But is it clear?
Avoiding ambiguous contracts

By Gregg L. Weiner

It has been said that "a smile is the chosen vehicle for all ambiguities." Commercial litigators know better, however. There is no better vehicle for ambiguity than a commercial contract. As clear as the contract seems when it is signed, a crafty litigator can come along years later after a dispute has arisen to make the contract a miasma of confusion.

What can you do to avoid a fight over contract language, and, if such a fight ensues, to win it? This article offers some suggestions. But, first, a little background.

You know trouble lurks when courts cannot even agree on a standard for determining a legal issue. That, unfortunately, is precisely the situation with respect to the rules for interpreting contract language. Courts have not established a consistent standard for determining when contract language is unambiguous, or, by contrast, when it is ambiguous. Generally speaking, though, the various tests boil down to whether particular language is objectively susceptible to more than one meaning.

Not surprisingly, that test has not led to uniform results. Indeed, trial courts and appellate courts frequently cannot even agree about whether a particular contract is ambiguous. See, for example, Den Norske Bank AS v. First Nat'l Bank of Boston, 75 F.3d 49, 56-57 (1st Cir. 1996) (reversing district court's finding that contract was unambiguous); Beloit Power Sys. Inc. v. Hess Oil Virgin Islands Corp. 757 F.2d 1427 (3d Cir. 1985) (reversing district court's finding that contract was ambiguous).

This judicial inconsistency is reminiscent of Supreme Court decisions (decided 5 to 4) holding that reasonable people could not disagree on a certain subject. It also suggests that, in reality, the test for whether contract language is ambiguous is a lot like Justice Stewart's famous description of how he determined whether something was pornographic under the obscenity laws: He knew it when he saw it.
So how will a dispute about contract language play out?

It is well settled that the determination of whether a contract term is ambiguous is a threshold question of law for the court. Thus, a party's contention that a contract is ambiguous first will have to be accepted by a judge before trial of the matter is required. This requirement that a judge make the initial determination of ambiguity is designed to impart stability and uniformity in commercial rulings and to provide protection to parties from the vagaries of juries.

But this rule is no panacea. Words may be vague or ambiguous; they may have specialized meanings in particular trades; they may have a particular meaning privately agreed to by the parties. Indeed, we live in a world where the president of the United States can testify that the truth of a statement at his deposition depended "on what the meaning of the word 'is' is."

All this on top of the fact that the court will be examining a commercial contract involving a subject matter about which the court lacks expertise and relating to a commercial transaction from which the court is far removed in time and circumstance. All in all, not a recipe for judges to find that complex commercial agreements are plain and unambiguous.

You may be thinking that President Clinton was sanctioned for his word-smithing, so you need not worry about ambiguity creeping into your commercial contract. You may also recall the generic interpretive principles (many embodied in catchy Latin phrases) that you learned in law school - examples include the principle that contract language is construed against the drafter (from the catchy Latin phrase contra proferentem) and that where specific items are listed, without any more general term, similar but unlisted terms are excluded (from the catchy Latin phrase expressio unius est exclusio alterius). Surely, you may be thinking, they can save the day.

It is true that courts make use of general interpretive rules when considering whether a contract is ambiguous. The problem is that there is an interpretive principle for every occasion, so that the crafty litigator can almost always find one that supports his or her interpretation of the contract.

As Professor Farnsworth has noted:

None of these rules, however, has a validity beyond that of its underlying assumptions. Their use in judicial opinions is often more ceremonial (as being decorative rationalizations of decisions already reached on other grounds) than persuasive (as moving the court toward a decision not yet reached).

Farnsworth, Contracts, § 7.11 at 496 (1982).

What about the old "four corners" rule, which holds that "extrinsic and parol evidence is not admissible to create an ambiguity in a written agreement which is complete and clear and unambiguous on its face?" W.W.W. Assocs. Inc. v. Giancontieri, 566 N.E.2d 639, 642 (N.Y. 1990). No doubt you remember that from law school too.

Not every state follows the "four corners" rule, however. Many have different rules that are more liberal in permitting a court to consider extrinsic evidence to create an ambiguity in a facially clear contract. See, for example, Tigg Corp. v. Dow Corning Corp., 822 F.2d 358, 363 (3d Cir. 1987) (finding Michigan law to require "an examination into the circumstances surrounding a contract even where no ambiguity as to finality or intended meaning is apparent on the face of the document").

In short, it is not as difficult as the uninitiated might suspect to persuade a court that a commercial contract is ambiguous. And, unfortunately, once the court makes a threshold determination that the contract is ambiguous, the parties' litigation is likely to drag on for years and years. The reason is this: After finding a contract to be ambiguous, a court may consider practically anything in determining the meaning of the contract. Among other things, courts may look at the parties' contract negotiations, their course of performance, their prior course of dealing, and trade usage in the relevant industry.

This is true even in states that follow the four corners rule, see, for example, Weiner v. Anesthesia Assocs., 203 A.D.2d 455, 610 N.Y.S.2d 608 (2d Dep't 1994), and is also the case outside the United States, where judicial systems are even more receptive to the admission of extrinsic evidence to determine the meaning of contract language. See Principles of European Contract Law (Lando Principles) Arts. 5.101-102 (stating that a "contract is to be interpreted according to the common intention of the parties even if this differs from the literal meaning of the words.").

Moreover, while there is nothing prohibiting a court from resolving a contract dispute on summary judgment where the contract has been held to be ambiguous, courts routinely hold (or suggest) that it is not appropriate to grant summary judgment where a contract is found to be ambiguous. The consequence of this judicial hostility to summary judgment rulings concerning ambiguous contracts is that disputes over the meaning of a commercial contract rarely are resolved by a court. These matters tend to get settled or be tried to a jury, hardly a comforting scenario for a deep-pockets commercial defendant.

Despite the uncertainties in the area of contractual ambiguity, the following general guidelines can help lead lawyers and clients through the thicket of ambiguous contracts and give them a fighting chance in the ambiguity war.
First and foremost, you must draft a contract that is facially clear and internally consistent. Use of clearly defined terms, a descriptive preamble explaining the parties’ intent in entering the contract and straightforward section headings are key in this regard.

Second, a commercial litigator should review the contract before it is signed with an eye toward identifying potential ambiguities, internal inconsistencies in language, areas of likely future dispute, etc. Litigators are more likely to identify points in the contract that can be exploited down the road (after all, that is what we are paid to do). Moreover, the perception of the corporate lawyers involved in drafting and negotiating the contract is tainted by that involvement. They will read the contract with that background and history in mind. But the litigator who has not participated in the contract negotiations will focus on the wording of the contract itself, which is precisely what the court reviewing the contract years later will do.

Third, in some jurisdictions, ambiguity may be created not only from the face of the contract, but also from extrinsic evidence addressed to the meaning of the words of the contract. Therefore, a party that wants to avoid a trial on the meaning of a contract’s language should make sure that the contract contains a choice-of-law clause providing that the interpretation of the contract will be governed by the law of a state that follows the "four corners" law. New York is one such state. A forum-selection clause containing a waiver of the parties’ right to a jury trial should be considered as well.

Fourth, once a dispute has arisen, the party urging an ambiguity should seek to gather and introduce any evidence it can muster in support of the ambiguity. Details from the parties’ negotiations, evidence of industry customs and accepted trade practices and pre- and post-negotiation statements and conduct of both parties should be offered to support the ambiguity. In presenting the evidence, it should be borne in mind that courts generally are more receptive to evidence that appears to be "objective,” that is, evidence supplied by disinterested third parties, than to the parties’ subjective views as to the meaning of the contract.

Fifth, although there is some judicial resistance, ambiguous contracts are in fact amenable to resolution by summary judgment. The proponent of the summary judgment motion initially should focus the court’s attention to the language of the specific contractual provision in dispute and any "objective" extrinsic evidence offered to support the facially clear meaning of the language.

Having first established the objective clarity of the contract language, the party seeking summary judgment must then sift through and discredit seriatim the extrinsic evidence that is offered by the opposing party. In this regard, it is helpful (if possible) to emphasize the “subjective” nature of the evidence offered in opposition to the motion and to cite well-established interpretive principles and maxims that support your client’s interpretation of the contract and undercut the reading of the contract urged by the party opposing the summary judgment motion.

Finally, even if you persuade the trial court that the contract is unambiguous, or that although the contract is ambiguous your client nonetheless is entitled to summary judgment, the appellate court very well may not agree. The risk of reversal on appeal - which is higher than one might suspect - counsels against reflexive dismissals of settlement offers received after having won summary judgment on a breach of contract claim.

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