank . . . sought to make its forms better looking and easier for customers to deal with. There was, at the outset, no particular interest in changing the document's language to make it more readable." C. FELSENFELD & A. SIEGEL, *supra* note 105, at 27. It became apparent, however, that a successful redesign would have to be accompanied by improvements in the text. The bank's legal staff attempted to identify provisions that had actually been litigated, and retained them. At the same time, they omitted rarely used sections, substituting a brief paragraph for a detailed list of circumstances when the consumer would be considered to be in default. "Perhaps the hardest part of this task was not writing in plain English, but identifying provisions taken from traditional contracts . . . that could be eliminated without injuring the legal enforceability of the document." *Id.* at 28.

The new forms did become a selling point for the bank. A study conducted by the Research Department of Batten, Barton, Durstine & Osborn showed that customers so much preferred the new personal loan note that they expressed interest in using other services of any bank that used this loan agreement. *Id.* at 29-30. From a business point of view, therefore, an innovative plain-language contractual formulation may have marketing benefits worth more than the risk of increased legal exposure. To compare the old personal loan note with the simplified version, see *id.* at 3 (old note), 241 (revised note). For examples of plain langnage forms, see P. TILL & A. GARGIULO, CONTRACTS: THE MOVE TO PLAIN LANGUAGE 46-49 (1979).

107. "Like soldiers who have been 'in the army' but not 'in combat,' most of the words in the cases have been 'in litigation' but not 'litigated.'" D. MELLINKOFF, *supra* note 101, at 375.

creased communicational clarity may, ironically, decrease definitional certainty.

The private developer of plain-language reformulations thus bears a legal risk which diminishes the market incentive for such communicative improvements. When the new formulation is an attempt to translate a preexisting formulation, the parties must depend on the courts' making the connection between the new formulation and the old content, with its penumbra of judicial construction and usages. We call this phenomenon "linkage." If courts adopt a linkage principle, the preexisting jargon will become a useful device for interpreting the reformulated clauses.[108] Absent a linkage principle, however, commercial drafters are vulnerable to the common law *contra proferentem* maxim of construction against the drafter, particularly in the consumer contract setting.[109]

Suppose, for instance, that one clause in a company's plain-language contract was ambiguous and that consulting the prior standardized version of the corresponding language would resolve the meaning in favor of the drafter company rather than the consumer. Which interpretation would a court likely support? The risk that a court will apply *contra proferentem* arguably chills the development of innovative contractual

108. This approach appears in National Merchandise Co. v. United Serv. Auto. Ass'n, 400 So. 2d 526 (Fla. Dist. Ct. App. 1981), which involved a dispute over interpretation of an innovative "Easy Reading Auto Policy." The policy stated that the insurer "will pay damages for bodily injury or property damage for which any covered person becomes legally responsible because of an *auto accident*," but nowhere specifically defined the term "auto accident." *Id.* at 529 (emphasis added by the court). A child died of drugs ingested in a parked car, and the trial court denied relief, reasoning that the auto was merely the situs and not causally related to the injury. Reversing, the appellate court looked to previous language and usage:

> There is a virtual parade of Florida auto insurance cases dealing with clauses insuring against injury "arising out of the ownership, maintenance or use" of an automobile. It is apparent to us that the words "arising out of the ownership, maintenance or use" of an automobile do not appear in insurance policies by mere happenstance. This is common and customary boiler plate language used in auto insurance contracts to define the scope and extent of coverage provided. . . .
>
> . . . .
>
> Thus, confronted with a term that is standardized in the industry, we must recognize the principle that . . . [c]ommercial transactions and contracts should be interpreted in light of custom or trade usage.

Id. at 530-31 (citations omitted). Hence, the court not only referred to the old contractual language to define "auto accident" as any accident "arising out of the ownership, maintenance or use," but it also invoked the associated stock of precedents and usages.

Although this approach is commendable, it does not appear to be widely accepted. Indeed, the significance of *National Merchandise* is limited; the same result would likely have been reached on other grounds.

109. For example,

> When the terms used are ambiguous, we are required to construe the policy against U.S.A.A., because it drafted the policy. Insurance policies are contracts, and it is well-established that contracts are construed against the drafter in the face of any ambiguities. "This rule is especially true when the drafter stands in a position of trust, or greater professional or business knowledge."

Id. at 530 (citations omitted) (quoting Planck v. Traders Diversified, Inc., 387 So. 2d 440, 442 (Fla. Dist. Ct. App. 1980), *petition dismissed*, 394 So. 2d 1153 (Fla. 1981)).

language, even language that attempts merely to express an unchanging set of relationships, as with a plain-language contract.[110]

Although market forces apparently suffice to motivate some plain-language reformulations, the barriers even to this relatively simple form of innovation have been surprisingly strong. Even when the formulation barriers can successfully be surmounted, subsequent free-riding on the new formulations may detract significantly from the market advantages that could otherwise be captured by the innovator. Furthermore, coordinating a change in contractual forms requires the cooperation of the state in recognizing the new conventions. Absent compensating benefits, then, the risks inherent in nonrecognized formulations will deter socially beneficial improvements in intelligibility. The plain-langnage experience supports the hypothesis that the progress of private contractual innovation will be slower and quantitatively weaker than its social benefits might justify.

b. Private Alternatives to Official Recognition

Thus far we have discussed only the official recoguition accorded by the state. However, private institutions can develop a form of unofficial recognition by formulating contractual conventions that become widely accepted as clear signals. Such unofficial recognition is less valuable than official recognition precisely because the state's nltimate interpretation may differ from the unofficial understanding. Nevertheless, as we shall show, unofficial forms provide a partial substitute for official ones, and may pave the way for official recognition or codification.

Trade organizations provide a mechanism to internalize at least some of the gains from contractual innovation. If an organization representing a significant subset of the formulation's potential users develops a term, it can supply the coordination necessary to overcome the free-rider problems discussed earlier.[111] Industry codes can therefore play a significant role in developing new formulations to respond to changing conditions within certain markets. Often, though, the content of private codes is not intended to be innovative. The International Chamber of Commerce's INCOTERMS, for example, codifies rules that were already widely used.[112] Even a mere codification increases access to tested for-

110. A persuasive case can be made against applying the traditional *contra proferentem* rule in these circumstances. The presumption against the drafter is designed to discourage the use of terms that, because poorly defined and thus ambignous, may be misleading. A plain language revision also seeks to improve langnage that may be misleading, but does so by attempting to increase the communicative value of the terms, even though the original wording may be sharply defined in a legal sense and therefore not ambiguous. As we have noted, an improvement in intelligibility might be socially desirable even if the cost is some increase in ambiguity.

111. *See supra* Part II, Section *B*.

112. *See* Portney, *Letter Rulings: An Endangered Species?*, 36 TAX LAW. 751 (1983).

mulations, enhances the communicative aspects of contracts, and addresses the problem of construing amorphous unofficial rules. Passive codifications do not, however, address the problem of lag.

The presence of trade organizations willing to take an active role in shaping new formulations does not always eliminate the lag between the development of new business conditions and the availability of the appropriate contractual formulations. The response to the fast-track construction manager development is instructive. Two rival professional organizations produced model contractual forms defining the role of the CM. The documents produced by the American Institute of Architects [AIA] [113] differed in significant ways from those of the prime contractors' trade group, the Associated General Contractors [AGC].[114] The difference diminished any reliability benefits such documents might normally generate and may also have caused further lag in the development of industry-wide prototypes, thereby creating an independent potential for confusion. Furthermore, although the CM phenomenon was important enough in the early 1970s to stimulate articles in the professional journals,[115] the trade formulations did not appear until nearly ten years later.[116] Finally, both sets of formulations have yet to be thoroughly construed; the state's response as the ultimate definitional interpreter is still pending. Thus, even when private codifications do respond directly to the lag problem, they are likely to operate with delay, possibly at cross-purposes, and always at the mercy of the official interpretation process.

Law firms are examples of another institution that produces innovative formulations, although their incentives differ from those of trade organizations. A large law firm with an extensive practice in a particular subject area has the experience necessary to the testing function. Moreover, it may be able to confine the benefits to its own set of clients, reducing free-rider effects. The feasibility of law firm innovation is illustrated by the widely held belief that bond covenants, indentures, and many other standard features of corporate financial agreements originated in a small group of New York law firms that had a dominant market position

113. AMERICAN INST. OF ARCHITECTS, *supra* note 86, Doc. Nos. A101/CM, A201/CM, B141/CM, B801. *See generally* J. Sweet, Lawmaking by Standard Forms: A Study of A.I.A. Contract Documents (1978) (unpublished manuscript).

114. ASSOCIATED GEN. CONTRACTORS, *supra* note 86, Doc. Nos. 8a (1977), 8d (1979), 8 (1980), and 520 (1980). For a discussion of the differences between the two sets of documents, see Sweet, *The Architectural Profession Responds to Construction Management and Design-Build: The Spotlight on AIA Documents*, LAW & CONTEMP. PROBS., Winter 1983, at 69, 78-81.

115. *See, e.g.*, Lammers, *Construction Manager: More Than A Hard-Hat Job*, AIA J., May 1971, at 31; Wagner, *Where, Oh Where, Are the Management Skills?*, ARCHITECTURAL REC., Dec. 1971, at 9.

116. The AIA's set of CM documents did not appear until 1980. *See* AMERICAN INST. OF ARCHITECTS, *supra* note 86.

in these transactions.[117] As our examples suggest, however, the success of such private efforts often depends on fortuitous special circumstances.

3. *Summary*

The existing stock of "established" terms—comprised of implied and express preformulations and other mature contractual prototypes—has a dual effect. On the one hand, the availability of well validated and officially recognized forms of agreement is necessary to enable parties to fashion an optimal combination of express and implied terms. On the other hand, the maintenance of an established stock poses certain problems. The status of time-tested formulations is, of course, partially justified by the genuine safety and reliability which they provide. But state support for the entrenched forms produces an inherent, but unwarranted, institutional bias against unconventional expression. The favored institutional status of old forms makes it less attractive to invest in the development of new formulations to respond to emerging business needs. A classic free-rider problem further weakens the vigor of the evolutionary process, as do the vexing logistics of coordinating a conversion to the new terms. Joint private efforts to generate innovative formulations may occasionally mitigate some of these problems, and market forces suffice to promote some development of new contractual forms. Nevertheless, the state's control of the recognition mechanism serves, on balance, to retard the evolution process.

III
PRESCRIPTIVE IMPLICATIONS: RETHINKING CONTRACT INTERPRETATION

We have analyzed the role of formulations as instruments which reduce certain types of errors in the articulation of contractual agreements. To be sure, private parties and institutions have natural incentives to reduce formulation error, including the opportunity cost of reliance on ill-fitting terms. Because the state retains ultimate control over the definition to be attached to any formulation, full realization of this goal depends inevitably upon the character of state involvement in the formulation process. Only the state has the power to minimize certain legal risks that otherwise deter private innovation.

Should the state choose to enhance the reliability of contractual forms, two distinct types of legal rules would be required. First, the state must motivate contracting parties to take sufficient precautions against the risk of their own formulation errors. Second, the state must choose

117. While this plausible hypothesis has been cited to us by a number of practicing lawyers and legal scholars, we have been unable to confirm it by other than anecdotal evidence.

principles of interpretation that preserve the utility of the core signalling devices of contractual formulation. In order to accomplish either of these goals, the legal interpreter must be sensitive to the distinctive ways in which contractual instructions can be defective. Such a sensitivity, however, requires a reassessment of traditional notions about the purposes of contractual interpretation.

A. The Purposes of Contractual Interpretation

Conflict between the subjective and objective theories of contract has been a dominant theme in contract jurisprudence for the past two hundred years.[118] The contemporary manifestation of this dichotomy centers on the debate over principles of interpretation and meaning. At first glance, the debate appears to be an illustration of the pendulum swinging between objective and subjective poles. At the one pole are the "textualist" arguments of the legal formalists who urge strict adherence to the parol evidence and plain-meaning rules in order to preserve the "objective" meaning of written agreements.[119] The opposite, subjective pole of the interpretation continuum takes as its starting point the assumption that "the purpose of the court in all cases is the ascertainment of the intention of the parties if they had one in common."[120] Following Corbin's lead, the seekers of the "true" meaning of agreements regard textual formalism as an anachronistic impediment to the consideration of

118. The "intuitionist" theory of the inherent moral force of promises formed the basis of objective obligation for the social contract theorists of the 17th and 18th centuries. The 19th-century response to the objective morality of contract was the "will" theory in which contract was conceived as merely executing and protecting the will of the parties. The 19th-century formalists, typified by Langdell and Pollack, used the notion that the essence of contract is the subjective agreement of wills—or the "meeting of minds"—to craft the classical bargain theory of consideration. Inevitably, the obvious difficulties in identifying subjective intention led to the evolution of an objective theory of agreement that focused on the "manifestation" of intent rather than its subjective reality. *See* Goetz & Scott, *supra* note 8, at 1263 & n.15.

119. The textualist argument is vividly captured in Judge Learned Hand's famous dictum:

> A contract has, strictly speaking, nothing to do with the personal, or individual, intent of the parties. . . . If, however, it were proved by twenty bishops that either party, when he used the words, intended something else than the usual meaning which the law imposes upon them, he would still be held . . . .

Hotchkiss v. National City Bank, 200 F. 287, 293 (S.D.N.Y. 1911), *aff'd*, 201 F. 664 (2d Cir. 1912), *aff'd*, 231 U.S. 50 (1913); *see also* Cernohorsky v. Northern Liquid Gas Co., 268 Wis. 586, 68 N.W.2d 429 (1955):

> The language of a contract must be understood to mean what it clearly expresses. A court may not depart from the plain meaning of a contract where it is free from ambiguity. In construing the terms of a contract, where the terms are plain and unambiguous, it is the duty of the court to construe it as it stands, even though the parties may have placed a different construction on it.

Id. at 592-93, 68 N.W.2d at 433 (citation omitted); RESTATEMENT OF CONTRACTS § 230 comment b (1932); 4 S. WILLISTON, *supra* note 36, § 609, at 403-04 n.2 (citing supporting cases).

120. Corbin, *supra* note 65, at 162; *see also* Farnsworth, *"Meaning" in the Law of Contracts*, 76 YALE L.J. 939, 951-52 (1967).

relevant contextual evidence.[121] Through the revised rules of the Uniform Commercial Code and the Second Restatement,[122] the "contextualists" have succeeded in reducing greatly the exclusionary potential of the interpretive process.

Conventional wisdom holds that the battle is over and the contextualists have swept the field. The Code and the Second Restatement have abandoned the plain-meaning rule and eviscerated the parol evidence rule.[123] However, a close examination of the case law reveals a surprisingly different picture. In numerous cases, courts are unwilling to accept the full implications of contextualization; in one guise or another, they still invoke the primacy of express, written texts to exclude extrinsic evidence.[124]

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121. Corbin, *supra* note 65, at 164-70; Farnsworth, *supra* note 120, at 959-65. Without context, the argument goes, the search for meaning must necessarily fail, since a text has no objective or unitary meaning apart from the peculiar referents

122. U.C.C. § 2-202 (1978); RESTATEMENT (SECOND) OF CONTRACTS §§ 212-214 (1979). Under the revised parol evidence rule of the Code and Second Restatement, certain extrinsic evidence is admissible even if the express terms of the contract are clear and apparently integrated. Indeed, extrinsic evidence of prior negotiation and dealing is always admissible to explain the meaning of a written instrument. *See* RESTATEMENT (SECOND) OF CONTRACTS, § 213 comment b (1979).

123. Sunbury Textile Mills, Inc. v. Commissioner, 585 F.2d 1190 (3d Cir. 1978) (notwithstanding written merger clause, extrinsic evidence of intention is admissible); Alyeska Pipeline Serv. Co. v. O'Kelley, 645 P.2d 767 (Alaska 1982) (extrinsic evidence may be turned to initially in construing a contract); Pacific Gas & Elec. Co. v. G.W. Thomas Drayage & Rigging Co., 69 Cal. 2d 33, 442 P.2d 641, 69 Cal. Rptr. 561 (1968) (meaning of writing ean only be found by interpretation in light of all circumstances); Michigan Bean Co. v. Senn, 93 Mich. App. 440, 287 N.W.2d 257 (1979) (parol evidence admissible to supplement and explain written agreement); United States Nat'l Bank v. Caldwell, 60 Or. App. 639, 655 P.2d 180 (1982) (intent of parties found in language and surrounding circumstances), *petition denied*, 294 Or. 536, 660 P.2d 682 (1983).

124. Indeed, the continuing vitality of the traditional parol evidence and plain-meaning rules cannot be underestimated. A quick search reveals the numerous recent decisions that have reaffirmed a textualist approach to interpretation. L.S.S. Leasing Corp. v. United States, 695 F.2d 1359 (Fed. Cir. 1982) (parties bound by objective import of words, citing *Hotchkiss*); Watkins v. Petro-Search, Inc. 689 F.2d 537 (5th Cir. 1982) (unambiguous writing will be accorded the meaning apparent on its face; objective and not subjective intent controls); S.A. Empresa de Viacao Aerea Rio Grandense v. Boeing Co., 641 F.2d 746 (9th Cir. 1981) (parol evidence not admissible to explain unambiguous exculpatory clause; Washington law); Mellon Bank v. Aetna Business Credit, Inc., 619 F.2d 1001 (3d Cir. 1980) (parties bound by unambiguous written expression of intent); Lee v. Flintkote Co., 593 F.2d 1275 (D.C. Cir. 1979) (plain-meaning rule bars evidence of meanings of unequivocal contract terms, parol evidence rule distinguished); Reed, Wible & Brown, Inc. v. Mahogany Run Dev. Corp., 550 F. Supp. 1095 (D.V.I. 1982) (parties bound by objective manifestations, citing *Hotchkiss*); Acree v. Shell Oil Co., 548 F. Supp. 1150 (M.D. La. 1982) (intention determined according to plain, ordinary, and popular sense of language used), *aff'd*, 721 F.2d 524 (5th Cir. 1983); William B. Tanner Co. v. Sparta-Tomah Broadcasting Co., 543 F. Supp. 593 (W.D. Wis. 1982) (unambiguous contract language should be given its plain meaning, with no need to consider extrinsic evidence or rules of construction), *rev'd on other grounds*, 716 F.2d 1155 (7th Cir. 1983); Goldberg v. Lowe, 509 F. Supp. 412 (N.D. Miss. 1981) (parties bound by objective manifestation); King v. Gilbert, 445 F. Supp. 479 (N.D. Ga. 1977) (plain meaning must be followed even if result is completely unintended by parties); Kreis v. Venture Out in America, Inc., 375 F. Supp. 482 (E.D. Tenn. 1973) (unambiguous language may not be altered by parol evidence); Eskimo Pie Corp. v.

The apparent disarray that afflicts judicial efforts to interpret contractual agreements results from a fundamental misconception of the purposes of contract interpretation.[125] The textualists have implicitly assumed that the purpose of interpretation is to maintain the reasonable expectations of contracting parties as a class by upholding the objective integrity of express contractual language. By contrast, the contextualists have assumed that the purpose of interpretation is to uphold the expectations of the particular parties to the agreement by determining from an analysis of all relevant evidence what they "really meant." Neither assumption accords fully with the underlying objectives of contract formulation, and it is this distortion that accounts for the apparent conflict over proper modes of interpretation.

What appear at first to be irreconcilable differences in judicial applications of the parol evidence and plain-meaning rules can be rationalized if the assumed goals of contractual interpretation are recharacterized. The purposes of contract interpretation, properly conceived, are neither to determine a fixed, objective meaning of a written agreement nor to ascertain the true or subjective understanding of individual contracting parties. Our thesis is that interpretation should[126] embrace the institu-

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Whitelawn Dairies, Inc., 284 F. Supp. 987 (S.D.N.Y. 1968) (U.C.C. parol evidence rule admits evidence of course of dealing, but is limited to objective facts as distinguished from oral statements of agreement, and does not encompass proof as to subjective intent); First Nat'l Bank v. Mid-States Eng'g & Sales, Inc., 103 Ill. App. 3d 572, 431 N.E.2d 1052 (1981) (plain meaning unless it clearly appears unusual meaning intended); Bethlehem Steel Co. v. Turner Constr. Co., 2 N.Y.2d 456, 141 N.E.2d 590, 161 N.Y.S.2d 90 (1957) (same); Lineberry v. Lineberry, 59 N.C. App. 204, 296 S.E.2d 332 (1982) (express contractual provisions unambiguous, parol evidence improperly admitted); HBOP, Ltd. v. Delhi Gas Pipeline Corp., 645 P.2d 1042 (Okla. Ct. App. 1982) (parol evidence inadmissible); Steuart v. McChesney, 498 Pa. 45, 444 A.2d 659 (1982) (same); Murphy v. Hagan, 275 S.C. 334, 271 S.E.2d 311 (1980) (meaning of unequivocal document determined facially); Berry v. Klinger, 225 Va. 201, 300 S.E.2d 792 (1983) (plain-meaning rule controls interpretation of "unambiguous" written contract).

125. This misconception stems, in turn, from the twin fallacies of objective and subjective meaning. The textualist assertion that words have plain or inherent meaning fails to recognize that a characterization of one meaning as "objective" is itself a conclusion dependent upon the values and assumptions of the interpreter. Thus, as Corbin suggested, "when a judge refuses to consider relevant extrinsic evidence on the ground that the meaning of written words is to him plain and clear, his decision is formed by and wholly based upon the completely extrinsic evidence of his own personal education and experience." Corbin, *supra* note 65, at 164. "In this process of interpretation, no relevant credible evidence is inadmissible merely because it is extrinsic; all such evidence is necessarily extrinsic." *Id.* at 189.

The myth of objectivity, however, is mirrored by the myth of subjective truth. In fact, context is infinitely elastic. In selecting certain bits of context and not others, the interpreter necessarily imposes his own set of assumptions and beliefs on the contract. *See, e.g.*, Peller, *supra* note 62; *see also* S. FISH, *supra* note 62; Abraham, *supra* note 62, at 683-88. The realization that interpretation is contingent on the underlying assumptions of the interpreter helps focus attention where it belongs: on the underlying assumptions themselves.

126. We do not use the term "should" in its ordinary normative sense. Rather, our proposal is a plea for internal consistency, for coherence in basic assumptions within the "community of interpretation" that shares those assumptions. *See* Fish, *Interpreting the* Variorum, CRITICAL INQUIRY,

tional goal of motivating improvements in both the express and implied preformulations that constitute the defining instruments of contract. This explains much of the apparent incoherence of the case law. Most modern courts, both under the Code and the common law, appear willing to admit parol evidence in order to identify any commercial practices that shape the agreement between the parties. But these same courts are often unwilling to permit extrinsic evidence to be used to challenge the plain meaning of clear and unambiguous express terms.[127] While the judicial practice seems superficially incoherent, further reflection reveals it as a valid approach to preserving the role of both implied and express forms.

Under this perspective, the opposing poles of the interpretive continuum are actually converse to their traditional representations. The contextual search of extrinsic evidence for subjective meaning is actually a key element of the process by which evolving customary norms of *general* application are recognized and officially adopted. On the other hand, the textualist effort to exalt objective meaning over individual intent is better understood as protective of the ability to assert *particularized* understandings in the face of contrary inferences from context. The dichotomy between objective and subjective meaning emerges as an inherent interpretive tension generated by efforts to accommodate both generalization and particularization, the core processes of contractual formulation. Failure to understand and confront the competing nature of these goals inevitably results in confusions about the appropriate policies to apply in contractual interpretation.

B. Principles of Interpretation

1. The Communication Function: Motivating Optimal Precautions

There are inherent limitations in the symbols we use to communicate that make disputes about meaning an unavoidable risk of any system

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Spring 1976, at 465, 483-84 (discussing notions of "interpretive communities"). If the goals of contract formulation require the preservation of instruments of generalization and particularization, then harmony within the "community" requires principles of interpretation grounded on the same assumptions. Whether these normative objectives are themselves preferable to possible alternatives raises a separate question beyond the scope of this inquiry.

127. A number of courts have balanced a liberal interpretation of the parol evidence rule with a strict adherence to the plain-meaning rule. *See, e.g.*, Mellon Bank v. Aetna Business Credit, Inc., 619 F.2d 1001, 1010 n.9 (3d Cir. 1980) ("This issue of ambiguity [of meaning] must be carefully distinguished from the issue of 'integration.' "); Lee v. Flintkote Co., 593 F.2d 1275, 1281 (D.C. Cir. 1979) ("Strictly speaking, the parol evidence rule does not bar extra-contractual evidence of meanings . . . that is the function of the plain meaning rule."); Steuart v. McChesney, 444 A.2d 659, 661-62 (1982) ("While adhering to the plain meaning rule of construction, this Court, too, has cautioned: We are not unmindful of the dangers of focusing only upon the words of the writing in interpreting an agreement."); *see also* Watkins v. Petro-Search, Inc., 689 F.2d 537 (5th Cir. 1982) (same); First Nat'l Bank v. Mid-States Eng'g & Sales, Inc., 103 Ill. App. 3d 572, 431 N.E.2d 1052 (1981) (same).

of information. In the particular case of contractual formulation, the presence and interaction of a number of other variables exacerbate the problem. The incidence of many types of formulation error depends directly on the level of precaution taken during the contracting process. Most administrative errors, for example, result from accidental misstatements or omissions. Similarly, incompleteness errors occur when parties fail to allocate the risks of various contingencies—usually those having a low probability—leaving terms unspecified. Finally, inconsistency errors result when parties fail to coordinate properly their express and implied instructions.

To the extent that litigation costs are subsidized by the state, contracting parties have inadequate incentives to reduce their own communication errors.[128] A number of legal rules, however, sanction parties who take insufficient precautions against the risk of errors in communication. Thus, for example, while administrative errors can generally be remedied by either party seeking reformation of the agreement, equity may bar relief to a party guilty of "inexcusable neglect."[129] Similarly, the law of mistake generally assigns the risk of reasonably foreseeable ambiguity or incompleteness errors to the party in the better position to avoid them, unless the other party had "reason to know" of the mistake.[130] Much like the rules of negligence and contributory negligence, these compound liability rules encourage both parties to take precautions to minimize such errors.[131] The common law maxim of *contra proferentem* is a further influence on the drafting efforts of contracting parties. Its hostile presumption provides an incentive to avoid drafting poorly communicative contractual terms.[132]

128. *See* A. SCHWARTZ & R. SCOTT, *supra* note 4, at 63-65. Negotiation and drafting costs are in a sense precautionary, in that they help reduce the likelihood, and perhaps the scope, of litigation, and thus its total cost. Litigation costs are not fully "internalized," however, unless they are borne by the parties themselves. Thus, state-subsidized litigation diminishes the relative incentive to negotiate and draft error-free formulations.

129. *See, e.g.*, Harley v. Magnolia Petroleum Co., 378 Ill. 19, 37 N.E.2d 760 (1941) (reformation denied parties who deeded property knowing of recorded lease but ignoring its contents). In the case of mistake, reformation will be granted despite the negligence of the party claiming relief. *See* RESTATEMENT (SECOND) OF CONTRACTS § 157 comment a (1979). This statement is overbroad, however, because it assumes that the party seeking relief has proven the error by clear and convincing evidence and that the other party has not changed position in reliance on the written instrument. *See, e.g.*, Yablon v. Metropolitan Life Ins. Co., 200 Ga. 693, 38 S.E.2d 534 (1946).

130. *See, e.g.*, RESTATEMENT (SECOND) OF CONTRACTS §§ 152-154 (1979); R. Scott, Contract Law and Theory 210-12 (1982) (unpublished manuscript).

131. *See generally* Krouman, *Mistake, Disclosure, Information, and the Law of Contracts*, 7 J. LEGAL STUD. 1 (1978).

132. *See, e.g.*, William B. Tanner Co. v. Waseca-Owatonna Broadcasting, 549 F. Supp. 411 (D. Minn. 1982) ("valid until used" is an ambiguous term and will be construed against the drafter); National Merchandise Co. v. United Serv. Auto. Ass'n, 400 So. 2d 526 (Fla. Dist. Ct. App. 1981) ("auto accident" is ambiguous term construed against drafter); Sears v. Riemersma, 655 P.2d 1105 (Utah 1982) (dispute involving seller's obligation to improve real property resolved against buyer

In addition to the substantive common law rules, procedural or evidentiary rules can also operate to create incentives for the reduction of formulation error. This is harder to see. Substantive rules are readily recognized as shaping the behavior of future contracting parties. By contrast, the plain-meaning and parol evidence rules are conventionally seen as merely helping to determine what the parties to the present dispute intended. This focus on particularized intent obscures the fact that rules of interpretation have a profound prospective effect. Moreover, while they are traditionally regarded as operating in tandem, the parol evidence and plain-meaning rules influence formulation behavior in distinct and different ways.[133] The following discussion indicates how skillful use of these tools can reduce the tension between conflicting methods of error-reduction.

2. *The Definition Function: Reducing Interpretation Error*

Interpretation errors result in part from the failure of courts to distinguish correctly among the different signals used by contracting parties. Even if an agreement were perfectly communicative between the parties initially, one of the parties may dispute its meaning as a strategic response to a now disfavored arrangement. Frequently, such disputes center on alleged inconsistencies between express and implied terms. Because of the inherently uncertain mediation of words, errors are inevitable in the process of defining the meaning of different combinations of terms. The risk of this source of interpretation error depends directly on two variables: (1) the extent to which the agreement employs both express and implied terms; and (2) the ambiguity of the express signals chosen by the parties. Different rules of interpretation regulate the operation of each of these variables. The parol evidence rule determines which implied and express terms are legally relevant. For instance, a narrow, common law version of the rule reduces the interaction between express and implied terms and thus reduces the risk of inconsistency disputes. The plain-meaning rule, on the other hand, regulates the evidence used to interpret express instructions and determine whether the parties have chosen trumping or supplementary signals. Rigorous application of the plain-meaning rule reduces interpretation error by encouraging more

who drafted contract for sale); *see also* M.W. Zack Metal Co. v. International Navigation Corp. of America, 675 F.2d 525 (2nd Cir.), *cert. denied*, 459 U.S. 1037 (1982); United States v. N.A. Degerstrom, Inc., 408 F.2d 1130, 1134 (9th Cir. 1969); Wofac Corp. v. Hanson, 131 Ga. App. 725, 206 S.E.2d 614 (1974); Jacoby v. Grays Harbor Chair & Mfg. Co., 77 Wash. 2d 911, 918, 468 P.2d 666, 671 (1970); Patterson, *supra* note 75, at 854.

133. The plain-meaning rule encourages parties to select clear signals that enable the interpreter to differentiate between supplementary and trumping expressions. The parol evidence rule, on the other hand, motivates parties to select express rather than implied formulations. *See* A. SCHWARTZ & R. SCOTT, *supra* note 4, at 46-47.

careful choices of clear, predefined signals. Nevertheless, if the normative goal is to minimize aggregate error, insensitive application of either the plain-meaning or parol evidence rule is counterproductive. The task is to reduce interpretation error without incurring greater costs in another dimension of the formulation process.

a. The Problem of Distinguishing Between Supplements and Trumps

When a dispute arises over an apparent inconsistency between express and implied terms, courts are required to distinguish between supplementary expressions and trumps. At least for "contingent" contracts,[134] optimal rules of interpretation can reduce the resulting risk of interpretation error. The capacity of contingent contractors to particularize details of the contract in express terms suggests a hierarchy of presumptions to resolve disputes over arguably inconsistent terms.

Consider hypothetical negotiations between Development Corporation and Marketing Corporation. Assume that Development grants Marketing the exclusive rights to distribute "Readi-Calc," its revolutionary computer program with advanced spreadsheet capabilities. Assume further that applicable law will incorporate into their written agreement a variety of implied terms, including a duty that Marketing use its best efforts in promoting the sale of the Readi-Calc program and a correlative duty that Development cooperate fully in efforts to achieve the contractual objectives.[135] The implied duty of cooperation would ordinarily oblige Development to keep Marketing informed of anticipated technological developments that would affect distribution of the product. In the present situation, however, the risk to Development if certain proprietary secrets escape is sufficiently acute that the parties agree to an express instruction that "any disclosures of technological research are to be at the sole discretion of Development." Nevertheless, because such disclosures are generally in the mutual interests of the parties, analysis of context and usages will show a significant exchange of information between the parties.

Subsequently, a new integrated software package is introduced by a competitor and captures the dominant position in the software market.

134. Contingent contracts are defined by the presumption that the parties are capable of foreseeing all possible contingencies and have explicitly provided for the allocation of associated risks. They stand in contrast to "relational" contracts, for which the presumption is untrue, and in which the parties must thus be presumed to contemplate a continuing relationship for resolving the allocations of risks as they become foreseeable. *See* Goetz & Scott, *Relational Contracts*, *supra* note 4, at 1089-90.

135. Unless otherwise specified, the obligation to use best efforts is an implied duty of the distributor in all exclusive dealings arrangements. *See* U.C.C. § 2-306(2) (1978). The duty of cooperation is implied in all contracts that leave particulars of performance to be specified by one party, or where one party's cooperation is necessary to, or materially affects, the performance of the other. *Id.* § 2-311(1), (3).

Development argues that Marketing has not marketed its program effectively and is thus in violation of its best-efforts obligation.[136] Marketing asserts that Development's failure to inform it of the competitor's forthcoming technological advance was a breach of the duty of cooperation which contributed to the loss.[137] Development counters that the agreement expressly authorized withholding such market-research data, and that the express provision trumps the contrary implications drawn from practices between the parties or in the trade. How should a legal decisionmaker apply rules of interpretation to resolve whether the express term was intended as a supplement or as a trump?

b. Parol Evidence: The Presumption that Express Terms Are Supplements

Contingent contracts generally occur in well-developed markets where transactions are repetitive and specialized terms are specific to the market or industry rather than to the contract. As a result, parties experience substantial savings by being able to incorporate the customary prototypes that typify their contractual context. These savings can best be captured by an initial presumption that the express terms of the agreement are merely supplementary and that all relevant extrinsic evidence is incorporated into the contract.

This analysis supports the liberal interpretation of the parol evidence rule adopted by the Code and Second Restatement in order to ease access to terms impliable from custom and usage.[138] An interpretive presumption that express terms supplement rather than trump the contractual context would resolve the initial evidentiary question in our hypothetical. The evidence of trade usage and performance supports disclosure of product research. It would be admissible under the Code's parol evidence rule and relevant to the interpretation of the express provision.[139]

Interpretive errors in contingent contracts result not from the presumption that express terms are supplements, but from the failure to appreciate that the parol evidence and plain-meaning rules are separate mechanisms with different functions. Our analysis challenges the conventional assumption that a liberalized parol evidence rule requires a similarly loose rule for interpreting the meaning of express terms. The economic benefits of implication justify the presumption favoring inclu-

136. *See id.* § 2-306(2) & comment 5.

137. *See id.* § 2-311(3). If the required cooperation is not forthcoming, "the other party in addition to all other remedies . . . is excused for any resulting delay in his own performance." *Id.*

138. *See supra* text accompanying notes 43-48.

139. See U.C.C. § 1-205(4) (1978); RESTATEMENT (SECOND) OF CONTRACTS § 203(b) & comment d (1979).

sion of the commercial context. But reluctance to set limits on this presumption invites the parties to attack even apparently clear, express trumps. Such attacks weaken the signals used by atypical parties to escape state-supplied terms.

c. *The Plain-Meaning Presumption*

Most language does not carry the blessing of an official meaning. The presumption that express terms are supplements therefore requires a limiting presumption as well: parties are bound by the plain and ordinary meanings of the words used in their agreement. A plain-meaning presumption limits the probative weight accorded to informal contextual evidence offered to controvert the apparent meaning of express terms.[140] This presumption challenges those courts who, in order to spare parties the consequences of inartful wording, have blunted the plain meaning of terms such as "wife,"[141] "all sums,"[142] and "alimony."[143] Similarly, the presumption would limit the effect of inconsistent extrinsic evidence in our hypothetical contract, since our parties used conventional language whose plain and ordinary meaning granted unrestricted discretion to Development. Had the parties used a recognized invocation, an even stronger argnment for limiting the interpretive weight given to extrinsic evidence would apply. For example, they might have signalled the right to withhold disclosure "for any reason, with or without cause."[144] It is tempting to argue that such a strict construction might subvert the parties' true intentions. However, the ability of contingent contractors to select language unencumbered by predefined meaning justifies this rule. The lingering argument against a strong plain-meaning presumption is that the interpreter must somehow distinguish between meaningful lan-

140. Practically, the presumption would create a relevance issue roughly proportional to the "plainness" of the express terms. In the extreme case of invoeations, context evidence might be held completely inadmissible. *Compare* Brunswick Box Co. v. Coutinho, Caro & Co., 617 F.2d 355 (4th Cir. 1980) (evidence of course of performance held to vary normal meaning of F.A.S. term in written contract) *and* Steuber Co. v. Hercules, Inc., 646 F.2d 1093 (5th Cir. 1981) (same, CIF term), *with* Southern Concrete Servs. v. Mableton Contractors, 407 F. Supp. 581 (N.D. Ga. 1975) (express term controls), *aff'd* 569 F.2d 1154 (5th Cir. 1978) *and* National Heater Co. v. Corrigan Co. Mechanical Contractors, 482 F.2d 87 (8th Cir. 1973) (FOB term can be varied by further express language in agreement itself.)

141. *In re* Soper's Estate, 196 Minn. 60, 264 N.W. 427 (1935) (eontext evidence admitted to establish that "wife" did not mean the woman to whom decedent was legally married, but rather the woman with whom he was living at death).

142. Davis v. Small Business Inv. Co., 535 S.W.2d 740 (Tex. Civ. App. 1976) (statutory presumption favoring "reasonable" construction requires phrase "all sums expended" to be interpreted as "reasonable sums").

143. Kohn v. Kohn, 242 Pa. Super. 435, 364 A.2d 350 (1976) (context evidence admissible to show parties said "alimony" but meant "child support").

144. These words were used to authorize one party to exercise unlimited discretion in Corenswet, Inc. v. Amana Refrigeration, Inc., 594 F.2d 129 (5th Cir.), *cert. denied*, 444 U.S. 938 (1979).

guage and empty boilerplate.[145] As a practical matter, however, few instances of such boilerplate can be identified;[146] this problem appears to have little empirical significance.

An important complement to any plain-meaning presumption is the use of rules of disclosure to motivate interparty communication. The Code, for example, requires that disclaimers of implied warranties be conspicuous.[147] Since atypical parties are more likely to know that their needs are unusual, they properly bear the burden of clearly announcing the shift in presumptions from the typical to the unusual transaction. The Code does not specifically require that predefined invocations trumping customary delivery or credit terms be conspicuous. Neverthe-

145. By "boilerplate" we mean terms that are so uniformly used by rote, or are so embedded in layers of legal jargon, that their meaning is lost or their intelligibility substantially reduced. *See supra* note 73 and accompanying text.

146. There are, however, some cases that may require the interpreter to distinguish between plain meaning and boilerplate. Assume, for example, that a buyer of fertilizer seeks to justify his refusal to order the quantity specified in the written contract by asserting that the trade custom is for sellers to adjust quantities to reflect declining market conditions. Assume also that the contract contains the following broad merger clause: "This document represents the final agreement on all terms, and may not be explained, supplemented or modified by additional terms, usage of trade or course of dealing." A. SCHWARTZ & R. SCOTT, *supra* note 4, at 58. Is the merger clause a protected invocation or is it boilerplate?

Several recent cases have determined (at least implicitly) that such a general merger clause is boilerplate and thus not insulated from the contractual context. *See, e.g.*, Nanakuli Paving & Rock Co. v. Shell Oil Co., 664 F.2d 772 (9th Cir. 1981) (standard-form merger clause excluding evidence of dealings or usages did not "carefully negate" all uses of such evidence). Even evidence of additional terms is not necessarily excluded by a boilerplate merger clause. *See, e.g.*, Sunbury Textile Mills, Inc. v. Commissioner, 585 F.2d 1190 (3rd Cir. 1978) (extrinsic evidence of intention admissible despite merger clause).

An exception to the plain-meaning presumption for broad merger clauses is consistent with the empirical assumptions that underlie the market for contingent contracts. In discrete, sequential transactions, the costs of particularization are frequently too high to justify attempts to improve the accuracy of express contractual instructions. Rather, formulation begins by tentatively incorporating the informal prototypes that have evolved from market contexts and from ongoing relationships. The nature of contingent contracting thus refutes any allegations that standard-form, general merger clauses carry talismanic implications that would exclude *all* "unofficial" unplied terms. It is possible to imagine a party so sufficiently idiosyncratic as to wish to particularize the entire transaction. However, the nature of this type of contractual relationship justifies a strong presumption that broad merger clauses, although perhaps excluding additional express terms, do not exclude evidence of context.

The denial of talismanic power to standard merger clauses requires parties who wish to escape context to do so by more precise expression. While the requisite precision is more costly for such parties than a simple incantation of a standard magic phrase, the boilerplate presumption is likely to minimize formulation costs for most contingent contractors. The conclusion that a clause is boilerplate necessarily assumes that it has been inappropriately included in prior contracts. This pattern of historic, inappropriate use justifies the conclusion that the words have been emptied of legal meaning.

147. U.C.C. § 2-316(2) (1978). Language in a written contract is conspicuous "when it is so written that a reasonable person against whom it is to operate ought to have noticed it." *Id.* § 1-201(10). "[T]he test is whether attention can reasonably be expected to be called to it." *Id.* § 1-201 comment 10.

less, a clear signal is fairly implied since the Code stipulates that extrinsic evidence of usages or dealings becomes an element of the meaning of the words used unless "carefully negated."[148]

d. The Institutional Interest in "Balanced" Interpretation

A plain-meaning presumption can have a marginal influence in reducing errors that result from the use of ambiguous signals where clear ones are available. Perhaps more importantly, skillful use of the presumption by courts will, over time, increase the supply of officially recognized invocations and other express conventions. Conversely, a failure to appreciate the distinct effects of the plain-meaning and parol evidence rules can strip terms of their meanings and thus erode the established stock of express preformulations.

In one illustrative case, the seller attempted to introduce evidence of a course of performance between the parties to suggest that the buyer had agreed to pay for unloading and storage charges.[149] The court admitted the evidence despite the contract's F.A.S. shipment term, a Code-defined invocation providing that, unless otherwise agreed, the seller pays for unloading and storage charges.[150] Is the course of performance a supplementary "agreement" and thus consistent with the F.A.S. term? Or is the context trumped since it imposes a meaning for the term that is diametrically opposed to its definition in the Code and in local usage? Unfortunately, the proper relation between language and context cannot be determined by even the most exhaustive search for the meaning of the parties. Resolution necessarily turns on the state's treatment of the contractual signals used by the parties.

The court apparently assumed that the F.A.S. term is a broad, general-purpose shipment term used to signal a set of performance obligations. Under that view, the course of performance would be evidence of a more carefully tailored implied term that redesigns the somewhat ill-fitting conventional meaning that the Code and local usage applied to F.A.S. The discussion above has shown, however, that legal recognition of prevailing contextual patterns threatens the parallel process of recognizing similarly useful express signals. In order to protect the express conventions from such institutional bias, the F.A.S. term must be recognized as a narrowly defined invocation crafted by the Code to permit escape from implied terms. Under this interpretation, the course of performance would be clearly trumped by the talismanic meaning attributed to the F.A.S. term. After all, if parties are to use express terms to trump implied terms, the language they use for this purpose must be insulated

148. *See id.* § 2-202 comment 2.

149. Brunswick Box Co. v. Coutinho, Caro & Co., 617 F.2d 355 (4th Cir. 1980).

150. U.C.C. § 2-319(2) (1978).

from the context that they are seeking to escape. Only additional express language should properly be permitted to modify an express convention; otherwise, reliance on the factual context will create a presumptive answer to the very question being posed.

But few words and phrases have sufficiently clear legal meaning to fall within the protection of the plain-meaning presumption. Unfortunately, the current regulatory process of judicial interpretation and occasional legislative codification produces less than an optimal supply of established conventions. Contracting parties often must resort to uncertain signals. Where the words used have ambiguous meanings, extrinsic evidence remains a necessary interpretive tool for distinguishing inartfully worded supplementary provisions from express trumps. This process carries an inherent and unavoidable risk of interpretation error. In sum, even the most skillful use of interpretive presumptions can be regarded as only a long-term solution to the problem.

3. *Indeterminate Signals: The Dilemma of Relational Contracting*

Interpretive presumptions designed to minimize the error caused by the interaction between implied and express terms are most effective when applied to contingent contracts. The interpretation problem takes on different dimensions with relational contracts, where the interpreter may be called upon to distinguish between terms that are inadvertently equivocal and those that are deliberately indeterminate. Relational contracts create interdependent relationships in which unknown contingencies or the intricacy of a desired response may prevent parties from articulating their agreement with precision.[151] Under these conditions, contractual terms may be problematic in a more limited sense than that just discussed. Terms of trade may *intentionally* be left imprecise as a "lesser of evils" expedient. The obvious solution to incompleteness—express particularization—incurs great risks of misinterpretation. It may therefore be preferable to allow the parties to employ deliberately indeterminate formulations, which implicitly instruct the dispute-resolver to construe the contract equitably. What is called for here is not an interpretation of the definitive terms as either supplements or trumps, but rather an equitable "filling in of the blanks" in light of conditions that were either difficult to anticipate or impractical to describe in advance.

Indeterminate terms are sometimes signalled as such at the time of contracting. Familiar examples of such indeterminate formulations are agreements to do something in a "commercially reasonable time" or to use "best efforts." Both statutory definition and common sense indicate that "a reasonable time for taking any action depends on the nature, pur-

151. *See* Goetz & Scott, *Relational Contracts*, *supra* note 4, at 1089-91.

pose, and circumstances of such action."[152] Likewise, best efforts is a term "which necessarily takes its meaning from the circumstances."[153] Frequently, however, at the time they contract, the parties are insufficiently aware of the need to adjust their relationship in the future. Thus, the signal of indeterminacy may be implicit, and the distinction between provisions that are deliberately indeterminate and those intended either as supplements or trumps will less easily be drawn.[154]

Suppose, for instance, that in the hypothetical relationship between Development and Marketing discussed earlier there are important uncertainties about many aspects of future technological developments. Mar-

152. U.C.C. § 1-204(2) (1978).

153. Bloor v. Falstaff Brewing Corp., 454 F. Supp. 258, 266 (S.D.N.Y. 1978) (quoting Perma Research & Dev. Co. v. Singer Co., 308 F. Supp. 743, 748 (S.D.N.Y. 1970)), *aff'd*, 601 F.2d 609 (2d Cir. 1979).

154. The peculiar problems that affect the interpretation of disputed relational contracts are illustrated by the recent case of Nanakuli Paving & Rock Co. v. Shell Oil Co., 664 F.2d 772 (9th Cir. 1981). Nanakuli, a paving contractor, negotiated a long-term contract with Shell in which Shell agreed to supply and Nanakuli agreed to purchase all its asphalt requirements. After extensive negotiations and drafting, a written contract was signed providing that the contract price for asphalt ordered and supplied was to be determined by Shell's "posted price at the time of delivery." The written contract contained a standard merger clause. Some ten years after the original agreement was concluded, Shell increased the price on a delivery of 7,200 tons of asphalt from the $44 per ton price prevailing at the time of the order to $76 per ton, its posted price at the time of delivery. Subsequently, Nanakuli sought $220,800 in damages for breach of the contract, alleging that the paving trade in Hawaii followed a practice of "price protection" by extending the old price for a period of time after a new one became effective. Nanakuli claimed that Shell had protected it from price increases in two previous instances. In response, Shell argued that if the relevant market were narrowed to the supply of asphalt alone, the usage was not clearly established. Shell further claimed that the two instances of price protection were isolated waivers, not a course of performance. Finally, it said that in any event the extrinsic evidence was clearly inconsistent with the express price term in the contract and thus the price term was controlling under U.C.C. § 1-205(4).

In reinstating the jury's verdict for Nanakuli, the Ninth Circuit held that the jury could properly have found a relevant usage and course of performance, and that this extrinsic evidence was not inconsistent with the express price term in the written contract. At first glance, *Nanakuli* seems to be a perfectly correct application of the rules of interpretation developed above. The court applied a presumption of consistency to the extrinsic evidence submitted by the buyer, holding that the express price term supplemented, rather than trumped, the price protection usage. The presumption was not overcome by the inclusion of a standard merger clause, which the court characterized as boilerplate rather than as an invoked term of art.

Further reflection, however, reveals an underlying conceptual problem. The court in *Nanakuli* framed the interpretive issue as a choice between supplementary expressions and trumps. This requires a binary resolution: either the express price term trumps the context or the price protection usage fully applies. While such a resolution may be entirely appropriate for contingent contracts, it may not be for relational contexts like the Nanakuli-Shell transaction. In such relationships, it is equally plausible to assume that the apparent conflict between the express price term and the custom of price-protection could not have been "solved" by the parties when they crafted their agreement. This hypothesis is supported by evidence that the price-protection issue first arose in 1970, seven years after the supply contract was negotiated and following major changes in Shell's management. If the formulations in *Nanakuli* were indeterminate rather than apparently inconsistent, then neither the outcome endorsed by the court nor the result urged by Shell would represent the optimal interpretive solution. Instead, an equitable adjustment of price would have been more consistent with the contractual instructions of the parties.

keting might then be unwilling to risk granting Development the clear but dangerously sweeping discretionary provision assumed in our earlier example.[155] Instead, the parties agree that "[d]evelopment reserves the right to take appropriate steps to protect its proprietary interests in technical developments." How would this alteration affect the resolution of the interpretive dispute? The earlier case was resolvable by the plain-meaning presumption. Under the present facts, however, the express formulation is not *clearly* a trump of the customary assumptions of disclosure. Therefore, the presumption that express terms are supplements seems to allow Marketing to establish, through usage and course of performance, the normal duty of mandatory disclosure. But that resolution assumes that the precise type of "appropriate steps" protection desired by Development could have been anticipated and clearly dealt with at the time of contracting. While such an assumption may be entirely appropriate for contingent contracting, it cannot be made with confidence in relational contexts. The parties to a relational contract may have failed to provide more detailed instructions simply because they were incapable of anticipating their needs precisely.

In this case, the parties implicitly have chosen an indeterminate instruction. An equitable adjustment of the relationship would be more consistent with that instruction than would either of the extremes of full disclosure or absolute discretion.[156] Under this analysis, broad or flexible obligations—such as the "appropriate steps" performance standard agreed to between Development and Marketing—are an implicit request for equitable definition of the standards for subsequent performance, with the interests of both parties to be taken equally into account. This joint maximization conception of the nature of relational obligations expands the contractual benefits to be divided prospectively between the parties.[157] For example, it seems plausible to assume that the parties would have agreed that "appropriate steps" might require Development to balance its normal obligations of cooperation against its protective interest in any *exceptionally* sensitive future research—the precise nature of

155. On the one hand, Marketing will recognize that withholding information will be legitimate in certain circumstances. On the other hand, it will fear that Development may wish to withhold information in unjustified circumstances. Development has a similar set of concerns. Moreover, the parties will lack confidence in their ability to foresee and describe hypothetical conditions that control whether information may be withheld. In addition, our earlier example may have been unrealistic in assuming that the clear solution, in which Marketing bears all of the risk, is economically tolerable.

156. *See generally* Speidel, *Court-Imposed Price Adjustments Under Long-Term Supply Contracts*, 76 NW. U.L. REV. 369 (1981); Speidel, *Excusable Nonperformance in Sales Contracts: Some Thoughts About Risk Management*, 32 S.C.L. REV. 241, 279 (1980).

157. *See* Goetz & Scott, *Relational Contracts*, *supra* note 4, at 1112-17. Of course, the benefits from "equitable adjustment" must be weighed against the increased uncertainty that such open-ended interventions may impose on contracting parties.

which would presently be impossible to describe.[158] On the other hand, nondisclosure is not an "appropriate step" for the more typical information exchanges where the special interests of Development do not outweigh those of Marketing.

Unfortunately, current rules of interpretation provide few effective mechanisms for distinguishing between apparent inconsistency and deliberate indeterminacy. For relational contractors, therefore, interpretive disputes will essentially be a lottery until the state provides the requisite instruments for more accurate signalling. To advance the normative objectives of contract law, courts must promote the evolution of predefined invocations that clearly trigger such equitable resolutions of interpretational disputes.

Technological changes in the legal dispute-resolution mechanisms might reduce some of the inherent tensions infecting interpretation of relational contracts. One ambitious form of state support would be for courts to issue on request private "letter rulings" at the initial stages of negotiated contracts. Ex ante interpretive rulings would enhance the reliability of contractual formulations. Rulings of general interest could be published, thus accelerating the process of legal recognition for express contractual prototypes. The cost of the additional state subsidy could be kept roughly congruent with the level of social benefits by retaining discretionary authority to reject requests.[159] As an alternative mechanism for reducing formulation error, the state could endorse the parties' ex ante choice of interpretive presumptions. If the state provided a menu of clearly defined presumptions or interpretive meta-rules, private contractors could select the principles and the assumptions that would govern the resolution of any dispute.[160]

CONCLUSION

This Article has examined the dynamic process in which contracting parties choose combinations of express and implied terms to formulate their agreements. Conventional resource-cost analysis supports the generally held view that the state's intervention facilitates this formulation process by providing widely suitable "off the rack" provisions, while leaving atypical parties free to design other, more unusual provisions.

But whether or not their goals are atypical, parties desire to reduce

158. In our software example, for instance, major developments such as spreadsheets, integrated software, and "windowing" would have been impossible to anticipate or describe until a very short time before they occurred. In addition, each of these developments presents different protective secrecy problems.

159. *See generally* Portney, *supra* note 112.

160. *See, e.g.*, Buffalo Sav. & Loan Ass'n v. Trumix Concrete Co., 641 S.W.2d 650 (Tex. Civ. App. 1982) (construing ambiguous contract according to construction given by parties themselves).

the errors caused by defects in the contractual formulations that express those goals. From this perspective, the role of the state has a markedly different cast. State-supplied terms offer advantages over privately-provided terms by reducing the risk of various types of design defect. However, since contractual formulations must satisfy *both* conventional and atypical purposes, state action in implying terms from the commercial context cannot fully mitigate the risk of error. The state must permit private parties to use express terms to redesign the implied agreement. Unfortunately, attempts to combine express and implied terms increase the danger that the agreement, as finally assembled, will contain design defects or error-causing uncertainties. The promise of expanded choice thus impels the state to provide standardized terms, both express and implied, that reduce the risks associated with these untested combinations. Ironically, by officially recognizing standard terms, the state is also implicitly *regulating* the formulation process.

State regulation of contractual formulations suffers from two problems. First, there is an institutional bias against unconventional methods of expression. To the extent that parties with conventional goals are channeled into conventional, error-minimizing formulations, this bias is socially desirable. Unfortunately, the bias also operates against the use of unconventional signals by parties pursuing nonstandard goals in what appear to be conveutional contexts. By preferring implied over express terms, the state makes creative or innovative formulations more costly. Second, the state's continuing control of interpretation—the primary recognition mechanism—restrains already weak market forces that might encourage innovation. The fundamental tension between the general advantages of standardization and the accommodation of nonstandard goals thus adversely impacts the effective range of choice available to contracting parties. Even with unlimited expenditures on negotiating and drafting, contractors who combine state-supplied terms with attempted private improvements may not attain the formulatious most appropriate to their substantive needs.

Our discussion has not identified any irrationalities in the pattern of private responses to contractual goals. To the extent that problems exist, therefore, remedial measures must be directed to the institutional framework, specifically, to the interpretive constraints that affect party choices. Much of the current uncertainty over proper modes of interpretation has resulted from two largely unrecognized failures of understanding. One of these is lack of attention to the distinct ways in which contractual formulations may be defective. The other is a reluctance to confront the interdependent and inherently conflicting processes by which contractual formulations develop. If contractual interpretation is successfully to reduce error, the state's modes of intervention must be sensitive both to the

needs of the evolutionary process itself, and to the appropriate responses to the various types of formulation error.

The appropriate policy responses involve classic tradeoffs. If the state follows the example of the Code in expansively incorporating contextual patterns, it will impose a corresponding burden on contracting parties who attempt unconventional expressions. On the other hand, if the state adheres to the narrower interpretive framework of the common law, the risk of formulation error will increase. Parties will be denied convenient access to the tested, cost-effective formulations embedded in their contractual context. In contingent contracts, the aggregate cost of formulation error will be minimized if the state explicitly acknowledges the need for incentives to produce both express and implied conventions. In relational contexts, while clearer signals are not available, recognition of the state's role can nevertheless serve to eliminate egregious errors of interpretation that increase aggregate costs.