

Winter 2013

A Lesson on Some Limits of Economic Analysis: Schwartz and Scott on Contract Interpretation

Steven J. Burton

University of Iowa, steven-burton@uiowa.edu

Follow this and additional works at: <http://www.repository.law.indiana.edu/ilj>

 Part of the [Contracts Commons](#)

Recommended Citation

Burton, Steven J. (2013) "A Lesson on Some Limits of Economic Analysis: Schwartz and Scott on Contract Interpretation," *Indiana Law Journal*: Vol. 88: Iss. 1, Article 6.

Available at: <http://www.repository.law.indiana.edu/ilj/vol88/iss1/6>

This Article is brought to you for free and open access by the Law School Journals at Digital Repository @ Maurer Law. It has been accepted for inclusion in Indiana Law Journal by an authorized administrator of Digital Repository @ Maurer Law. For more information, please contact wattn@indiana.edu.



JEROME HALL LAW LIBRARY

INDIANA UNIVERSITY
Maurer School of Law
Bloomington

A Lesson on Some Limits of Economic Analysis: Schwartz and Scott on Contract Interpretation

STEVEN J. BURTON*

Contract interpretation has been a hot topic of scholarly debate since 2003, when Professors Alan Schwartz of Yale and Robert E. Scott of Columbia published their provocative article, Contract Theory and the Limits of Contract Law, much of which develops an efficiency theory of contract interpretation. In 2010, they published a restatement of this theory and reply to critics, which has not yet drawn much commentary. This Article suggests that, even as restated, their theory offers an object lesson on some limits of economic analyses of the law. The Article assumes that their central argument is mathematically and economically impeccable. It suggests, however, that the theory nonetheless fails. Their central argument rests on a naïve understanding of the nature of language and the legal context of contract interpretation. Their efficiency claim neglects an alternative theory that does not rest on economics, but that probably would support a more efficient law. And their basic premise—that efficiency should be the sole goal of a law for business contracts—makes the theory strikingly vulnerable. In particular, virtually everyone, Schwartz and Scott included, agrees that rule of law values should constrain all laws. When considered, however, they doom Schwartz and Scott’s interpretation theory, as they may doom any monist theory.

INTRODUCTION

Judging by the huge number of reported cases raising contract interpretation issues, parties often manifest their intention in unclear language. Words may be vague or ambiguous, pronouns and syntactical errors may create indefinite referents, and two or more clauses may have incompatible implications for resolving a dispute.¹ When a party contends that contract language thus fails, as relevant to a dispute, interpretation is needed and litigation may ensue.² In a litigation context, a court may find that the language is “unambiguous” and enter judgment accordingly as a matter of law.³ Or the court may find that the language is

† Copyright © Steven J. Burton 2013.

* John F. Murray Professor of Law, University of Iowa. For their comments on the drafts, the author thanks Eric G. Andersen, Shawn Bayern, Lisa Bernstein, James W. Bowers, Melvin A. Eisenberg, Michelle Falkoff, Thomas P. Gallanis, Herbert Hovenkamp, Mark Osiel, Todd D. Rakoff, and participants in the Iowa Legal Studies Workshops held on October 29, 2010 and July 21, 2011. Serena Stier’s comments were exceptionally helpful, as always. Mauricio Cardona, Rumsin Khoshaba, Scott Quelhorst, Samantha Rollins, and Andrew Tran provided extraordinary research assistance.

1. See 2 E. ALLAN FARNSWORTH, FARNSWORTH ON CONTRACTS § 7.8, at 269–74 (3d ed. 2004) [hereinafter FARNSWORTH ON CONTRACTS]; E. Allan Farnsworth, “*Meaning*” in the Law of Contracts, 76 YALE L.J. 939, 952–58 (1967) [hereinafter Farnsworth, “*Meaning*”]; *infra* text accompanying note 24.

2. Farnsworth, “*Meaning*,” *supra* note 1, at 962–63.

3. Courts generally use “ambiguity” to cover all kinds of unclear terms. Sometimes, it would be more informative to distinguish ambiguity from vagueness, as this Article will when it makes a difference. See *infra* text accompanying notes 71–76.

ambiguous and proceed to resolve the ambiguity itself or charge a jury with doing so. There is a near-consensus that the interpreter's job is to ascertain the meaning(s) of the relevant language when the contract was made, if possible.⁴

After decades of relative neglect, contract interpretation became a hot topic of scholarly debate after 2003.⁵ In that year, Professors Alan Schwartz of Yale and Robert E. Scott of Columbia published *Contract Theory and the Limits of Contract Law*,⁶ much of which presents and defends a novel theory of contract interpretation.⁷ The article provoked much commentary, including the present author's passing critique in his 2009 book, *Elements of Contract Interpretation*.⁸ In 2010, Schwartz and Scott reacted by publishing *Contract Interpretation Redux*,⁹ a restatement and clarification of their theory, as well as a reply to critics.¹⁰

4. See RESTATEMENT (SECOND) OF CONTRACTS § 200 (1981) (explaining that interpretation means ascertaining the meaning of a promise or agreement or a term thereof). Of course, sometimes interpretation will not yield a defensible answer. Existing law then resorts to contract implication, non-interpretive default, or closure rules; or finds that there was no agreement and, therefore, no contract. The covenant of good faith and fair dealing, which the law implies in every contract, exemplifies implication. See, e.g., U.C.C. § 1-304 (2006); RESTATEMENT (SECOND) OF CONTRACTS § 205 (1981). An example of a closure rule is *contra proferentem* ("interpretation" against the drafter). See, e.g., RESTATEMENT (SECOND) OF CONTRACTS § 206 (1981). The best known example of a failure to agree is *Raffles v. Wichelhaus*, (1864) 159 Eng. Rep. 375 (Exch.).

5. Significant earlier works include David Charny, *Hypothetical Bargains: The Normative Structure of Contract Interpretation*, 89 MICH. L. REV. 1815 (1991); Arthur L. Corbin, *The Interpretation of Words and the Parol Evidence Rule*, 50 CORNELL L. Q. 161 (1965); Margaret N. Kniffin, *A New Trend in Contract Interpretation: The Search for Reality as Opposed to Virtual Reality*, 74 OR. L. REV. 643 (1995); Eric A. Posner, *The Parol Evidence Rule, the Plain Meaning Rule, and the Principles of Contract Interpretation*, 146 U. PA. L. REV. 533 (1998).

6. Alan Schwartz & Robert E. Scott, *Contract Theory and the Limits of Contract Law*, 113 YALE L.J. 541 (2003) [hereinafter *Contract Theory*].

7. *Id.* at 568–94.

8. STEVEN J. BURTON, *ELEMENTS OF CONTRACT INTERPRETATION* 214–20 (2009) [hereinafter *ELEMENTS*]; Adam B. Badawi, *Interpretive Preferences and the Limits of the New Formalism*, 6 BERKELEY BUS. L.J. 1 (2009); Shawn J. Bayern, *Rational Ignorance, Rational Closed-Mindedness, and Modern Economic Formalism in Contract Law*, 97 CALIF. L. REV. 943 (2009); James W. Bowers, *Murphy's Law and the Elementary Theory of Contract Interpretation: A Response to Schwartz and Scott*, 57 RUTGERS L. REV. 587 (2005); Kent Greenawalt, *A Pluralist Approach to Interpretation: Wills and Contracts*, 42 SAN DIEGO L. REV. 533, 571–93 (2005); Avery Wiener Katz, *The Economics of Form and Substance in Contract Interpretation*, 104 COLUM. L. REV. 496 (2004); Juliet P. Kostritsky, *Plain Meaning vs. Broad Interpretation: How the Risk of Opportunism Defeats a Unitary Default Rule for Interpretation*, 96 KY. L.J. 43 (2008); Jody S. Kraus & Robert E. Scott, *Contract Design and the Structure of Contractual Intent*, 84 N.Y.U. L. REV. 1023 (2009); Jeffrey M. Lipshaw, *The Bewitchment of Intelligence: Language and Ex Post Illusions of Intention*, 78 TEMP. L. REV. 99 (2005) [hereinafter Lipshaw, *The Bewitchment of Intelligence*]; Jeffrey M. Lipshaw, *Models and Games: The Difference Between Explanation and Understanding for Lawyers and Ethicists*, 56 CLEV. ST. L. REV. 613 (2008); Geoffrey P. Miller, *Bargains Bicoastal: New Light on Contract Theory*, 31 CARDOZO L. REV. 1475 (2010); Richard A. Posner, *The Law and Economics of Contract Interpretation*, 83 TEX. L. REV. 1581 (2005); Steven Shavell, *On the Writing and the Interpretation of Contracts*, 22 J.L. ECON. & ORG. 289 (2006).

9. Alan Schwartz & Robert E. Scott, *Contract Interpretation Redux*, 119 YALE L.J. 926

This Article continues the debate and offers a larger lesson. Part I identifies the three main issues that a theory of contract interpretation should address. Part II summarizes Schwartz and Scott's theory and its central supporting argument, which is based entirely on efficiency concerns. While assuming that their argument is mathematically and economically impeccable, Part III shows that it nonetheless fails for three non-economic reasons. Their argument rests on a naïve understanding of the nature of language and the context of interpretation in contract law. Their efficiency claim neglects an alternative, noneconomic theory of contract interpretation that probably would support a more efficient law than would their theory. And their basic premise—that efficiency should be the sole goal of a law for business contracts—makes their theory strikingly vulnerable to refutation on the basis of rule of law values, the relevance of which virtually everyone recognizes. This Article concludes that these deficiencies make Schwartz and Scott's theory an object lesson on some limits of economic analyses of the law.

I. THREE ISSUES IN CONTRACT INTERPRETATION

A theory of contract interpretation should tell an interpreter how to perform three tasks to ascertain the meaning of the parties' manifestations of intention when they made their contract. An interpreter (1) identifies the term(s) to be given meaning(s), (2) decides whether a term is relevantly ambiguous, and (3) resolves a relevant ambiguity if one appears. Among contracts scholars, there is no consensus about how an interpreter should accomplish these tasks. Consequently, normative theories of contract interpretation proliferate.¹¹

The first task, identifying the term(s) to be interpreted, is necessary because a contract's terms generate the parties' contractual rights and obligations and, therefore, determine what counts as performance or breach. This task needs to be undertaken most often when the parties have put their contract into writing. They later may disagree, for example, on whether an oral agreement established a contract term when they made it before concluding the written contract. Thus, parties may make such "parol" or "extrinsic" agreements in the course of negotiations. But they may intend the written contract to supersede them. When they so intend, the written contract discharges those agreements, whose terms do

(2010) [hereinafter *Redux*].

10. *Id. Redux* begins with a quick dismissal of ELEMENTS's theory. However, Schwartz and Scott mischaracterized that book's arguments and recommendations in many ways. To illustrate, they called ELEMENTS's theory "untenable" because it urges courts to consider course of dealing and other extrinsic evidence. Thus, they say, it would preclude summary judgments. *Id.* at 929 & n.10 (citing ELEMENTS's discussion of merger clauses, which is not relevant to their point). ELEMENTS actually says, three times: "The admissible evidence should not include evidence of . . . the parties' course of dealing." ELEMENTS, *supra* note 8, at 212; *see also id.* at 22, 209. Further, it says, three times, that the question of ambiguity should be retained because summary judgments are necessary. *Id.* at 119–21, 204–05, 209. And, it says twice that a court on summary judgment should not hear extrinsic evidence but should consider allegations, arguments, proffers, and the like about the evidence. *Id.* at 114–15, 209. Recounting the other problems with Schwartz and Scott's characterization would be tedious.

11. *See supra* notes 5, 8.

not generate contractual rights and obligations.¹² The writing then contains the only terms for matters within the contract's scope.

The parol evidence rule governs performance of this task.¹³ Under existing law, it applies only when an agreement is enforceable, written, and "integrated."¹⁴ The written agreement may be "completely" or "partially" integrated. It is completely integrated when it is the final and exclusive expression of the parties' contract.¹⁵ It is partially integrated when it is final as to the written terms, but does not exclude additional terms.¹⁶ The parol evidence rule has two corresponding branches. In summary form, it provides: (1) when an enforceable, written agreement is completely integrated, a parol agreement does not establish terms if they contradict or add to the written terms; and (2) when an enforceable, written agreement is only partially integrated, a parol agreement may add to, but may not contradict, the written terms.¹⁷

As its predicates indicate, the parol evidence rule applies only *when* an enforceable, written agreement is integrated, partially or completely. It says nothing about *whether* the written contract is integrated. Substantively, the answer to the question of integration turns on the parties' intention to integrate or not.¹⁸ In a few jurisdictions, a "context rule" allows a court to consider all of the factors relevant to the question of integration.¹⁹ In a far greater number of jurisdictions, by contrast, a "four corners rule" limits the allowable factors to the written contract alone.²⁰ Jurisdictions that follow either rule employ the parol evidence rule as stated above.

Having identified the contract's terms, an interpreter may need to determine their meaning(s).²¹ The law usually does this in two steps. First, a judge decides whether language relevantly fails—whether it is "ambiguous"—and usually does so on a motion for summary judgment.²² Then, if the language is ambiguous, a judge or jury resolves the ambiguity after a trial, if a party offers extrinsic evidence.²³

In the legal context, a term is "ambiguous" when it bears an array of reasonable meanings and the parties advocate (normally) two of them. Each of the meanings in play may generate different rights and obligations, setting the stage for an

12. RESTATEMENT (SECOND) OF CONTRACTS § 213 (1981).

13. *Id.* § 213 cmt. a (the parol evidence rule "defines the subject matter of interpretation").

14. *Id.* §§ 209, 210, 213.

15. *Id.* §§ 209(1), 210(1)–(2).

16. *Id.* §§ 201(1), 210(1)–(2).

17. *Id.* § 213; ELEMENTS, *supra* note 8, at 64. Parol agreements are admissible when proffered for purposes other than establishing contract terms, such as proving that the written contract is or is not enforceable, or proving a term's meaning. RESTATEMENT (SECOND) OF CONTRACTS § 214 (1981). Professors Calamari and Perillo have warned wisely that the rule is easier to state than to apply. John D. Calamari & Joseph M. Perillo, *A Plea for a Uniform Parol Evidence Rule and Principles of Contract Interpretation*, 42 IND. L.J. 333 (1967).

18. *E.g.*, *Masterson v. Sine*, 436 P.2d 561, 563 (Cal. 1968); *Gianni v. R. Russel & Co.*, 126 A. 791, 792 (Pa. 1924); FARNSWORTH ON CONTRACTS, *supra* note 1, at § 7.3, at 225, 229, 233.

19. *E.g.*, RESTATEMENT (SECOND) OF CONTRACTS §§ 209 cmt. c, 210 cmt. b (1981).

20. ELEMENTS, *supra* note 8, at 105, 109–11.

21. *See supra* note 4 and accompanying text.

22. This is not the case for transactions in goods. *See* U.C.C. § 2-202 cmt. 1(c) (2004).

23. ELEMENTS, *supra* note 8, at 152–55.

interpretive dispute. The late Professor E. Allan Farnsworth identified four types of contractual ambiguity.²⁴ Term ambiguity occurs when a term bears two or more distinct meanings. “Bank,” for example, may refer to the side of a river or a financial institution, among other things. Sentence ambiguity is due to bad syntax. Consider: The house had a gazebo in the yard that was white. Was it the house, the gazebo, or the yard that was white? Structural ambiguity occurs when two (or more) contract terms contradict each other. A contract’s termination clause, for example, may allow either party to terminate at any time, but only with one year’s notice. The *force majeure* clause, however, allows one party to terminate if a *force majeure* event occurs. Must that party give one year’s notice of termination when a *force majeure* event occurs? Lastly, vagueness occurs when one word’s meaning shades into another’s. “Red” is vague because it shades into pink, orange, and purple, with no lines of demarcation. Contract terms requiring a builder to construct a house in a “good and workmanlike manner,” or a seller to deliver goods that are “fit” for a specified purpose, are vague.

Under existing common law, the “plain meaning rule” is prevalent for deciding whether contract language is ambiguous in any of these ways. Some understand this rule to require judges to hold, as a matter of law, that the contested term is unambiguous when it has one ordinary meaning on the contract document’s face.²⁵ A competing “context rule” tells a judge to consider all evidence bearing on the parties’ intended meaning(s).²⁶ Properly understood, however, the plain meaning and context rules are not competitors. In its most common version, the plain meaning rule provides that *when* a contract is unambiguous, it must be given its plain meaning.²⁷ This rule says only that an *unambiguous* contract must be given its *unambiguous* (plain) meaning—a tautology with which no one can reasonably disagree. The battle is over the four corners rule, which here says *whether* a contract is unambiguous depends on the contract document alone.²⁸

Having identified the contract’s terms and found a relevant ambiguity, an interpreter must resolve the ambiguity by deciding which of the contested meanings generates the parties’ rights and obligations. Existing law does little to help in performing this task. It tells an interpreter to find the parties’ intention on the basis of all relevant evidence.²⁹ In this context, however, intention is often a poor touchstone. The parties may not have had an *ex ante* intention on the relevant meaning at all. Abstractions that seemed clear when a contract was drafted may turn out to be unclear after a dispute arises and poses a concrete issue. Parties sometimes accept a known ambiguity because they would incur excessive costs if they negotiated and drafted to address a remote contingency clearly. In that case, their intention itself is ambiguous.

24. Farnsworth, “*Meaning*,” *supra* note 1, at 952–57.

25. *E.g.*, *Sturman v. Socha*, 463 A.2d 527, 533 (Conn. 1983).

26. *Pac. Gas & Elec. Co. v. G.W. Thomas Drayage & Rigging Co.*, 442 P.2d 641, 645 (Cal. 1968) (Traynor, C.J.); 3 ARTHUR LINTON CORBIN, CORBIN ON CONTRACTS § 535, at 19–20 (1960). *See also* RESTATEMENT (SECOND) OF CONTRACTS § 212 cmt. b (1981).

27. *E.g.*, *Intermountain Eye and Laser Centers PLLC v. Miller*, 127 P.3d 121, 125 (Idaho 2005).

28. ELEMENTS, *supra* note 8, at 109–11.

29. *Id.* at 158–85.

II. SCHWARTZ AND SCOTT'S THEORY OF CONTRACT INTERPRETATION

For contracts between business firms, Schwartz and Scott recommend what they call “formalist” or “textualist” interpretation under a default rule.³⁰ That is to say that, to identify contract terms, they endorse the parol evidence rule together with the four corners rule.³¹ To determine whether a term is ambiguous, they endorse the plain meaning rule which, for them, refers to a term’s meaning in “majority talk”—the typical meaning of the term among judges, businesspersons, lawyers, and jurors—together with the four corners rule, which excludes extrinsic evidence.³² Though not entirely clear on the point, they apparently would resolve ambiguities on the basis of all relevant evidence, including extrinsic evidence.³³

A. *The Theory's Recommendations*

Schwartz and Scott recommend that contract law include a parol evidence rule, together with a four corners rule for deciding the question of integration, as a default.³⁴ The parties, they say, should be free to agree that a court may consider extrinsic evidence, such as the contract’s negotiating history and any trade usages.³⁵ Under current law in any jurisdiction, a party who wants to exclude extrinsic evidence must prove that the contract was integrated. They may do this by manifesting their intention to integrate in a merger clause in the written contract (for example, “this writing is the final, exclusive, and complete expression of the parties’ contract”). Schwartz and Scott’s proposal would presume that a written contract is integrated; hence, parties that want to allow extrinsic evidence would write an “anti-merger” clause.

The major focus of the theory is the question of ambiguity. To answer it, they recommend a default rule that embraces “textualism” and licenses courts to consider an “evidentiary base” that excludes extrinsic evidence, including the parties’ course of dealing, the contract’s negotiating history, any trade usages, and other extrinsic evidence.³⁶ Their base consists of the whole contract document and the pleadings, briefs, what the parties did and did not do, prayers for damages, and the judge’s life experience.³⁷ They say that this base “ordinarily will convey sufficient contextual information” to make interpretation possible.³⁸

30. For a discussion of their theory’s limitation to business contracts, see *infra* text accompanying notes 112–13. At one point, Schwartz and Scott insist that they urge courts to follow party preferences—which they say favor a narrow evidentiary base—rather than urging courts to use such a base. *Redux*, *supra* note 9, at 952. This distinction is logically untenable. For Schwartz and Scott to urge courts to do what the majority of firms wants, and to find that the majority wants courts to use a narrow evidentiary base, entails that Schwartz and Scott urge courts to use such a base. Accordingly, they explicitly do so many times. *See id.* at 930–31, 932, 935, 941, 944, 946–47, 957; *Contract Theory*, *supra* note 6, at 584.

31. *Redux*, *supra* note 9, at 932.

32. *Id.*; *Contract Theory*, *supra* note 6, at 584–90.

33. *See Redux*, *supra* note 9, at 963 n.94.

34. *Id.* at 932; *Contract Theory*, *supra* note 6, at 547 & n.7.

35. *Redux*, *supra* note 9, at 939–44.

36. *Id.* at 933 n.20.

37. *Id.* at 933, 964; *Contract Theory*, *supra* note 6, at 572. The 2010 base reflects a

Notably, this context includes only the document and a judge's context when he or she interprets (ex post). It excludes extrinsic evidence of the parties' context when they contracted (ex ante). The latter context differs from a judge's because it does not include any litigation documents or the parties' life experiences.³⁹ Hence, it is unclear how a judge could use his or her ex post context to ascertain the parties' ex ante intention.⁴⁰

It appears that Schwartz and Scott would expand the default base to include all relevant evidence, including extrinsic evidence, when an interpreter resolves an ambiguity.⁴¹ It is not clear, however, how this recommendation flows from their central efficiency argument, the conclusion of which would aim to exclude extrinsic evidence, mainly to reduce drafting and litigation costs.⁴²

B. The Central Efficiency Argument

Schwartz and Scott's theory applies only to contracts between firms.⁴³ They define "firms" to include corporations with five or more employees, limited partnerships, and professional partnerships such as law and accounting firms.⁴⁴ They would reassign contract disputes involving firms selling to individuals to consumer, real property, and securities law; individuals selling to firms to employment law; and those between individuals to family and real property law.⁴⁵ So limiting the theory's domain makes an economic analysis more plausible.

Schwartz and Scott support their recommendations with a "monist" efficiency argument. A monist argument depends on one—and only one—value, such as welfare maximization. Thus, in their 2003 article, they introduced their theory with the bold claim that efficiency should be the sole goal of contract law for business contracts:

The theory's affirmative claim, in brief, is that contract law should facilitate the efforts of contracting parties to maximize the joint gains (the "contractual surplus") from transactions. The theory's negative

change from the one they recommended in 2003. The 2003 base consisted of "the parties' contract, a narrative concerning whether the parties performed the obligations that the contract appears to require, a standard English language dictionary, and the interpreter's experience and understanding of the world." *Contract Theory*, *supra* note 6, at 752. Thus, the 2003 base included the parties' contractual obligations, which cannot be determined until *after* the contract has been interpreted. That base did not include any litigation documents, as does the 2010 base. For an analysis of each factor in the 2010 base, see *infra* text accompanying notes 114–20.

38. *Redux*, *supra* note 9, at 952.

39. For a discussion of the implications of this shift from the ex ante context to an ex post context, see *infra* text accompanying notes 118–19, 121–25.

40. For Schwartz and Scott, a court's interpretive purpose is to find the parties' ex ante intentions, though courts will sometimes err. *Redux*, *supra* note 9, at 931, 937–39, 943; *Contract Theory*, *supra* note 6, at 568–69.

41. See *supra* text accompanying note 33.

42. *Contract Theory*, *supra* note 6, at 584–94.

43. *Redux*, *supra* note 9, at 928; *Contract Theory*, *supra* note 6, at 544–45.

44. *Contract Theory*, *supra* note 6, at 545. For analysis, see *infra* text accompanying notes 112–13.

45. *Contract Theory*, *supra* note 6, at 544.

claim is that contract law should do nothing else. Both claims follow from the premise that the state should choose the rules that regulate commercial transactions according to the criterion of welfare maximization.⁴⁶

In 2010, in response to criticism, Schwartz and Scott opened the door to monism's opposite, "pluralism," which encompasses more than one value. They recognized that the rule of law values of predictability and stability should count in a normative theory, in addition to efficiency.⁴⁷ But they ignored these and other rule of law values when restating and extending their argument.⁴⁸ Consequently, their argument remains monist, based on efficiency defined as welfare maximization.

The argument's core architecture can be reconstructed succinctly in the form of a simple syllogism: (1) The law governing the interpretation of business contracts should be the default rule that the majority of business firms wants; (2) the majority wants the default rule to license textualist interpretation with a narrow evidentiary base; therefore, (3) the default rule should license textualist interpretation with a narrow evidentiary base.⁴⁹ Of course, for (3) to be sound, (1) and (2) must be true. Accordingly, Schwartz and Scott make efficiency arguments to establish the truth of each premise.

To establish that the law should be the default rule that the majority of business firms wants, they assume that, if contract writing and judicial interpretation were costless, firms could minimize interpretive error by exhaustively detailing their intentions in the contract document.⁵⁰ Courts could minimize error by hearing all relevant evidence.⁵¹ But contract writing and adjudication are not costless.⁵²

46. *Id.* at 544.

47. *Redux*, *supra* note 9, at 928 n.5, 934–35. For the criticism to which they were reacting, see *ELEMENTS*, *supra* note 8, at 214–16.

48. *Redux*, *supra* note 9, at 934–35. Schwartz and Scott distinguished "procedural" rule of law values from "substantive" values, such as efficiency. They would accept that their theory might be pluralist: "If a theory is pluralist when it combines the procedural virtues of the rule of law with a single substantive norm, then we have a pluralist theory," thereby changing their position from the one embodied in the above quotation. *Id.* at 934. However, they insist that their theory is "monist in a substantive sense" for two reasons. First, firms prefer efficient default rules. Second, "scholars have yet to show how the efficiency norm can be combined with other substantive norms to yield predictable—that is, nonarbitrary—adjudications. In the absence of such a showing, substantively pluralist theories necessarily serve the rule of law virtues less well than substantively monist theories do." *Id.* at 934–35. The second reason founders because, by the same token, scholars have yet to show that a single substantive norm can be combined with procedural norms nonarbitrarily. In any event, the analysis in *Redux* and *Contract Theory* does not address the "procedural" side, nor does it show how the procedural can be combined with the substantive. A claim that they did address procedural values in *Contract Theory* is not sustained by the citation they gave. *Compare Redux*, *supra* note 9, at 934 & n.24 with *Contract Theory*, *supra* note 6, at 594–609.

49. *Redux*, *supra* note 9, at 940–41, 946–47, 957.

50. *Id.* at 930, 941. For criticisms of this assumption, see Bowers, *supra* note 8, at 628–29; Kostritsky, *supra* note 8, at 48, 49–52. See also Lipshaw, *The Bewitchment of Intelligence*, *supra* note 8.

51. *Redux*, *supra* note 9, at 930 n.11, 954. For reasons to doubt this, see *ELEMENTS*,

Therefore, they argue, “any socially desirable interpretive rule would trade off accuracy against contract-writing and adjudication cost.”⁵³ The law should do this by excluding some relevant evidence in order to shave costs while tolerating less accuracy.⁵⁴ The practical question, they say, concerns how much to exclude; in other words, what should be the “evidentiary base” for interpretation?⁵⁵ For business contracts, the argument continues, firms are in a better position than judges to trade costs off against accuracy because parties bear the costs and benefit from accuracy.⁵⁶ Accordingly, party preferences would better identify efficient interpretation rules. These preferences are heterogeneous. So, the law should adopt the default rule that the majority of firms wants and empower those in the minority to opt out by contracting for different rules.⁵⁷

To establish that the majority of firms wants a textualist default that confines courts to a narrow evidentiary base, Schwartz and Scott give another efficiency argument.⁵⁸ They say that the “correct answer” to a contract interpretation question is “the solution to a contracting problem that the parties intended to enact.”⁵⁹ Here is the novel and crucial part: The majority wants courts to find the correct answer *on average*; that is, most firms would accept the risk of misinterpretations when the correct answer is “*the mean of the distribution of possible interpretations*.”⁶⁰ Firms are risk neutral, the argument goes, so they are indifferent to *the magnitude of the variance around this mean*.⁶¹ The majority’s desire for a narrow evidentiary base follows, they say.⁶² The majority is willing to trade off some degree of accuracy for a savings in costs. A narrow base can achieve enough accuracy while saving drafting costs because, knowing that a court will use one, parties would draft only until the contract is clear enough for a court to reach the correct answer on average.⁶³ Moreover, litigation costs would be lower because some relevant evidence, notably extrinsic evidence, would not be admissible.⁶⁴

supra note 8, at 33–34, 206–10.

52. *Redux*, *supra* note 9, at 930, 941, 953–54.

53. *Id.* at 944; *Contract Theory*, *supra* note 6, at 580.

54. *Redux*, *supra* note 9, at 930.

55. *Id.* at 964; *Contract Theory*, *supra* note 6, at 547, 571–73.

56. *Redux*, *supra* note 9, at 930, 944.

57. *Id.* at 930–31, 939–45; *Contract Theory*, *supra* note 6, at 580, 595–97, 618.

58. For a critique of this analysis, see *infra* Part III.A.

59. *Contract Theory*, *supra* note 6, at 568–69.

60. *Redux*, *supra* note 9, at 931 (emphasis added); *Contract Theory*, *supra* note 6, at 576–77, 619.

61. *Redux*, *supra* note 9, at 931; *Contract Theory*, *supra* note 6, at 576. Schwartz and Scott assume that courts are unbiased; therefore, errors will be distributed symmetrically. *Redux*, *supra* note 9, at 945; *Contract Theory*, *supra* note 6, at 574–75. There are reasons for doubting this assumption. See *infra* note 76.

62. *Redux*, *supra* note 9, at 931.

63. *Id.* at 931, 944–47; *Contract Theory*, *supra* note 6, at 577.

64. *Redux*, *supra* note 9, at 963; *Contract Theory*, *supra* note 6, at 573–74, 583–84. Schwartz and Scott also offer four bits of empirical evidence to buttress this analysis: (1) quotations of two contract clauses (one of which does not concern interpretation); (2) the common practice of including merger clauses in commercial contracts; (3) two case studies of arbitration practices in two commodities markets (which cannot be easily generalized); and (4) firms’ frequent use of choice-of-law clauses to select New York law (which choices could be made for any of a variety of reasons). *Redux*, *supra* note 9, at 955–57 & nn.69–71. They rightly describe this evidence as “sketchy.” *Id.* at 955; see also Miller, *supra* note 8, at

III. A THREEFOLD CRITIQUE OF SCHWARTZ AND SCOTT'S THEORY

This Part assumes that Schwartz and Scott's theory is mathematically and economically impeccable. Nonetheless, it exposes three major flaws that render it clearly unacceptable. First, their central argument fails because it hinges on the possibility of a coherent and workable "mean of the distribution of possible interpretations." This concept is incoherent and unworkable because it neglects the nature of language and meaning, as well as features of the litigation context in which interpretation questions arise as a practical matter. Second, Schwartz and Scott claim that the majority wants a textualist default rather than the familiar Corbinian contextualist rule. But they ignore a third, noneconomically based alternative that probably would increase accuracy while decreasing costs in comparison with their default. Third, the monism of their theory excludes universally recognized rule of law values, which should constrain all laws. When considered, these values doom the theory, as they may doom any monist legal theory. Together, these three flaws strongly suggest that Schwartz and Scott's theory of contract interpretation is an object lesson on some limits of economic analyses.

A. *The Theory's Central Argument*

Schwartz and Scott complain that their critics have not addressed their efficiency argument.⁶⁵ This Part exposes one telling flaw in that argument.⁶⁶ To set the context, recall the argument's syllogistic architecture: (1) The law governing the interpretation of business contracts should be the default rule that the majority of business firms wants; (2) the majority wants a default rule that licenses textualist interpretation with a narrow evidentiary base; therefore, (3) the default rule should license textualist interpretation with a narrow evidentiary base. For (3) to be sound, (1) and (2) must be true.⁶⁷ Accordingly, Schwartz and Scott must establish (2).

To do so, they say that the majority wants courts to find the correct answer—"the mean of the distribution of possible interpretations"—which would be the meaning of a term in "majority talk."⁶⁸ The concept of this mean assumes a two dimensional graph, with the values of a term's possible meanings on the horizontal axis and the probabilities that a court will adopt each meaning on the vertical axis.⁶⁹ Schwartz and Scott apparently believe that plotting the intersections of meanings and probabilities will result in a normal distribution, or bell curve.⁷⁰ The most probable, or "correct," interpretation would be at the apex.

To see why this picture is incoherent, consider two basic features of language: ambiguity and vagueness. First, recall that contract interpretation is needed when a

1508–11, 1522 (concluding that Schwartz and Scott's prediction is confirmed by an empirical study of large firms' choice-of-law clauses, though without sorting the many reasons that parties may have for choosing New York law).

65. *Redux*, *supra* note 9, at 935, 964.

66. Samantha Rollins and Scott Quellhorst deserve a special note of appreciation for their help on this Part.

67. *See supra* text accompanying note 49.

68. *Redux*, *supra* note 9, at 931; *Contract Theory*, *supra* note 6, at 584–91.

69. *See Redux*, *supra* note 9, at 945 n.47.

70. *Id.* (the midpoint of a bell curve is "the most likely probability").

party contends that the relevant contract language fails to settle a dispute.⁷¹ Language may fail in any of four ways—term ambiguity, sentence ambiguity, structural ambiguity, and vagueness. Term ambiguity occurs when a term bears two or more distinct meanings. Sentence ambiguity is due to bad syntax. Structural ambiguity occurs when two (or more) contract terms contradict each other. And vagueness occurs when one word’s meaning shades into another’s, as red shades into pink, orange, and purple, with no lines of demarcation.⁷²

Schwartz and Scott’s normal distribution should be analyzed separately for ambiguity and vagueness. Assume for the moment that vague terms, like “red,” can intersect with the probabilities to yield a “mean of the distribution of possible interpretations.” Thus, the shades of red line up on the horizontal axis at an infinite number of points. Now consider the other three kinds of language failure before returning to analyze vagueness.

In a legal context, term ambiguity, sentence ambiguity, and structural ambiguity have one notable thing in common. Call it “bipolarity,” though “multipolarity” is possible if there are more than two parties to a lawsuit. A failure of language is bipolar when the language in question is ambiguous because it refers to two (and only two) distinct things. In contract litigation, interpretation problems frequently arise from the parties’ respective contentions that a term is unambiguous, or unipolar, and ambiguous, or bipolar.

Here is the rub: Normal distributions cannot result from the possible meanings of bipolar terms. Only two meanings can be plotted on the horizontal axis. Two points can support a line, but not a curve. Moreover, there is no mean of a distribution of two meanings that represents a possible and relevant meaning. Such a mean would not represent a possible meaning (except by rare coincidence) because it is arbitrary. It would not represent a relevant meaning because, in a litigation context, a judge chooses between the meanings the parties advocate.⁷³ Even if there is a third relevant meaning, neither party wants it. Hence, when it comes to bipolar terms, there is no workable normal distribution and, therefore, no “mean.” And bipolar problems of contract interpretation are common enough for this flaw to make their theory seriously incomplete.

From a practical perspective, the concept of a mean also fails to work for vague terms, which also are bipolar as the litigating parties present them to a judge. A court or jury chooses between the (usually two) meanings advocated by the (usually two) parties.⁷⁴ Neither of the meanings may be the “correct answer.” In that case, there is no need to settle on a correct meaning. Assume that a contract for

71. *See supra* text accompanying note 2.

72. *See supra* text accompanying note 24.

73. ELEMENTS, *supra* note 8, at 106 (stating that a third, fourth, or fifth meaning is possible but, as other terms in the contract may be ambiguous but irrelevant to the dispute, such meanings are irrelevant) (citing cases).

74. There is a question whether Schwartz and Scott’s argument is like the question whether the chicken or the egg came first. Their first premise is that the law should be what the majority of firms wants it to be because firms are in a better position to make the cost/benefit trade-off: Firms pay the costs of interpretation and benefit from greater accuracy. *Redux, supra*, note 9, at 930–31. They make an efficiency argument to support their view of what the majority wants. *Id.* If their efficiency argument were sound, however, there would be no need to ask what the majority of firms wants.

the sale of goods required the seller to deliver “red” fabric. The seller delivers fabric that the buyer thinks is too pink. An interpreter need not decide which shade of red the contract called for, only whether the fabric delivered is too pink. In other words, if there were a bell-shaped distribution representing the probabilities of the possible shades of red to pink, the seller may have delivered fabric that is far to one side of the apex. The buyer may claim that the required shade also is far to that side, but not as far. The court need not decide what the “correct answer” shade of red is, only whether the fabric is further to one side than the buyer thinks it should have been. In other words, the court may decide that the delivered fabric was *not* what the contract required, nothing more.

This point holds when one party advocates the “correct meaning,” if there is one. Assume that one party advocates the correct meaning while the other advances an unreasonable meaning. The court need not validate the first party’s meaning. If one of the two contested meanings is unreasonable, the unreasonable meaning is excluded, the contract is not ambiguous, and as a practical legal matter, it has the reasonable meaning whether it is or is not correct.⁷⁵ Thus, a vague term’s “correct meaning” is irrelevant in litigation. Schwartz and Scott’s argument fails for all of the four ways in which language can fail because all terms are bipolar, practically speaking.⁷⁶

In addition, an essential premise of their argument is that the majority of firms wants a textualist default because, under that law, they would draft only to the point where a court will reach the correct answer on average. This would save on drafting costs, while a narrow evidentiary base that excludes extrinsic evidence would save on litigation costs.⁷⁷ But as the foregoing analysis shows, it makes no sense to say that there is a point that represents the correct answer. Therefore, firms will not draft to the point at which a court will reach the correct answer on average. Further, even if there were such a point, it is unrealistic to suppose that firms are able to draft to it at reasonable cost. They would have to figure out “all possible meanings” (however Schwartz and Scott use the term) of each possible term in their contract, assign numbers to each such term, calculate the means, and gauge the probabilities.⁷⁸ Performing this rather Herculean task is out of the firms’ practical reach.

A second basic feature of language also undermines Schwartz and Scott’s second premise. They claim that, from the parties’ perspectives when drafting a contract, a term’s most likely meaning will or should be its meaning in “majority talk,” not “party talk.”⁷⁹ It is doubtful, however, that there is a “majority talk” with

75. ELEMENTS, *supra* note 8, at 106.

76. Consequently, it is questionable whether Schwartz and Scott are correct when they say that firms are indifferent to the variance around the mean because courts are unbiased, so a court likely will err in favor of one party as often as it will err in favor of the other party. *Redux*, *supra* note 9, at 945; *Contract Theory*, *supra* note 6, at 575. When terms are bipolar, there is no meaningful “variance around a mean.”

77. See *supra* text accompanying notes 50–64.

78. The idea of a “most likely” interpretation is relative to all less likely interpretations. To identify the most likely, all possible interpretations must be considered to rule out all but one possible interpretation.

79. See *supra* text accompanying note 32. Schwartz and Scott acknowledge that this distinction may blur around the edges. *Contract Theory*, *supra* note 6, at 571 n.58.

constant meanings for parties and judges in different places, with different life experiences, at different points in time, and with respect to relevant contract language. The English language is shot through with dialects, slang, and usages that vary from one subgroup of speakers to another on the basis of locality or region, level of education, national origin, ethnic heritage, racial identity, religion, cultural tastes, and other characteristics of linguistic subgroups. Probably for this reason, even Williston emphasized the importance of context and local usage.⁸⁰ Moreover, meanings would vary among different individuals within the majority, if there were one. A speaker of the language who grew up on a farm feeding chickens, for example, might consider roosters, hens, and capons to be “chickens.” One who grew up in a family with a retail poultry shop, by contrast, might exclude roosters, hens, and capons.⁸¹ Also, meanings in any language are in flux as they emerge and fade over time.⁸² At any point in time, some speakers of “majority talk” may use an emerging meaning while others use one that is fading. Additionally, as Schwartz and Scott recognize, the subject of contract interpretation may not be a single word, but rather a phrase, sentence, paragraph, or an entire document, often using specialized language.⁸³ In many cases, there probably is no relevant “majority talk” containing meanings of the subject of interpretation at all. Consequently, the so-called “normal distribution” is a jumble, not a bell curve with an apex, rendering the concept of a “mean” incoherent.

To summarize, Schwartz and Scott’s argument for the second premise of their syllogism depends crucially on the concept of a “mean of the distribution of possible interpretations,” which is supposed to represent the correct answer and a term’s meaning in “majority talk.” The concept employs faulty assumptions about language, meaning, and the litigation context in which interpretation questions arise. When these assumptions are brought to the fore and analyzed, it turns out that the majority of firms will not want courts to reach correct answers on average because there will be no such things, in “majority talk” or otherwise.⁸⁴ For this reason, Schwartz and Scott’s central argument fails for want of a sound second premise.

80. See generally *Redux*, *supra* note 9, at 932; *Contract Theory*, *supra* note 6, at 549. Schwartz and Scott repeatedly call their theory “Willistonian.” They embraced Grant Gilmore’s characterization of Samuel Williston’s view, *id.* at 549, though Gilmore was badly mistaken. Williston embraced what he called a “local standard” for interpreting formal contracts: “The inquiry of a court which has before it a writing demanding interpretation should be then.—What was the meaning of the writing at the time and place it was made between persons of the kind or class who were parties to it?” 2 SAMUEL WILLISTON, SELECTIONS FROM WILLISTON’S TREATISE ON THE LAW OF CONTRACTS § 617, at 1194–95 (1926). Indeed, he wrote, “though a private convention is not competent to change the meaning of five hundred feet to one hundred inches, or the meaning of Bunker Hill Monument to the Old South Church, the local or technical usage, if different from ordinary or normal usage, may be competent to produce this result.” *Id.* § 611, at 1180. Accordingly, he did not embrace anything like “majority talk.”

81. Corbin, *supra* note 5, at 168.

82. LUDWIG WITTGENSTEIN, PHILOSOPHICAL INVESTIGATIONS § 18, at 8e, §23, at 11e (G. E. M. Anscombe trans., Prentice-Hall, Inc. 3d ed. 1958) (1953).

83. *Redux*, *supra* note 9, at 933 n.19.

84. If the majority did want such answers, its desire would be incoherent and should be disregarded.

B. Accuracy and Cost

Schwartz and Scott's second premise also rests on a claim about interpretive accuracy and costs. The premise is that the majority prefers a textualist default because firms would trade some inaccuracy off for a reduction in drafting and litigation costs.⁸⁵ There is no empirical evidence on either side of the tradeoff, so no one knows whether this is true. Nonetheless, gauging the trade-off is a comparative exercise: For their claim to be convincing, there should be no alternative law or proposal that would produce greater accuracy at lower cost. This Part suggests that a recently proposed alternative that is not based on efficiency probably would be better in these respects. But one need not endorse this alternative to see that Schwartz and Scott's support for their second premise is, at best, incomplete.

Schwartz and Scott appear to agree that the issue is a comparative one. They compare their "textualist" theory to a familiar "contextualism" that is associated with Professors Arthur L. Corbin and E. Allan Farnsworth, Chief Justice Roger Traynor of the California Supreme Court, and the *Restatement (Second) of Contracts*.⁸⁶ Their contextualism assumes that the preferred purpose of contract interpretation is to give contract language the meaning that the parties had in mind—their subjective intentions—whenever possible.⁸⁷ It also assumes that admitting more evidence on interpretation questions will enable an interpreter to come closer to these intentions.⁸⁸ Accordingly, the familiar contextualism would admit all relevant evidence to identify a contract's terms, decide whether the relevant term is ambiguous, and resolve any ambiguity that appears.⁸⁹ Schwartz and Scott suggest, probably correctly, that such a broad evidentiary base increases costs by comparison with the textualism they recommend.

From an efficiency standpoint, there is a better alternative that Schwartz and Scott do not consider for its accuracy and costs, though they were well aware of it. In *Redux*, they criticized several aspects of a contract interpretation theory put forward by the present author, dubbed "objective contextual interpretation" (OCI).⁹⁰ OCI would license courts to consider a wider "evidentiary base" than Schwartz and Scott's, but a significantly narrower base than the Corbinian contextualists'.⁹¹ Thus, to decide whether a term is ambiguous and resolve any

85. See *supra* text accompanying notes 50–64.

86. *Pac. Gas & Elec. Co. v. G.W. Thomas Drayage & Rigging Co.*, 422 P.2d 641, 645 (Cal. 1968) (Traynor, C.J.); RESTATEMENT (SECOND) OF CONTRACTS § 200 (1981); Corbin, *supra* note 5; Farnsworth, "Meaning," *supra* note 1.

87. *E.g.*, RESTATEMENT (SECOND) OF CONTRACTS § 201(1) (1981).

88. Schwartz and Scott agree with this. *Redux*, *supra* note 9, at 933. But the link between more evidence and the parties' subjective intentions is tenuous. ELEMENTS, *supra* note 8, at 33–34.

89. See text accompanying *supra* notes 86–89.

90. ELEMENTS, *supra* note 8, at 193–214. Schwartz and Scott's representations of OCI are erroneous in many ways. For one example, see *supra* note 10.

91. ELEMENTS presents three general alternatives: literalism, objectivism, and subjectivism. Other discussions set something like literalism against subjectivism (contextualism). ELEMENTS, *supra* note 8. Schwartz and Scott deny that they are literalists because they would allow courts to consider the entire contract document, not just single words or phrases. *Redux*, *supra* note 9, at 933 n.19.

ambiguity, OCI would allow courts to consider the whole contract document together with the contract's purpose(s), the objective circumstances when the contract was made, any relevant trade usages, and any practical construction (course of performance).⁹² OCI would exclude evidence of the parties' course of dealing, the contract's negotiating history, statements of intention during the negotiations, and a party's testimony about its own intention, though the familiar contextualism would include these elements. The excluded evidence is relevant only to the parties' subjective intentions, whereas OCI aims at the parties' objective intention, the conventional meaning(s) manifested in the contract's language.⁹³

The most important of Schwartz and Scott's criticisms is that OCI "sacrifices both cost and accuracy,"⁹⁴ that is to say that it increases costs while decreasing accuracy. However, it is simply not true that, by comparison with their textualism, OCI does this. Rather, for performing all three interpretive tasks, OCI probably would decrease costs while increasing accuracy by comparison with their theory.

The first interpretive task is to identify the contract's terms. OCI does this on the basis of the contract as a whole and its evident purpose(s), giving merger clauses presumptive effect.⁹⁵ Schwartz and Scott's recommendation is almost the same, except that they apparently would exclude the contract's purposes when the purposes are not stated in the contract.⁹⁶ Purposive analysis is well known to increase accuracy. Judges often can find "evident" purposes from the whole document alone at negligible cost. For this task, then, if different at all, OCI probably would be somewhat more accurate than Schwartz and Scott's recommendation, while it would cost about the same.

The second task is for a court to determine whether the applicable contract term is relevantly ambiguous. OCI would have a court make this determination—usually on a motion for summary judgment—on the basis of the whole document; the alleged facts of the parties' dispute; and the parties' allegations, affidavits, and proffers of evidence regarding the objective circumstances when the contract was made, any practical construction (course of performance), and any usage of trade.⁹⁷ This limited context would be far less costly than Schwartz and Scott's counterpart because OCI would legitimate material parts of the parties' ex ante context, not the judge's ex post context instead.⁹⁸ So, because the parties will not know who the judge will be if litigation ensues, OCI better contains pre-litigation costs. OCI better enables the parties to forecast an adjudicatory result when they draft a contract, consider whether to perform or breach, decide whether to challenge the other party's performance, attempt to settle a dispute, and plan for litigation. Litigation costs also would be low because the parties would offer a court only allegations, affidavits, and proffers of evidence—not evidence—about the limited

92. ELEMENTS, *supra* note 8, at 209, 212.

93. *Id.* at 202–09, 220–22.

94. *Redux*, *supra* note 9, at 929.

95. ELEMENTS, *supra* note 8, at 195–202.

96. *Redux*, *supra* note 9, at 953, 961–63 ("Parties who want the court to see additional evidence, but avoid trials, can (and must) embed the evidence in the contract itself.").

97. ELEMENTS, *supra* note 8, at 204–05. The role of summary judgments in OCI has been a point of misunderstanding. *See supra* note 10.

98. *See supra* notes 39–40; *infra* text accompanying notes 118–19, 121–25.

context. OCI also would be more accurate because it allows a judge to perform this task, on a motion for summary judgment or similar motion, on the basis of the applicable term and material parts of the ex ante context.⁹⁹

The third task is to resolve any relevant ambiguities. OCI would appear to be less costly and more accurate here too. It would admit evidence to establish the same elements that a court could consider on the question of ambiguity.¹⁰⁰ By contrast, though they are not entirely clear on the point, Schwartz and Scott apparently would admit all relevant extrinsic evidence, as would Corbinian contextualists.¹⁰¹ If this is right, pre-litigation costs would be higher than with OCI because parties would have to anticipate more extrinsic evidence and assess whether it can be discovered, proved, and be credible at a trial. Litigation costs also would be higher because, when planning for litigation, the parties would have to predict which extrinsic evidence will be admissible and credible, locate it through investigation and discovery, and present and contest it in court.

Moreover, admitting evidence of Schwartz and Scott's wider context at this stage would produce less accuracy than would OCI. They believe that a wider context will get an interpreter closer to the parties' intended meaning.¹⁰² However, they want interpreters to find the parties' "objective ex ante intentions," as does OCI.¹⁰³ Admitting all relevant evidence would allow some that bears *only* on the parties' subjective intentions, such as any course of dealing, the contract's negotiating history, and testimony by a party about its intention. This evidence would reduce accuracy because it would, if anything, lead the interpreter away from the objective ex ante intention and toward what the parties had in mind. Further, juries normally would consider the extrinsic evidence and resolve the ambiguity.¹⁰⁴ They are notoriously unpredictable in any case, and especially in commercial cases. A wider context increases the variables, making it more difficult for them to deliberate reasonably. Consequently, juries would be less predictable and less likely to reach the correct answer, if there is one and it is relevant.¹⁰⁵

Thus, Schwartz and Scott's argument for their second premise—that the majority of firms wants a default rule to license textualist interpretation with a narrow evidentiary base—founders on grounds of accuracy and cost, in addition to the incoherence and unworkability of a "mean of the distribution of possible interpretations." Their argument compares their theory with Corbinian contextualism, but they neglect a third theory. Yet OCI appears to be a more accurate and less costly alternative by comparison with their theory; intuitively, the majority of firms probably would prefer it to their textualism. Again, their central argument fails without its second premise. Even if the law should be the default rule that the majority of firms wants, it would not follow that it should license textualist interpretation with a narrower evidentiary base than OCI's.

99. ELEMENTS, *supra* note 8, at 209.

100. ELEMENTS, *supra* note 8, at 212.

101. See text accompanying *supra* notes 33, 41–42.

102. *Redux*, *supra* note 9, at 933.

103. ELEMENTS, *supra* note 8, at 210–11; *Redux*, *supra* note 9, at 939.

104. ELEMENTS, *supra* note 8, at 152–55.

105. *Id.* at 214.

C. The Theory's Monism

As indicated, legal theories are monist when they rest on one, and only one, value, such as efficiency.¹⁰⁶ Monism stands in contrast to “pluralism,” which embraces more than one value. Schwartz and Scott’s central argument is monist because it is based on efficiency (welfare maximization) alone.¹⁰⁷ This monism renders its conclusion strikingly vulnerable. As they acknowledge, rule of law values also matter.¹⁰⁸ When considered, these values powerfully undermine their conclusion. The monism of their theory renders it incapable of success, as does the monism of any monist theory.

1. Monism and the Rule of Law

A fatal deficiency in monist legal theories is that, due to their monism, they inevitably fall short of reaching their ultimate normative goal—justifying final recommendations about what the law should be, all things considered.¹⁰⁹ More than one value is needed to get there. Thus, perhaps everyone would agree, all laws should be compatible with rule of law values, including consistency and equal treatment, notice and predictability, adequate justification, and fulfillment of the law’s dispute avoidance and settlement functions. But these values do not support any law’s content. A legal theory needs at least one additional value, such as efficiency, to succeed. A monist theory therefore faces a dilemma: It cannot consider rule of law values without losing its monism; but excluding rule of law values puts its goal out of reach.¹¹⁰

To illustrate, assume that it would be efficient to interpret business contracts according to “majority talk,” using Schwartz and Scott’s default evidentiary base. To repeat for convenience, the base would consist of the contract document; evidence of what the parties did and did not do; evidence that does not involve the interpretation dispute; the pleadings, briefs, and prayers for damages; and the judge’s life experiences.¹¹¹ To see why their efficiency theory is destined to fall short, consider the rule of law implications for the theory’s scope of application and each element of the base in turn.

As indicated above, the theory applies only to contracts between “firms,” which Schwartz and Scott define as corporations with five or more employees, limited partnerships, and professional partnerships such as law and accounting firms.¹¹² They would reassign contract disputes involving firms selling to individuals to consumer, real property, and securities law; individuals selling to firms to employment law; and those between individuals to family and real property law.¹¹³

106. See *supra* text accompanying notes 46–48.

107. See *supra* text accompanying notes 46–48.

108. *Redux*, *supra* note 9, at 934–35.

109. See generally Steven J. Burton, *Normative Legal Theories: The Case for Pluralism and Balancing*, 98 IOWA L. REV. 535 (2013).

110. See *id.*

111. See *supra* notes 36–38 and accompanying text.

112. See text accompanying *supra* notes 43–44.

113. See text accompanying *supra* note 45.

However, among other problems, these distinctions are not compatible with the rule of law values of consistency and equal treatment. Distinctively contract law issues arise in cases within all of these categories, including issues concerning offers, powers of acceptance, acceptances, mistakes, material breaches, damages, and so forth. Inconsistency and unequal treatment would result if the law were to treat common issues differently due only to the parties' identities as firms or individuals. Applying the same laws to the common issues, however, makes the distinctions pointless. Hence, two components of the rule of law—consistency and equal treatment—ground a powerful challenge to the efficiency theory's scope of application. The monism of a monist theory neglects this challenge.

Now consider each element of the default evidentiary base in turn. First, including the contract document is not controversial. The contract document is the starting point for interpretation because it raises the interpretive issue. But, as Schwartz and Scott recognize, an interpreter normally needs more kinds of evidence to answer it.¹¹⁴ Second, evidence of the parties' ex post conduct (what they did and did not do) is needed to identify the legal dispute and to locate the applicable contract term(s), if there are any. But this evidence normally will not help to determine whether the contract is integrated, whether the relevant term is ambiguous, or what that term means if it is ambiguous.¹¹⁵ It will not help to determine what the parties' obligations were or whether a party performed as promised or breached. Third, evidence that does not involve the interpretation dispute would seem to be irrelevant or, at least, peripheral. This analysis leaves two elements for further consideration—the litigation documents (pleadings, briefs, and prayers for damages) and the judge's life experience.¹¹⁶

Including litigation documents poses rule of law problems involving reasonable notice and predictability, and adequate justification. Contract parties and their lawyers interpret contract terms when (1) negotiating and drafting them; (2) deciding whether to perform or breach; (3) deciding whether to challenge the other party's performance; (4) negotiating to settle a dispute; (5) deciding whether to litigate; (6) planning litigation; (7) drafting litigation documents, including pleadings, motions, and briefs; (8) presenting and arguing about extrinsic evidence, if any, at trial; and (9) making oral arguments to trial and appellate courts.¹¹⁷ Some third parties also interpret contracts.¹¹⁸ All interpreters should have fair notice of

114. *Redux*, *supra* note 9, at 952–53.

115. In a few cases, a practical construction (course of performance) will help. But this kind of extrinsic evidence is just the sort of costly evidence that Schwartz and Scott want to exclude.

116. Neither of these elements consists of “evidence” in the usual sense, but dismissing them just for this reason would be too picky.

117. *But cf. Redux*, *supra* note 9, at 957–58 (“[I]nterpretation issues arise in litigation contexts.”).

118. Third parties with a stake in interpretation include a party's subcontractor(s), third party beneficiaries, some assignees, auditors, investors, executors, and trustees in bankruptcy. Moreover, subparts of firms should be able to rely on a document as it moves from sales to manufacturing to shipping to billing to customer service. Having to consult the document's extrinsic context can undermine the salutary functions of standardized terms. *See* ELEMENTS, *supra* note 8, at 25–26; Todd D. Rakoff, *Contracts of Adhesion: An Essay in Reconstruction*, 96 HARV. L. REV. 1173, 1222–23 (1983).

the interpretive context at all of these points. Under Schwartz and Scott's proposal, however, none of them will. The parties and others will not know what they will or should say in litigation documents, nor what the opponents will say, if and when litigation ensues and the documents are filed.

Litigation documents, moreover, rarely contribute to a justification for a judicial decision. Virtually all justifications for enforcing contracts make the parties' ex ante choices central. Litigation documents, however, are not parts of their ex ante context; instead, they are parts of a judge's ex post context. It is at best unclear how they can help anyone—whether judge, party, or interested third party—implement the parties' ex ante choices. Moreover, a justification depends on relevant evidence, not on a party's (presumably self-serving) allegations, assertions, arguments, or prayers for relief. Listing documents that might *refer* to relevant evidence is not a substitute for saying what such evidence is, determining its admissibility, hearing it, and finding the facts.

To fulfill its dispute avoidance and settlement functions, contract interpretation law should be administrable by courts, as should all laws. It also should be administrable by parties and others before litigation commences: The law should *guide* them to apt interpretations.¹¹⁹ But litigation documents will not be available to anyone before litigation begins.

Legitimizing the judge's life experience, as part of an "evidentiary base" for interpretation, is even more problematic. The parties will not know which judge(s) they will get in litigation when they negotiate and draft, ascertain their rights and obligations, decide whether to perform or breach, decide whether to challenge the other party's performance, negotiate to settle a dispute, decide whether to litigate, and plan for litigation. At each of these points, however, they need to forecast how a court will resolve their dispute if litigation ensues. Including the judges' extrajudicial backgrounds thus undermines notice and predictability when it is needed most—when trying to avoid litigation. Due to the uncertainties, moreover, both trial and appellate proceedings would proliferate, the latter because the appellate judges will have different backgrounds from both the trial judge's and from one another.

Consistency and equal treatment would suffer, too, because the law would encourage different judges to decide the same case differently depending, for example, on whether they had been prosecutors, defense attorneys, corporate counsels, public interest advocates, professors, or something else. In addition, fundamental due process includes the right to a hearing. But judges do not (and should not) disclose to litigants the extrajudicial experiences that would be a part of their respective interpretive contexts. Evidence of a judge's biography is not admissible. Consequently, the litigants could not introduce evidence to counter false facts in that context or to argue to a trial judge about the context's significance, much less to argue about such things to diverse panels of appellate judges. The judges' extrajudicial backgrounds also would not contribute to

119. On the guidance function of law, see, for example, JEREMY BENTHAM, *Of Laws in General*, in THE COLLECTED WORKS OF JEREMY BENTHAM (H.L.A. Hart ed., 1970); H.L.A. HART, THE CONCEPT OF LAW 39, 54–58, 79–88 (2d ed. 1994); KARL N. LEWELLYN, THE BRAMBLE BUSH 12–13 (2d ed. 1951); JOSEPH RAZ, PRACTICAL REASON AND NORMS *passim* (2d ed. 1990).

adequate justifications of their decisions. The law should leaven differences in their backgrounds by requiring them to apply common, public, and generalizable legal standards, and to consider only the evidence made relevant by those standards and otherwise admissible under the law of evidence.

Schwartz and Scott observe, to the contrary, that “the rule of law virtues are thought not to be violated even though the fate of a criminal defendant is importantly a function of whether the trial judge is a former prosecutor or a former public defender.”¹²⁰ Descriptively speaking, a judge’s extrajudicial experience no doubt plays a causal role in some cases. Former prosecutors and former public defenders, however, cannot *justifiably* decide the same case differently due to their respective life experiences. Considering their backgrounds would undercut their justifications’ generalizability. Counsel, moreover, are not and should not be allowed to argue that a judge’s extrajudicial experience *should* make a difference. And judicial opinions do not and should not give anecdotes from the author’s extrajudicial experiences as parts of legal justifications.

2. Possible Rejoinders

Three possible rejoinders to this critique of Schwartz and Scott’s monism come to mind, but none are convincing. One is that the critique fails because rule of law values are not really values at all. Patently, however, this is not true, and Schwartz and Scott do not take this view. No more needs to be said on this score unless and until someone makes such a rejoinder credible.

Second, Schwartz and Scott might insist that the critique of their monism reads their “evidentiary base” too literally. Thus, the base might consist of the contract document alone. The other named factors—what the parties did and did not do, evidence that does not involve the interpretation dispute, the litigation documents, and the judge’s extrajudicial experiences—would merely describe features of the judge’s context that influence the interpretive decision (and all other judicial decisions). At least in Schwartz and Scott’s most recent version of their theory, however, the evidentiary base is not just descriptive. It provides the context for giving meanings: “[C]ontext is crucial to interpretation A minimum evidentiary basis ordinarily will convey sufficient contextual information.”¹²¹ They contrast it with a wider base that would admit evidence at trial of the contract’s negotiating history, trade usages, the parties’ course of dealing, if any, and the like. Hence, they do not simply *describe* the interpretive context, as one would expect if it were only an inevitable cause. Rather, they would license judicial reliance on its elements as a matter of law, thereby *legitimizing* them as *justifications* for judicial interpretations.

Third, Schwartz and Scott might object because their theory recommends a default rule that instructs courts to adopt the meaning of contract language in “majority talk,” which embraces typical meanings used by judges, lawyers, business people, and jurors, in the majority language.¹²² Thus, judges know “majority talk” and are able to give meaning(s) to contract language on the basis of

120. *Redux*, *supra* note 9, at 948 n.54 (responding to *ELEMENTS*, *supra* note 8, at 36–37).

121. *Id.* at 952; *see also id.* at 938–40.

122. *Contract Theory*, *supra* note 6, at 570–71.

the recommended evidentiary base.¹²³ Though that base emphasizes the judge's ex post context, not the parties' ex ante context, the rejoinder might continue, typical meanings would be the same at both points in time. Therefore, the judge's context will suffice to "recover the parties' intentions," which Schwartz and Scott say, is the purpose of contract interpretation.¹²⁴ As suggested above, however, there is no such as thing as "majority talk."¹²⁵ So, it is doubtful that meanings in that "language" bridge the gap between judges' contexts and the parties' contexts in many cases.

To draw the larger lesson, this threefold critique assumes that Schwartz and Scott's contract interpretation theory is mathematically and economically impeccable. Nonetheless, it shows how an exclusive focus on efficiency excludes several kinds of considerations that matter to a theory's success. Their theory manifests a certain naïveté about the nature of language and meaning, which require separate analyses of ambiguity and vagueness to see that their central argument is incoherent and unworkable. Similarly, their theory assumes that there is something they call "majority talk," which contains correct answers to interpretation questions. But there is no such language. Their theory, moreover, neglects the litigation context in which interpretation issues arise. The parties present a judge with (normally) two possible meanings between which the judge must choose. Omitting this legal context obscures the facts that two meanings are relevant, and they cannot support a bell curve with a "mean." And their theory's monism excludes important, universally recognized rule of law values that constrain all laws. These values can undermine any monist theory's recommendation, thereby defeating the point of the enterprise. Efficiency should never be the sole concern of a normative legal theory.

CONCLUSION

This Article has offered three criticisms of Schwartz and Scott's provocative theory of contract interpretation, along with a larger lesson. First, their central argument fails because its second and essential premise depends crucially on an incoherent and unworkable concept, the "mean of the distribution of possible interpretations." Second, the argument supporting the second premise also fails because they ignore a better alternative, OCI, which probably would produce greater interpretive accuracy at lower cost. Third, their theory's monism precludes it from reaching final recommendations about what the law should be, all things considered, as it should if it is to be adopted. Their theory fails if any one of these criticisms is sound.

123. It is puzzling why, with the emphasis on "majority talk," a judge or other interpreter would find it helpful to consider the pleadings, briefs, and prayers for relief. By Schwartz and Scott's definition, judges know "majority talk" just because they speak that language. Considering prayers for relief seems especially irrelevant. Moreover, the judges' extrajudicial experiences are likely to be diverse, producing centrifugal forces pulling their interpretations away from stable "majority" meanings.

124. *Redux, supra* note 9, at 937–38.

125. *See supra* text accompanying notes 79–83.

The larger lesson stems from the way in which these deficiencies in Schwartz and Scott's theory exemplify how any monist efficiency theory can easily founder. Their singular focus on efficiency obscures important concerns about the nature of language, ambiguity and vagueness, the legal context in which interpretation questions arise, alternatives not based on efficiency, and rule of law values. Noneconomic concerns like these can doom any monist efficiency theory of contract interpretation, as they doom Schwartz and Scott's.