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A Consequential Approach to Interpretation and Interpretive Risk: Rethinking Judicial Intervention from Contracts to the Chrysler Bankruptcy

J. P. Kostritsky†

A contract begins with express terms. If all contracts were complete and precise, and the exact way in which the express terms were meant to settle any later arising controversies were obvious, a court’s role would necessarily be limited. However, because even carefully drafted contracts involving commercial firms fail to deal with certain contingencies and because the language parties use may be intractable, questions about a possible role for courts may arise when parties sue on such contracts. A party may ask a court to intervene in a private contractual agreement in one of two ways. If the contract has express terms that seem to address the controversy but leave certain matters on which the dispute turns unresolved, a court may intervene and grant a remedy by interpreting the express terms broadly. If contractual relief is not available under the express terms, a court may imply a term into the contract. In each instance, a court must decide on a framework for deciding whether intervention—either in the form of a broader contextualized interpretation or in the form of an implied term—is warranted.

These types of intervention seemingly raise distinct doctrinal issues of interpretation and implied terms (gap filling), yet under an economic approach they are linked analytically. Whether a court announces a particular rule that permits a court to go beyond the express terms of the contract adding terms or even announcing a contrary interpretive rule, one that declines to add terms or to broadly interpret express terms, there is in each case a choice by a court amounting to an interpretive rule. Each type of intervention should depend on whether the intervention by a court will maximize gains from trade and minimize all of the costs from

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1 See George M. Cohen, Interpretation and Implied Terms in Contract Law, in ENCYCLOPEDIA OF LAW AND ECONOMICS (2d ed.) (forthcoming), available at http://ssrn.com/abstract=1473854 (noting that generally if a contract is complete “there is no efficiency-enhancing role for a court other than to enforce the contract according to its terms.”).


3 See Cohen, supra note 1, at 2. (noting that no contract actually describes all possible contingencies and explicitly provides a response for each contingency, and thus “no real-world contracts are fully complete in this sense”).

4 The court might decide not to intervene beyond implementing the express terms which themselves leave the particular matter unresolved, leaving the party requesting relief without any remedy.

5 The Uniform Commercial Code exemplifies the broader, contextualized approach. See e.g., U.C.C. Section 2-202 cmt. 1 (rejecting “premise that the language used has the meaning attributable to such language by rules of construction existing in the law rather than the meaning which arises out of the commercial context.”)

6 See Cohen, supra note x, at 2 (stating that the legal issue addressed by interpretation and intervention is “whether one or more parties have performed as the contract requires, or have breached”). Judge Posner distinguishes implied terms and interpretation of express terms but then concludes that they are linked since “[g]ap filling and disambiguating are both, however, ‘interpretive’ in the sense that they are efforts to determine how the parties would have resolved the issue that has arisen had they foreseen it when they negotiated the contract. Richard Posner, The Law and Economics of Contract Interpretation, 83 TEX. L. REV. 1581 (2005).

7 Id. at 3 (stating that even finding an express term is a “catchall” “is itself an act of interpretation that requires justification”).
If one subscribes to growth and wealth as ultimacies, then the interpretive rules must be justified in the consequentialist terms of maximizing value and minimizing costs since enhancing those goals will promote growth and wealth.  

Whether and when intervention of a particular sort might be justified when contracts are in some way incomplete (or when statutes incorporated into parties’ contracts leave certain issues unresolved) must be decided on a comparative basis. That comparison must include a review of different possible interpretive rules for contracts. The rule of Professors Kraus and Scott declines to add terms or to interpret terms broadly (as by, for example referencing objectives) absent express delegation; the other rule (advocated here) announces in advance an interpretive rule that adds terms or broadly interprets terms if doing so will maximize gains from trade and minimize transaction costs. That comparison must, in addition to considering intervention (or nonintervention) by a court, also include other private strategies since the courts, including the interpretive rules it announces, are only one type of “governance mechanism.”

Resolving the intervention question in interpretation cases has proved extremely controversial, even among scholars who agree that the goal of legal rules should be to maximize gains from trade and to minimize the costs and frictions of transacting. One group, the new formalists, argues that courts concerned with costs and the economic goal of adding value should employ only formalism when they interpret contracts, and ignore objectives of the parties in the interpretive process. These textualist arguments are predicated on a number of assumptions, some articulated and some implicit, which this essay will challenge. The textualist approach denies relief to any party whose claim depends on a court either going beyond the express terms of the contract or implying contractual terms. Its logic would foreclose a court from using a consequentialist analysis to engage or interpret ambiguous, vague, or incomplete contracts. It

8 The full range of costs will be explored later. See infra. The study of transaction costs, including the various frictions and costs arising from uncertainty, bounded rationality and opportunism, and the role that they play in transactions preoccupied Oliver Williamson. His studies help readers understand why parties might not be able to reach complete express contractual arrangements that could control the various frictions in relationships and “effect adaptability and promote continuity.” Williamson, infra note x, at 30. His insights focus on how parties devise governance mechanisms to overcome those obstacles to increase wealth, which is the “source of real economic value.” Id. at 30

Professor Douglas North has studied social institutions to determine how they impact on wealth and economic performance. See EMILY CHAMLEE-WRIGHT, THE ANNUAL PROCEEDINGS OF THE WEALTH AND WELL-BEING OF NATIONS, 8 (2009).

This article accepts growth and wealth as the ultimate goal that parties are trying to achieve in their contractual arrangements.

9 See supra note x. This article therefore makes cost a central component of the normative analysis of contract interpretation. Cf. STEVEN J. BURTON, CONTRACT INTERPRETATION (2009).


11 Cohen, supra note x, at 5.

12 OLIVER WILLIAMSON, THE ECONOMIC INSTITUTIONS OF CAPITALISM 17 (1985) (advancing “proposition that the economic institutions of capitalism have the main purpose of economizing on transaction costs.”).

13 The proponents of a theory which ignores the parties’ objectives in contract interpretation include Professors Kraus &Scott. See Kraus & Scott, supra note x. The exclusion of the parties’ objectives, together with the exclusive focus on the express terms, seem to also rule out considering the consequences of various interpretive rules.

14 Ambiguity refers to a situation in which the precise meaning of express terms is unclear. Judge Posner refers to the process of deciphering meaning as one of “disambiguating” contracts. Posner, supra note x, at 1589.
Essay

is in effect a rule that the party asking for an additional term \textit{will always lose}, unless the party has expressly delegated authority to a court using broad open ended language.

Using an economic framework in which cost considerations are paramount, this essay presents a persuasive case that a more expansive interpretive rule than a rule that automatically denies any party relief when that relief requires a court to go beyond the express terms unless that party has requested judicial intervention in advance.\footnote{Steven Shavell, \textit{On the Writing and the Interpretation of Contracts}, 22 J. L. Econ. & Org. 289 (2006).} That case depends on first analyzing why, and in what ways, a contract with express terms might nevertheless fail to address certain events.\footnote{Id.} The reasons why contracts remain incomplete or leave residual uncertainty even when there are express terms raise directly what type of interpretive rule should be announced \textit{ex ante} by a court to deal with the problem of \textbf{interpretive risk}.\footnote{Kraus & Scott, supra note x, at 1025.}

Interpretive risk refers to the risk that parties face when they have drafted an express contract but have failed to completely resolve all possible issues and have stopped short in drafting so that the level of particularity in the language fails to resolve a later disputed matter that cannot easily be resolved under the language used. This essay will attempt to identify the precise parameters of a rule to minimize such risks, and the factors that might justify intervention employing an economics-based consequentialist approach to contract interpretation. It hopes to mitigate the concern that a broad interpretive rule --at least if that rule is one that interprets terms by resorting to a justificational framework that invokes the pursuit of chosen consequences, such as minimizing the \textit{ex ante} risks (costs) facing parties who use express terms--will inevitably lead to uncertainty and greater costs in litigation and enforcement.

The interpretive rule suggested here is different than the narrow caricature of an interpretive rule portrayed by the textualists. They equate every broad interpretive rule with a rule that “subordinates[] formal contract doctrine to \textit{ex post} judicial revision” in effect, providing parties with “a judicial insurance policy against formal contract terms . . .”\footnote{Kraus & Scott, supra note x, at 1025.} Identifying an interpretive rule should be crafted as an intervention choice. Recognizing that there is an interpretive risk in all contracts that parties would be willing to adopt and that would enhance the willingness of both parties to engage in exchanges. \textit{Ex post} judicial revision of contracts would not be permissible unless it is clear that both parties \textit{ex ante} would have agreed to such revision as an interpretive rule that would maximize surplus and minimize cost across contracts for all classes of transactors.

The particular components of an interpretive rule matter. In deciding on the best interpretive rule, one should consider that there might be alternative ways to craft an interpretive rule and that \textbf{the way in which the interpretive rule is crafted, tailored and applied might affect whether its adoption will result in net welfare improvement}. Textualist proponents have assumed a broad interpretive rule will necessarily run contrary to majoritarian preferences of commercial parties yet the precise contours of what a broad interpretive rule would mean has remained largely unexplored. If the interpretive rule is crafted as a universal rule -- as the textualists’ rule is -- declining to intervene or to override express terms in all cases unless the

\footnotesize{\textsuperscript{15} See Alan Schwartz & Robert E. Scott, \textit{Contract Interpretation Redux} \url{http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1504223} (noting failure of courts to distinguish vague from ambiguous terms).}

\footnotesize{\textsuperscript{16} Steven Shavell, \textit{On the Writing and the Interpretation of Contracts}, 22 J. L. Econ. & Org. 289 (2006).}

\footnotesize{\textsuperscript{17} Id.}

\footnotesize{\textsuperscript{18} Kraus & Scott, supra note x, at 1025.}
parties delegate interpretive authority to a court *ex ante*, a court might decide to depart from such a universal rule and to craft exceptions depending on the facts and context of a case to avoid negative welfare effects. Those exceptions then become part of the interpretive rule to be evaluated. Courts might decide not to enforce an express term in a contract - and thereby depart from textualism - if doing so would lead to catastrophic or deadweight losses for both parties, or if doing so would promote opportunistic behavior which acts as a drag on gains from trade. If a court crafts an interpretive rule with particular rationales for intervention even absent delegation, then in assessing whether a presumptive rule of non intervention absent delegation or an alternative rule of broad contextualized interpretation should govern, the comparison must further consider that the alternative rule to textualism might permit broad interpretation or a departure from express terms but only in a range of circumstances articulated by the courts that can be justified in terms of welfare improvement.

In comparing interpretive rules, one must therefore consider not only the particular parameters of the rule but also particular factors, such as the way a burden of proof is allocated, that affect the application of the rule. If, for example, textualism is rationalized in terms of majority preference because it relieves one party of a costly burden of proof or persuasion that would otherwise arise under a contextualist, broad approach, then, by postulating a different burden of proof and incorporating that allocation into the particular type of interpretive rule, courts could avoid the negative welfare effects that textualists predict would inevitably follow from intervention.

By looking at how courts actually decide interpretation cases, rather than at projections of a high judicial error rate, the judicial competence of courts becomes apparent, at least if that is not the expectation when things went bad at Dow just before the deal was to be consummated and it would seem that a court of equity would be justified in refusing to enforce the clause in the contract requiring specific performance if doing so would have led to catastrophic losses for both firms. See Answer of Defendants, *Rohm and Haas Co. v. the Dow Chemical Co. and Ramses Acquisition Corp.*, No. 4309-CC (Del. Ch. Feb. 3, 2009), 2009 WL 355704, where Dow alleged that the acquisition would threaten “the very existence of both companies.” *Id.* at 25. The case settled before the Delaware Court of Chancery had to resolve the issue of whether the court should depart from the express terms of the contract calling for specific performance. However, equity would be justified in refusing to enforce the clause in the contract requiring specific performance if doing so would have led to catastrophic losses for both firms.

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19 A recent case illustrating an example of when a court should justifiably depart from the express terms of a contract involves the recent acquisition by Dow Chemical of Rohm and Haas. A case could have been made that, on a projected basis, forcing the combination would have sunk both firms’ asset projects, resulting in a rather clear economic waste in a broadly social sense. Of course, the merger was completed and Dow is handling the fusion well, it seems. But that was not the expectation when things went bad at Dow just before the deal was to be consummated and it would seem that a court of equity would be justified in refusing to enforce the clause in the contract requiring specific performance if doing so would have led to catastrophic losses for both firms. See Answer of Defendants, *Rohm and Haas Co. v. the Dow Chemical Co. and Ramses Acquisition Corp.*, No. 4309-CC (Del. Ch. Feb. 3, 2009), 2009 WL 355704, where Dow alleged that the acquisition would threaten “the very existence of both companies.” *Id.* at 25. The case settled before the Delaware Court of Chancery had to resolve the issue of whether the court should depart from the express terms of the contract calling for specific performance. However, equity would be justified in refusing to enforce the clause in the contract requiring specific performance if doing so would have led to catastrophic losses for both firms.

20 Kraus and Scott strongly criticize the result in one case, *Hunt Foods & Industries v. Doliner*, 270 N.Y.S. 2d 937 (App. Div.), *aff’d*, 272 N.Y.S. 2d 686 (App. Div. 1966) as a decision that improperly broadly interpreted a formal written unconditional option to include an oral agreement that added a condition. The problem with departing from a formalist interpretation is that it ignored the fact that the parties had avoided incorporating the conditional nature of the option into the written agreement precisely because doing so would, so Kraus and Scott argue, improperly burden the acquiring company from proving that the target had bid-shopped. Kraus & Scott, *supra* note x, at 1054. On that rationale the court should have enforced the formal agreement and disallowed evidence of the oral agreement making the option conditional. *Id.* However, had Kraus and Scott admitted that the court could easily allocate the burden of proof to the target company rather than to the acquiring company, it is no longer clear why a formalist interpretation of the agreement would be required.

21 *See infra*
competence is framed in terms of a court’s ability to craft interpretive rules to maximize gains from trade and minimize the costs of transacting.

The essay challenges the textualist approach to interpretation and seeks to reframe the issue in the following way. Instead of assuming that if the parties adopted express terms in a contract, there must be an accurate interpretation and that the court’s job is to achieve a sufficiently accurate answer on average without adding too much to the cost of achieving accuracy, this essay assumes that even when parties employ express terms, if the parties’ own strategy is to leave some matters to less rather than more elaborate specification, there is often no accurate interpretation. Matters remain unresolved for cost reasons and the court’s job is to reduce the interpretive risk from leaving matters less resolved. The parties will deduct the interpretive risk from their gains from exchange. They will nevertheless stop drafting if the interpretive risk is less than the residual costs of drafting further. Rather than focus on achieving accuracy and weighting the costs of achieving accuracy in interpretation, courts as interpreters should focus on how the interpretation adopted would increase or decrease interpretation risks (costs) over time to different classes of transactors. A number of doctrines and cases in Contracts that cannot be explained by the logic or the announced rule of the textualists argues for a trenchant explanatory theory that can explain these “microdata.” It will argue that judges (with certain exceptions in outlier cases) are doing a superior job of handling interpretive issues in a way that enhances value for the parties even if the contours of their interpretive rule are not fully and consciously articulated. Judges enhance value by reducing interpretive risk created by contracts with residual uncertainty. In some cases they reduce the risk that a party will act opportunistically by interpreting contracts to incorporate trade uses that control such opportunism. In other cases, they control opportunism and therefore diminish interpretive risk when they directly supply a term that makes part performance in a unilateral contract limit an offeror’s power of revocation.

The question of how to interpret express terms when the meaning is not self-evident has potentially far ranging effects beyond Contract law; it has implications for how express terms in statutes should be interpreted, at least when those statutory provisions become part of a contract. The methodology of interpretation proposed here should at least be consulted on how the recent Chrysler bankruptcy interpretive issue should be resolved. The same wealth justification that determines what interpretative rules courts should announce ex ante to govern interpretive risk should also guide courts when they interpret sections of federal bankruptcy law which become part of every creditor’s agreement with every debtor. If an ambiguity exists in a federal statute, then a consequentialist interpretation should govern meaning, one that takes account of the ex

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22 See infra text at 28.
23 See infra.
25 Kostritsky, supra note 2, at 33 (discussing ALCOA case as an outlier case).
26 The Chrysler bankruptcy addressed the question of whether a sale of Chrysler’s assets was a permissible sale under §363 or whether it was impermissible under the statute because it failed to afford certain classes of secured creditors the protections afforded creditors by the bankruptcy law under Chapter 11. The rising popularity of §363 sales has engendered a sharp debate in the scholarly and popular press. See infra note 76.
27 The extent to which interpretation matters should be resolved by reference to objectives as well as the “common good” has been the subject of great debate in the statutory interpretation arena. See e.g., Frank H. Easterbrook, Judicial Discretion in Statutory Interpretation, 57 OKLA. L. REV. 1 (2004) and William N. Eskridge, Jr., Dynamic Statutory Interpretation, 135 U. PA. L. REV. 1479, 1516 (1986-1987).
ante effects on the willingness of parties to enter exchange transactions in the future since that would directly affect the future creation of wealth in private transactions. Part II will explore the role of consequentialism and formalism in the common law decision-making. Part III explores why and when interpretative issues will arise in contracts with express terms. Part IV proposes a cost benefit approach to crafting an intervention choice in the form of announced interpretive rules. Part V catalogs the misguided assumptions of the textualists. Part VI uses existing case law and the Restatement of Contracts to demonstrate how far current law deviates from textualism and to suggest an economic welfare improvement explanation for the results. Section VII concludes by exploring the implications of a consequentialist framework for statutory interpretation issues in the context of bankruptcy law and the recent Chrysler case.

II. The Role of Formalism and Consequentialism in Common Law Adjudication and Contract Interpretation (Decision-making)

Resolving whether formalism should be the preferred interpretive default rule for the interpretation of contested contracts cannot be resolved without understanding what role formalism played in the separate and distinct arena of common law decision-making and why it was later rejected by both scholars and courts. The insights of the legal realists into the deficiencies of formalism as a basis for common law decision-making should be relevant in deciding whether formalism should prevail as the preferred rule for Contracts interpretation.

Early adherents to formalism argued that goal achievement should play no role in legal decision-making. Instead, courts were to use a purely deductive process in which a judge could work from the generality of law in the form of an expressly stated doctrinal rule to its application (or nonapplication) to a set of facts. Hume demolished this notion, demonstrating that it was impossible for a generality to tell which special cases were contained within it. A noun cannot tell you what categories are included within the noun. The idea that pure deduction can be used to work from the generality of a doctrine to its application (or non-application) to facts that vary from those stated in the generality of the doctrine has thus been rejected as impossible. It was therefore no longer possible “to believe that every legal question has a right answer that a properly trained lawyer or judge can deduce by correctly applying the canonical legal materials to the facts.”

The Legal Realists relentlessly pursued the insights of Hume and suggested that since doctrine alone would not predict what case outcome should prevail; cases should be resolved by uncovering the policy considerations that were operating in the cases at a sub rosa level.

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28 See infra Section VII.
29 These deficiencies have been well documented.
30 “Mechanical legal formalism holds that the ‘law’ consists of a collection of rules contained in a well-defined set of source materials—principally statutes, regulations, contracts, and prior judicial decisions—along with a relatively small number of fundamental legal concepts. At least according the pure version of Formalism, every legal question has a right answer that a properly trained lawyer or judge can deduce by correctly applying the canonical legal materials to the facts.” Matthew Stephenson, Legal Realism for Economists, 23 J. ECON. PERSP. 191 (2009).
31 Conversation with Ronald J. Coffey, Professor Emeritus Case Western Reserve University School of Law. See also DAVID HUME.
32 Id. at 193.
33 See e.g., John P. Dawson, Duress Through Civil Litigation, 45. MICH. L. REV. 571 (1945).
The view that cases cannot be decided without a consideration of the projected consequences of a legal decision prevailed. We are all consequentialists now. We cannot imagine judges deciding a possession issue in the famous *Pierson v. Post* case without the court’s considering how the rule will affect those subject to it and how a particular legal decision will further certain goals. Similarly, we cannot decide what the legal test for an offer should be or whether silence should operate as assent without considering what the consequence would be on the cost of transacting. In confronting whether an objective or subjective theory should govern the determination of an offer, courts consider what the costs of a subjective approach would be given the difficulty of ascertaining a party’s unmanifested subjective intent. In postulating that the decision between two alternative rules should depend on the costs to transacting, the courts are certainly focusing on a key consequence of an interpretive rule for assessing whether an offer exists.

However, when law and economics scholars consider how courts should interpret contested contracts, curiously, they embrace formalism and suggest that goals or objectives should play no role in deciding cases. They posit that if the parties have not expressly adopted a rule delegating broad interpretive authority to a court, that the parties intend to foreclose courts’ considering of goals or anything else beyond the parties’ language when they interpret contracts.

Formalists project negative welfare consequences if courts go beyond the parties’ express terms. Following Hayek, who projected the obstacles to outsiders attempting to make improvements by intervening in a private exchange, the new textualists suggest that the parties will be worse off if a court goes beyond the express terms without any express delegation by the parties. In short, the new textualists have offered an instrumental defense of formalism.

Whether an unvarying rule embracing formalism absent express delegation should be the preferred default rule depends on a careful analysis of the costs and benefits of the suggested textualist rule, as well as alternative interpretive rules and informal, non legal strategies. These costs and benefits must include a consideration of how these various approaches would minimize the costs of contracting for *ex ante* transactors deciding whether to engage in an exchange or not. But before addressing the cost benefit analysis of textualism and its alternatives, one must first address how parties draft contracts and how residual uncertainty even with express language may exist. That unresolution in contracts must be accounted for in the cost benefit analysis of judicial intervention. Section III will define the scope of the inquiry and provide a cost/benefit analysis of competing interpretive rules and it will examine current cases and doctrines in Contract which cannot be explained by textualism. Sections IV and V will address those costs and benefits and lay out the analytical framework of the textualists and implicit assumptions on which such cost benefit analysis is predicated and identify its assumptions, limitations and its distortions.

III. Scope of Inquiry. When Does an Interpretation Issue Arise?

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34 3 Cal. R. 175 (1805).
36 See Schwartz & Scott, *supra* note x.
37 FRIEDRICH A. HAYEK
38 See infra Section III.
Understanding that residual questions will exist even if the parties use express terms raises the issue of what courts should do in the face of such uncertainty. The textualists suggest that if the parties use express terms and do not delegate interpretive authority to a court through the use of vague terms such as “good faith” or “reasonableness,” the courts should uniformly refuse to go beyond the text. Another formulation of this announced interpretive rule is that whenever a party’s lawsuit depends on the court going beyond the text, that party will lose unless it had the foresight to add a clause specifically delegating authority to a court. Such an approach would necessarily lead to a lack of resolution on issues not determined by the express language.

To understand how and why a contract containing express terms could nonetheless leave residual uncertainty requires first a defining of the scope of the interpretation issue and second an illustration of residual uncertainty. What to do in such cases must await analysis of the problem and its scope.

The first question with interpretation is whether it is limited to cases involving only how to apply the express terms if they appear applicable to an event, or whether it also includes the question of what is to be done when the express terms do not cover in any way an event or condition. Interpretation needs to be narrowed to determine what the boundaries of the discussion are.

If the decision is made that the express term is meant to settle a controversy and to address the circumstance at issue, then unless the coverage of the event or condition is perfectly obvious because of a match with the unquestioned meaning and scope, there is a boundary of coverage issue. And once the boundary of the coverage of the clause is an issue, the connection between coverage and non-coverage of an event under the express terms becomes apparent. In each case, the court must grapple with an issue that is not resolved by the express terms, either in terms of the scope of the clause’s coverage or in terms of an actual gap.

Even if there is an express term, a further question exists, again requiring a judicial response, of in what way is the express term meant to settle the question. Unless the court is to let the party asking for relief fail whenever the express terms do not settle the application because of the unambiguous and unquestioned meaning of the term, the problem of interpretation will not go away. 39

If a contract, for example, obligates a company to pay a fixed fee to a headhunter if the company hires anyone whose name was supplied by the headhunter, 40 there is a question of how that express term is meant to settle the payment issue. Residual uncertainty under how the payment term is meant to operate still exists. An interpretation question might arise if the headhunter firm delivered a local phone book to the company and the company, while not using the phone book since it is a useless resource, nevertheless does hire an employee whose name appeared in the phone book. The payment clause is not drafted with sufficient particularity that would allow a court to simply apply the language to the facts in such a way that no interpretive decision would be required. The inexactitude would permit the headhunter -- using textualism --

39 A recent example involves the meaning of the term “subsidiary” in AMD vs. Intel.
40 This example was first discussed in Aaron Edlin, See comments made by Professor Aaron Edlin, Professor of Law, University of California, Berkeley, at the Columbia University Conference on Contracts held April 7-8, 2006.
to demand payment under the literal terms. The company could only contest that interpretation if the court were willing to look beyond the contract’s express terms.

If one subscribed to the interpretive rule of textualism, it would not tell the court which of several interpretations it should adopt. It would simply tell the court that if a party’s interpretation depended on matters extrinsic to the contract, the company would lose. The company would lose if it tried to argue that a court should advert to and reference goals beyond the clause in determining whether the headhunter should be paid for delivering phone books. A broad interpretation would allow the court to reference overall goals of maximizing joint surplus.

The parties could have drafted with a greater degree of specificity but failed to do so. It may be that it was so apparent to the parties that when an employer hired an agent the law would supply a fiduciary duty to constrain the actions of the headhunter or to supply a standard by which to measure the performance of the headhunter. That implied standard permits a court to determine if performance is defective even if it would meet the literal meaning of the express terms.

Denying a court the opportunity to do that absent an express opt-in would add to the cost of all future transactors who might undertake additional drafting costs to ward off courts from insisting on literal interpretation. If most parties would assume that an express opt-in would not be needed to rule out an unreasonable interpretation that permitted the headhunter to be paid for delivering the phone books, then a decision for the headhunter would deter future transactors from contracting altogether. They might be worried that parties would have to draft carefully to avoid unreasonable interpretations of language.

IV. Intervention Choice and the Reduction of Costs for Parties: A Framework

Before using a cost benefit analysis to assess the best interpretive strategy for courts to take in cases in which the parties have adopted express terms and yet failed to delegate broad interpretive authority to a court, one must model a framework for how parties bargain, why they enter into exchanges at all through other than spot transactions, and how an interpretive rule of a particular type announced in advance would affect the achievement of the parties’ goals, including the reduction in ex ante perceived costs of transacting.

Courts must defend their intervention choice (to intervene or add to parties’ contracts or not to intervene) in terms of cost because parties themselves want to minimize the costs of transacting. Parties who exchange through other than spot transactions do so to minimize the

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41 An analogous doctrine in statutory interpretation permits courts to rule out interpretations that would promote “unreasonable consequences.” Eskridge, supra note x, at 1483.

42 A more difficult question of interpretation would arise if the headhunter performed a valuable service, such as assembling the resumes of qualified people, and transmitting those resumes to the employer. This might be equivalent to the Faculty Appointments Register for law school teaching jobs. Pre-screening the resumes would provide a more valuable service but one that would be entitle the headhunter to a larger fee. Lee Fennell contributed this insight.

43 The economist denominates such a world that consists exclusively of spot transfers as a market.
costs of exchange. They want to reduce the risk of transacting as a way of minimizing costs. Some risks may constitute a cost of transacting; other costs may have no particular risk associated with them; they are simply costs such as the cost of an input to production. There are many other costs that derive from various risks, including the interpretive risk derived from a particular interpretation rule, that parties face \textit{ex ante}. These costs and risks are viewed by the parties to any transaction \textit{ex ante} and probabilistically.

In drafting contracts the parties may adopt an express term that is meant to settle a controversy in some way. But the parties may fail to keep drafting with the level of particularity and detail needed to resolve all possible questions that may require resolution under those terms. Part of the problem is the uncertainty and the unforeseeability of the future. Parties draft contracts \textit{ex ante} and the contract will be performed at a later point in time so the question may arise of how to interpret express terms given later development (the state of nature). We need to worry about how to interpret contracts because parties cannot devote infinite resources to articulating their bargain. If drafting and even more importantly, thinking costs were free, interpretive problems would never arise.

Thus, the use of express terms is beset by the same cost of drafting issues where parties decide to use no express terms or leave gaps in contracts. For that reason, I will treat these two issues together in this essay using examples from both interpretive and gap filling disputes.

The tradeoff generally takes place under a framework that asks whether the “costs of specifying” are either (1) more than the costs of risking non specification, or (2) more than the surplus achievable by the exchange. One would not undertake drafting costs if such costs outweigh the possible gains from trade. The first prong of the above cost analysis is important and is sometimes overlooked. One would not want to continue to draft if the drafting costs outweighed the risk of non-specification. Thus, the party may compare the residual cost of an interpretation risk against the cost of drafting further. This will be referred to as “interpretive risk.”

In evaluating the cost of interpretive risk in any contract setting, one must factor in the interpretive rule that a court would use and announce in the future to interpret that contract. This \textit{ex ante} interpretation risk is a cost that a party faces \textit{ex ante} and one would expect a court to attempt to decrease this risk to classes of transactors represented by each party to lower the overall costs of contracting, at least in cases where the court can intervene at a lower cost than whatever other mechanisms exist to lower the interpretive risk these include reputational and informal sanctioning mechanisms. That rule (which affects interpretive risk) is the one that can be identified from the courts’ decisions.\textsuperscript{44} It can be further refined and articulated if one carefully analyzes those opinions to identify the particular factors that warrant a departure from textualism, even absent an express delegation clause.

The interpretive rule announced by the textualists is a rule that would exclude resort to the parties’ objectives in contract interpretation unless the parties expressly delegated such authority to consult objectives. By implication it would also rule out the implication of law-supplied rules unless the parties expressly delegated the authority to a court to imply terms into contracts.

\textsuperscript{44} See Kraus & Scott, \textit{supra} note x at ____.
Although the textualist approach would admittedly leave certain matters unresolved, the proponents have three sorts of answers to the residual uncertainty problem in contracts. The first set of arguments is built on an implicit assumption that whenever parties fail to draft with a level of particularity that would eliminate the interpretation issue, they necessarily intend that any residual interpretive issues should be resolved by informal mechanisms.\(^{45}\)

The second type of answer to whether the court should intervene to resolve residual uncertainty is based on a reduction of cost analysis. The argument proceeds as follows. Even if there are residual uncertainty issues, the court should not intervene with an interpretive rule that adds terms to contracts or broadly interprets such terms using extrinsic evidence at least not in contracts between commercial firms because the majority of such parties would prefer a hands off approach based on cost analysis and parties’ preferences.

Third, empirical evidence supports the argument that textualism is the preferred choice since most parties studied by Eisenberg and Miller\(^{46}\) opted for New York law to govern under the choice of law provision. Since New York courts adopt a decidedly textualist approach, the decision to have New York law governs supports the conclusion that textualism is the preferred rule among commercial firms.

The next section, by undermining the assumptions underlying textualism, suggests a unitary rule for interpretation denying all relief to a party where the language is ambiguous unless the party has expressly delegated broad interpretive authority to a court may not be appropriate in all circumstances.

V. Textualists: Misguided Assumptions

A. Overoptimism and Non Legal Enforcement

The textualists argue that if the parties did not expressly delegate interpretive authority to a court on a particular matter arising under a contract that is later disputed, then the parties intended to rely exclusively on non-legal enforcement to resolve the dispute rather than have a court resolve it.\(^{47}\) This position is premised on the idea that reliance on private strategies to resolve matters not clearly and unambiguously intended to be covered by the express reduces costs for parties more than the alternative of judicial enforcement, at least if the parties have not expressly resolved the matter themselves through unambiguous language that covers the matter and leaves no residual uncertainty.

If a matter is not addressed with a sufficient degree of precision in the contract, then the parties knowingly choose to exclude from legal enforcement any matter that was not addressed by the written terms. Yet, it is far from clear that when the parties’ stop short in drafting, that they are deliberately opting out of all legal enforcement for matters not explicitly addressed or matters requiring interpretation beyond the explicit terms.

A number of flaws undermine this argument in favor of exclusive and deliberate reliance on informal mechanisms. Acceptance of the argument requires one to reject a number of

\(^{45}\) See Kraus & Scott, supra note x, at __.

\(^{46}\) See infra note 58.

\(^{47}\) See e.g., Kraus & Scott, supra note x.
assumptions, many of which seem plausible and in fact more plausible than the proposition that parties universally intend to rely exclusively on informal enforcement mechanisms. One would wonder why parties would want courts to abandon all interpretive techniques that are routinely used in the case law and whether it would be safe to assume that they had intended to foreclose such techniques based simply on the failure to adopt a specific phraseology such as good faith or reasonable. One would think that parties who wanted to bar such widely used techniques would explicitly exclude them rather than leaving it to a court to infer that the absence of an open ended phrase or vague term meant that the parties intended such exclusion. Therefore, courts should not necessarily assume that the failure to cover a particular matter, even if that matter is consciously adverted to beforehand, means that the parties intended to rely exclusively on informal enforcement.

First, the argument seems to assume that a particular level and degree of informal enforcement, one that is “pervasive and robust,” existence. In many instances the conditions for such enforcement are not present, as where there is no effective means for transmitting information about possible shirking behavior by contracting parties, the group is too large or lacks homogeneity, or there is no agreement on what behavior would warrant reputational sanctions. In such instances, it may be unwise to assume that the parties intended to rely exclusively on informal enforcement, even if they stopped short of drafting with a sufficient level of precision to resolve all issues.

The second problematic assumption of the new textualists is based on a particular behavioral assumption about dispute resolution. That hypothesis suggests that if a court lends legal enforcement to a matter that does not either expressly demand judicial resolution via an express delegation or that does not clearly resolve the matter in question through a relevant contractual clause, then that enforcement will have negative welfare effects. It will “crowd out informal enforcement.” While there is some experimental data supporting this crowding out thesis, I remain skeptical of this thesis for two reasons. First other experimental data suggests that there can be complementarities between legal and non legal enforcement.

Once the high cost of litigation is accounted for, a logical objection to the crowding out phenomenon is apparent. Litigation is so expensive that it is a very rare case when either party would prefer litigation over informal sanctions. In the rare case where the parties resort to litigation, it is usually because there are large dollar amounts at stake and those dollars have prompted one party to act in an opportunistic fashion. This is precisely the type of case where litigation could helpfully supplement informal sanctions which are likely to be ineffective when the benefits of opportunism outweigh the reputational costs.

B. Contrary Cost Analysis: Crafting an Intervention Choice

48 Stephenson, supra note x.
49 Scott,
51 William C. Whitford
The arguments for a textualist interpretive approach absent an express delegation rely on a particular cost benefit analysis. It assumes that parties themselves weigh the costs of drafting vs. the cost of enforcement in deciding how far to draft. If they draft express terms, they have invested large front end costs to avoid ex post enforcement costs. The textualists assume that parties themselves have devised an answer in the contract but that it will be sometimes costly for a court to figure out what the right answer is (the accuracy problem). They recognize that if courts depart from the text and take in more evidence, courts would have a greater probability of reaching the accurate result. However, because parties are risk neutral and only care about a court getting the correct answer on average, most parties would prefer that courts adopt a textualist extra enforcement costs are not worth the gains in accuracy.

Several problems undermine this version of a cost benefit analysis. The textualist argument overlooks a fundamental problem: that there may be no correct answer. If each party admits that it did not know the meaning of the other party, then the “accuracy” at the center of a contract agreement is unresolution. To resolve that lack of resolution, the court should frame an interpretive rule that reduces the interpretive risk for all classes of transactors taking account of all possible costs as a way of achieving the parties’ presumed goal of lowering transaction costs and maximizing surplus. Thus, the tradeoff is not between weighing the greater accuracy that could be achieved by taking in more evidence and the sufficient degree of accuracy that can be achieved by looking only at the contract’s terms.

Once unresolution is accounted for, then the question for courts is whether the parties would prefer courts to intervene to resolve the lack of resolution with an announced interpretive rule if that rule could be crafted in such a way as to enhance the willingness of parties to exchange.

The cost benefit analysis for textualism is also distorted because it seems to rest on untested empirical assumptions. Textualism assumes that the costs of judicial intervention will always be too large when the parties did not signal their intention to delegate or that even if there are situations where judicial intervention would be beneficial, it is too costly to identify those examples. Yet, the parties’ failure to adopt an express delegation clause may be due to many different reasons, not all of which signal their intention to foreclose intervention. They may well stop drafting because they anticipate that the current framework by courts is one in which courts regularly adopt a variety of interpretive techniques which go beyond unthinking formalism. Most parties would assume that courts are not indifferent to the goals of parties in contracting and that parties, at least behind a Rawlsian veil of ignorance, would want judges whom they can count on to realize those joint goals. Thus, the parties may assume that there is no need to adopt a specific phrase inviting courts to exercise broad interpretive authority. The textualists have conflated the parties’ individual contractual goals in specific transactions with overall goals that are shared by all transactors in exchange. They have forcefully argued that parties would prefer literalism to a method that resolves interpretive disputes by referencing the parties’ contractual goals. The difficulty with this argument is that the notion that specific shared contractual goals

53 Kraus & Scott, supra note x.
54 See Cohen, supra note x, at 5 (“Economists and courts start from the presumption that courts should follow the intention of the parties. To admit incompleteness, however, is to admit that the intention of the parties is uncertain, or at least disputed.”)
55 Robert W. Gordon
exist is a myth and should not form the basis for guiding interpretive disputes. Thus, while it is true that parties might not want courts to resort to contractual goals since it is not clear that a joint view of those goals exists, parties might indeed want a court to resolve unresolution by resort to overall goals of adopting an interpretive method to maximize joint surplus and minimize costs.

The biggest problem with textualism’s cost benefit analysis is the model of the tradeoff made by parties deciding what kind of interpretive rule they would prefer. One key piece of the argument is that because commercial parties are risk neutral, they only care about a court reaching the correct answer on average. For that reason a firm “is unwilling to incur additional costs in order to increase the accuracy of any particular finding.” The tradeoff is between admitting more evidence later on to increase accuracy and the costs of doing so, which include greater uncertainty from the admissibility of such evidence. They are willing to give up some degree of accuracy (some wrong judicial determinations of terms) to save costs since the greater accuracy is not worth the costs of achieving it.

Two problems undermine this way of analyzing the tradeoff. First firms are not risk neutral except in one limited sense. Risk neutrality has two meanings. In one of its two distinct meanings, risk neutral parties comprise those who “in arriving at the present value of a future income stream of possible values, do not discount the \textit{ex ante} expected value in light of their uncertainty, risk.”

Most actors, including commercial firms, are not risk neutral in this sense of evaluating projects that they might initially invest in. The sense in which firms are thought to be risk neutral is “with reference to selecting from among risky projects after valuation of a future income stream of risky values has been correctly established in light of risk.” At this second stage, if managers can costlessly shift from one risky project to another, then as amongst those differing and risky projects, firms are risk neutral.” This is the sense in which economists mean to refer to firms being risk neutral.

If firms are not risk neutral, then they would indeed care about achieving greater accuracy in interpretation. So, to the extent that the assumption of risk neutrality does not hold, then the conclusion that parties care only about average accuracy is less convincing. But for our purposes, it does not matter whether one accepts that firms are or are not risk neutral. What matters is that regardless of one’s conclusion on their degree of risk neutrality, the argument that the parties would only care about reaching accuracy in an average number of cases overlooks a fundamental mistaken assumption. If there is unresolution, then courts deciding cases must necessarily go beyond the text to a consequentialist framework to reach any solution that the parties would prefer.

C. Empirical Evidence and Arguments


\textsuperscript{57} See Cohen, \textit{supra} note x, at 15 (“Contracting parties do not demand enforceable coin flips to resolve their disputes.”)
The third pillar supporting textualism is based on empirical data. The textualists argue that empirical evidence supports their theory that the majority of commercial parties would prefer a formalist approach to contract interpretation issues. Based on an examination of 13 different types of 8K filings two scholars looked at the choice of law and forum provisions in 2,865 contracts. They concluded that firms who incorporate in Delaware tend to flee Delaware when picking choice of law, often in favor of New York. They find that California law was chosen in only 8% of the cases while New York law was chosen in 46% of the contracts. Because the authors perceive that New York law is more conservative than either Delaware or California law, they conclude that the predominance of New York for the governing law reflects a choice by firms for strict formalism over jurisdictions that engage in “the frequent exercise of equitable overrides by courts.”

However, several flaws undermine the conclusion that the designation of New York law rather than New York or California law reflects an overriding commercial firm preference for formalism over other types of interpretive approaches. First, if there is a flight from Delaware law with Delaware attorneys preferring New York law rather than Delaware law, that choice does not support the notion that they are fleeing a more liberal jurisdiction in favor of a more formalist jurisdiction since both Delaware and New York are formalist. There is case law to suggest that there is no basis for saying that New York law is any more formalist than Delaware given the Delaware law cases. Delaware case law is very hostile to law-supplied terms, once it is decided that express language is intended to cover the situation, one way or the other, leaving only how express language is to be interpreted. It is also hostile to the content of law supplied terms even when there is no express coverage for the situation in controversy. Thus, given the highly formalist nature of Delaware law, the hypothesis that choice of New York law and the rejection reflects a preference for greater formalism is selected because it is more formalist is highly suspect.

The second reason that the choice of New York law over Delaware law in the contracts is not meaningful is that the number of confirmed Delaware attorneys in the studies is slim to none. An attorney’s locale can be a significant factor in the choice of law that is ultimately chosen. Additionally, while sophisticated parties may be interested in the choice of forum for litigation

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59 See Eisenberg & Miller, Flight to New York, supra note x, at 1488 (listing different types of contracts) (Problems with 8K filings).

60 Eisenberg & Miller, Flight to New York, supra note x, at 1495 (claiming data shows that New York “dominates as a choice of law for contracts with Delaware corporations”).

61 Id. at 1490.

62 Kraus & Scott, supra note x, at 1062.

63 See ASQR.case.

64 Cite

65 Eisenberg & Miller, Flight to New York, supra note x, at 1479.
purposes, the choice of law to be applied in most instances may be left up to the attorney’s choosing rather than the client, who is likely not well versed in the jurisdictional differences of applicable law.

In Eisenberg and Miller’s first study, examining choices of law and forum in 8K merger contracts, Delaware is not the attorney place of business for any firm in their sample. Thus, there is no evidence presented relating to the preference of Delaware attorneys for either Delaware or New York law. This same problem exists in Eisenberg and Miller’s second article, analyzing the preference for New York as the choice of law and forum in a variety of 8K filings, where there are only two Delaware attorneys considered and they are split, with one choosing Delaware and the other New York. Thus, the studies do not show that Delaware attorneys prefer New York law as the choice of law. There is too little data to support that conclusion.

The third reason that the choice of New York law over Delaware law may not reflect a choice for formalism is that attorneys representing firms incorporated in Delaware and who employ attorneys who draft contracts designating New York law as the choice of law may be doing so because the attorney’s firm has a branch office in New York. This is a political economy explanation, namely New York lawyers want to deal with local law which they may know better and can defend or enforce in local courts. It is understandable that an attorney with a firm from Ohio, for example, with a New York branch office, representing a business incorporated in Delaware would designate New York law as the governing law rather than Delaware law because the attorney would have local expertise on New York law. The choice of law may be one based on a desire to avoid malpractice claims that might arise if the Ohio law firm had to give an opinion involving the law of a jurisdiction with which they were not familiar. The studies do recognize that there is a “significant association” with the attorney’s locale and choice of law. However, because the studies do not address where a firm “does business,” it ignores the hypothesis that the choice of New York law can be explained by the fact that any law firm with a branch office in New York would make the choice of New York law to avoid having the contract depend on the law of a jurisdiction with which they were not familiar. This third explanation for the preference for New York law raises a principal/agent problem since choice of law provision not the commercial firm’s preference may reflect the attorney’s own choice.

Thus, there is no compelling case, despite the presence of cited empirical data, to support the conclusion that commercial firms are choosing New York law over Delaware law because New York law is more formalist than Delaware law. A host of other competing explanations for the choice of New York law may explain the preference for New York law.

66 “The contracting attorney’s state is likely to be associated with choice of law because the attorney is licensed in the state, is familiar with the state’s law, and has an economic incentive to have its state law govern.”
68 Eisenberg & Miller, Flight to New York, supra note x, at 1496.
69 David P. Porter contributed this insight.
70 Eisenberg & Miller, Ex Ante Choices of Law and Forum, supra note x, at 1983 n. 36. (“It may be that attorneys in these cases practiced in firms that also had offices in the selected forum, but our data did not permit us to investigate this question.”). See also, Eisenberg & Miller, Flight to New York, supra note x, at 1498 (noting that attorney addresses were only identified for “approximately 38 percent of the contracts”).
VI. Explaining Courts and Restatement’s Departures from Textualism in Contracts: Empirical Evidence Offers a Challenge to the Formalists

Many doctrines and cases in contracts cannot be explained by textualism. The illustrations in the next section from current doctrine and case law provide many instances in which courts announce an interpretive rule that broadly interprets text with extrinsic evidence or that interprets text with reference to certain objectives even if the parties have not specifically delegated interpretive authority to a court. In other cases a court adds terms to a contract even if not expressly agreed on. Any theory of contracts must explain the results in these cases or offer an explanation as to why courts are persisting in approaches which the textualists argue should be rejected since they add to rather than diminish the costs of contracting. Whether these doctrines and interpretive rules add to or diminish costs will be discussed below.

A. Jacob & Youngs: Interpreting Conditions to Avoid Forfeiture: Whether Goals Should Affect Interpretation

If courts should ignore objectives or goals in contract adjudication and give effect exclusively to the parties’ chosen means, then the court reached the wrong result in the famous case of Jacob & Youngs since it decided what effect, if any, to give to the express conditions based on an anti-forfeiture objective. Under the textualist approach, since the parties did not invoke broad interpretive authority of the judiciary, the court should have totally ignored forfeiture concerns and strictly enforced the condition even though if doing so would lead to a forfeiture result. Despite the criticism of the case when courts invoke the anti-forfeiture principle, they may be doing so in a way that achieves improvements in welfare.

In Jacob & Youngs, the parties chose language that created a number of express conditions, including an express condition requiring the installation of a particular brand of pipe, Reading. Textualists assume that commercially sophisticated firms deliberately choose language and terms that effectuate their goals. When the parties chose to delineate the pipe brand as a condition, it is asserted that they were choosing strict enforcement of the condition since that is the normal approach afforded express conditions in a contract. Had the parties not wanted to opt for strict enforcement, they could have avoided express condition language or delegated interpretive authority to a court through the use of a term like “Reading quality pipe.”

In the case itself, Justice Cardozo chose to forego strict enforcement largely on the ground that doing so would lead to forfeiture since it would deprive the contractor of the final payment. The precise doctrinal approach is based on interpretation of language that might be either a promise or a condition. In such cases the court takes account of possible forfeiture in deciding whether to construe the language as creating a promissory duty or a condition. Under that approach, the court construed the language as created a duty to use Reading pipe. The failure to use the correct brand pipe would result only in damages but no forfeiture since the owner would not be discharged from payment.

The textualists criticize the result as one that will add to the parties’ costs of contracting. The argument is that if the court simply gives effect to and enforces the language denominating—if it construes the language as a promise

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71 Jacob & Youngs, Inc. v. Kent, 230 N.Y. 239 (N.Y. 1921)
72 Id. at 243-244 (“This is merely to say that the law will be slow to impute the purpose, in the silence of the parties, where the significance of the default is grievously out of proportion to the oppression of the forfeiture.”).
the brand of pipe, the owner will avoid all of the costs of having to prove that the pipe installed is inferior since the court will insist that any departure is a failure to occur of the condition resulting in an automatic discharge. If the court fails to adhere to this approach of strict textualism in the treatment of the condition in the contract, costs will necessarily rise.

The cost analysis is based on determining who would bear the burden of proof on what issues under contrasting types of terms that could have been written by the parties. If the parties adopted an express condition and the court enforced the condition as it was written, it would “set out a precise rule that allows B [the owner] to verify performance or non-performance at relatively low cost.” Reaching a contrary result would add to the owner’s costs since he would be saddled with the burden of proving that the substitute pipe did not conform, a relatively high burden that would increase “back-end verification costs.”

However, the analysis of costs in *Jacob & Youngs* is more complicated than at first appears. Moreover, the textualist approach would ignore certain costs in the analysis which, if accounted for, might change the conclusion on whether a textualist approach would foster net improvements in welfare.

What the analysis of costs ignores is that there might be some residual uncertainty about whether the parties would want the clause of the condition enforced under all circumstances, even in cases where it would lead to economic waste and a forfeiture for one party. Since the contract itself contains a condition but does not specify whether it would apply in every case regardless of the circumstances, there is arguably an interpretive issue that requires a judicial resolution. Would the textualists want that ambiguity or unresolution resolved in favor of a forfeiture outcome? Would the textualists want to deny any restitutionary recovery to the builder?

To decide if there are any circumstances that might justify the outcome in *Jacob & Youngs* and similar cases, all of the costs of an announced interpretive rule that denied any recovery should be considered. If a court were to deny any recovery based solely on whether there was a clause containing an express condition, that approach would allow one party to seize upon insignificant defects to gain a large windfall at the expense of the other party, a form of opportunistic behavior.

One could argue that when such costs are accounted for both parties, including the owner, would not have wanted the court to deny any recovery. That result would have allowed the owner to avoid payment despite having received substantially what he bargained for. If that interpretation (enforce despite minor deviation) were adopted, it would constitute an interpretive risk for all future transactors. Potential contractors would potentially demand higher payment upfront to deal with the interpretive risk of a court strictly enforcing conditions despite the trivial departure. That result is something that owners themselves *ex ante* would want to avoid since it would unnecessarily add to their cost of contracting.

The counterargument is built on the notion that sometimes it may be hard to verify to a court whether a particular matter is really equivalent. To avoid courts having to grapple with such complex equivalence issues the parties may choose to adopt an express condition so that

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73 Kraus & Scott.
there is no inquiry into the magnitude of the departure. One way to deal with the owner’s reluctance to shoulder the cost of proving to a court that an item is not equivalent would be to rearrange the burden of proof. One could put the burden on the contractor to prove that the pipes were substantially equivalent.

Rearranging the burden of proof could thereby achieve the owner’s goal of avoiding costly back end enforcement costs and simultaneously diminish the opportunity for opportunistic behavior. Such a result could presumably maximize the gains from trade.

The analysis suggested here is consistent with the idea that parties would trade off the additional costs of drafting with greater particularity with the interpretive risk that would come with leaving the matter of whether the court should give effect to the condition not matter how insignificant the deviation and no matter how great the forfeiture. The court should presumably announce an interpretive rule for dealing with conditions that also involve a potential forfeiture (in the case law). The announced rule can take account of the concern regarding high ex post costs when matters are highly unverifiable (as when the stipulated event that is the subject of a condition is a matter of personal taste) and determine whether those costs should be evaluated differently in cases with a stipulated event of an express condition concerns matters that are more susceptible to objective measurement (such as the difference in two brands of pipe) and also involves a large forfeiture potential. The rule could also take account of cost concerns by shifting the burden of proof on the quality issue to the party seeking payment.

The interpretive rule, as crafted, would take account of the danger of forfeiture and the potential for opportunistic behavior while remaining sensitive to the burden of proof issues for matters that are unverifiable to a court since they involve matters of personal taste rather than fungible objectively measureable brands.

The actual case law in the area of conditions takes account of precisely these factors in a nuanced analysis. The courts take account of the avoidance of forfeiture as a goal when deciding whether to literally enforce the conditions of the contract. Doing so in cases where there is large potential forfeiture and a readily verifiable minor deviation arguably results in a net improvement in overall welfare by deterring opportunistic behavior.

**B. Residual Uncertainty: Courts Taking Account of Overall Objectives in Contract Interpretation**

Another example of express terms leaving residual uncertainty involves the express terms of an easement. A clause prohibited only three-wheeled ATV’s and did not cover or prohibit the use of four-wheeled ATV’s.  

When the grantor of the easement sought to restrict the holder of the easement from using the easement for four--wheeled ATV’s, the easement holder argued that the express terms did not expressly rule out four--wheeled ATV’s and so should be permitted.

This case raises the question of what the intervention choice should be. If it followed textualism’s dictates, it should refuse to intervene beyond the express terms and should refuse to consider the parties’ objectives to interpret the contract. At the time that the easement was

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74 The example comes from Steve Burton’s recent book on the interpretation of Contracts. See supra note 9.
drafted, four-wheeled ATV’s were not in existence, which explains why there was no express term covering the contingency or the later arising condition of four-wheeled ATV’s. The lack of such vehicles may explain why the parties failed to adopt a clause forbidding similar vehicles which might be developed in the future.

This is a case where the express term is meant to settle the controversy in some way and yet one must still ask: in what way does the express term settle the question? If one uses the textualist approach, one would posit that the absence of a broad or open ended term would foreclose interpretation by a court that looked to goals or ends beyond the contractually chosen means. Yet, deciding that there is no interpretive issue itself requires interpretation that cannot be settled by the express terms. Therefore if the court refuses to intervene in that way, it is nonetheless a choice not to intervene which must be justified.

One could argue this residual uncertainty should be decided by consequentialist decisions about how much the four-wheeled vehicle adds to dust/smoke/noise. That is what court did. Such an approach seems to make sense. Whether it can be justified as an interpretive rule that will minimize the costs and risks of contracting requires further analysis.

The parties could have decided that there was some interpretive risk of not further specifying the kinds of vehicles that would be prohibited on the easement, and not drafting the clause in such a way that it took account of vehicles that were later developed. Since the parties were not aware of four-wheeled vehicles at the time of contract execution, they may not have realized that the clause in question would later require interpretation beyond the express terms.

The question for the collective (judiciary, agency, legislature) is whether intervention using the parties’ objectives, a broad interpretive rule, would minimize costs for the parties more than a literalistic interpretation that excluded such objectives. In deciding what a court should do, one should consider why the parties may have failed to try to eliminate all interpretive risk. One could argue that the parties may have decided that leaving the term unresolved as to the matter of later developed vehicles would present little danger to the parties since courts could readily expand the class of covered vehicles to achieve the objective of reducing noise and dust. Literalism, on the other hand, would promote a kind of opportunistic behavior by the holder of the easement, yet another case where literal interpretation would act as a drag on gains from trade.

One could argue that if a court insists on a literal interpretation, that such an approach will result in certain reductions of risk and costs. The approach would alert all parties that if they fail to cover a contingency, the court will not supply the missing term, adding to predictability and possibly reducing the risks of uncertainty to parties since parties would know that literalism would always prevail.

Yet, the decision about intervention should depend on which approach will best reduce costs for the parties and would be most preferred by parties ex ante. The rule should mimic what the parties would want in hypothetical bargain terms. Ex ante, the parties will prefer an interpretive rule that will minimize the costs of transacting. In cases where the risk of an event occurring (such as the development of a four-wheeled ATV) is not foreseeable, the parties might decide that pursuing further drafting is not worth the cost. This may be due to the interpretive risk that they face and because they can safely cease drafting, since a court could readily
determine at a low cost (straightforward issue) what vehicles should be included within the parameters of a clause covering three-wheeled vehicles.

Moreover, the literalistic approach will increase costs for all parties in the form of an unremedied opportunism. Parties will have to exert defensive costs to constrain such opportunism. Instead of being able to rely on a court to broadly interpret three-wheeled vehicles to cover four-wheeled vehicles, they may undertake the extra drafting costs to figure out unforeseeable developments even if they would prefer to rely on a court to resolve such residual uncertainties. The question for the court is whether intervention beyond the express terms will minimize costs for the parties more than the approach of literalism (a decision not to intervene). Intervention would be justified in cases where: (1) the objectives are readily ascertainable and self-evident from inquiring into the purpose of the clause (why were any all-wheeled vehicles prohibited in the first place), and (2) not subject to ready manipulation by a party as would be the case in which a party would profit at the expense of the other by falsely inflating a term such as seller’s costs, and (3) where the court is convinced that intervention will minimize costs by preventing defensive expenditures.

C. Trade Usage: When Should Trade Usage Govern Meaning: Should a Specific Opt Be Required

Another contentious issue for the interpretation of Contracts is whether parties need to specifically opt in for trade usages to govern meaning. The textualist approach would seemingly deprive the court of any interpretive authority to go beyond ordinary meaning without an explicit authorization by the parties to do so. Current law is to the contrary and provides that unless specifically negated by the parties, trade meaning may be admitted to interpret or supplement parties’ agreements.

The requirement of explicit party choice seems to mask the idea of judicial intervention by making the interpretive approach depend on such party choice. The court, however, is choosing whether and on what basis it will go beyond the express terms of the contract and consider trade usages. The court is announcing an interpretive rule on the degree of explicit choice and opt in required for parties wanting courts to consider trade usages in contract interpretation.

What interpretive rule should be adopted must depend on a consideration of which rule or opt out would minimize all costs of exchange for all future parties and promote growth if that interpretive rule were announced ex ante by a court.

One possible cost from the current rule (evidenced in the case law and in U.C.C. 2-202) not requiring express opt in is that some parties may strategically claim a private meaning that differs from ordinary meaning. Yet to determine whether those costs are great enough to justify

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75 See Alan Schwartz article.
78 See supra note x.
79 For a discussion of the moral hazard problem that arises when parties claim a private meaning that differs from ordinary meaning, see Alan Schwartz & Robert E. Scott, Contract Theory and the Limits of Contract Law, 113 YALE L.J. 541, 586 (2003).
an interpretive rule requiring express opt-in, the costs of requiring parties to opt in must also be considered.

The costs of requiring parties to expressly opt in to trade usages include the transaction cost of knowing that the meanings that parties in the trade attach to words are different from the ordinary meanings that parties not in the trade attach to those same words. Because parties in the trade may assume that the trade meaning is the ordinary meaning, they may see no need to expressly opt in to a trade usage term in the contract. Requiring such express opt in provisions poses large transaction costs for parties in the trade.

The other cost from requiring parties to opt in is that parties may strategically and opportunistically rely on ordinary meaning to escape from the trade meaning whenever it turns out to be a bad deal. While there may be such cases, those cases most emblematic of this kind of strategic behavior seem to be “outlier” cases in which the evidence of the trade usage is so vague that it invites opportunistic behavior such as when a fixed quantity is deemed to be merely an estimate under trade usage. However, there are many cases in which courts invoke trade usage in a way that seems to deter rather than promote opportunistic behavior. Often a party relying on plain meaning seems to be trying to escape from a trade usage that was definite and applicable for no other reason than it was more advantageous to do so.

So, the potential costs of opportunistic behavior must be weighed in determining which interpretive rule, opt in or opt out, would minimize the costs of transacting. Certainly, if a default rule of ordinary meaning will promote opportunistic behavior, and the court could constrain that behavior with an opt out rule, then the parties might be inclined to prefer the opt out rule.

In considering the costs and the reduction in costs that might occur with a particular version of an interpretive rule (either opt in or opt out), one would also have to consider the effect that requiring an opt in rule would have in a class of cases where the trade usage at issue is specifically designed to control a form of opportunistic behavior. Absent an express opt in, the trade usage would not govern the outcome of those cases. That failure would generate costs in the form of controlled opportunistic behavior unless the parties could effectively control the opportunism by other private strategies such as informal enforcement.

The decision to exclude valid trade usages that are universally adhered to and are themselves designed to curb opportunism would generate costs that might deter future transactions and would be considered a cost of the exchange. Those costs could be mitigated by parties resorting to informal mechanisms but those informal mechanisms themselves have a cost which might outweigh the costs of associated with a court intervening to announce in advance an interpretive rule that courts would incorporate trade usages into contracts as part of interpretation. Moreover, to the extent that the informal mechanisms are not pervasive and robust in a certain factual setting, then the cost of parties denying effect to trade usages designed to deter opportunism might be that opportunism itself would be unchecked.

**D. Section 45: Intervention Choice When No Express Terms**

When no express terms are present to cover *in any way* a future event or circumstance, the question that may arise is whether the court should nevertheless add a particular term to the

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80 *Id.*
parties’ contract. In unilateral contracts, courts faced the issue of whether it should imply a term of irrevocability of the offer once partial performance by the offeree had begun.

The same justificational framework under an economic approach must resolve what a court should do when parties omit terms altogether considering what approach would best minimize the costs of contracting for the parties to promote growth.

If the logic of textualism is accepted, then if the parties have included no express term and delegated no authority to a court, a court should not intervene and should therefore refuse to imply a term of irrevocability. Presumably if the parties had wanted a court to intervene in such cases, they would have announced their intention by express delegation.

Yet, even if a court decides not to intervene as, for example, implying a term of irrevocability in unilateral contracts, it must justify that intervention choice. The question is whether collective intervention to refuse to imply a term or to supply a term of irrevocability would serve to better minimize transacting costs for the parties.

The risk in the unilateral contract situation is that once the offeree begins to perform, the offeror will either revoke the offer or engage in opportunistic behavior by making a less favorable deal once the offeree has sunk costs. If a court declines to intervene with an interpretive role offering protection, parties may react to this interpretive risk by negotiating express contractual protection in every case involving a unilateral contract. These negotiated protections however are costly. Or the parties could rely on reputational sanctions to police against the potential for opportunistic behavior by the offeror, a private strategy to protect against the risk.\(^81\) Parties could also decline to begin performance in unilateral contracts, without an express option a move that would ensure that offerees are protected against lost reliance costs.

However, if parties fail to adopt an express term of irrevocability, parties may assume that a court will protect against opportunistic behavior and thus fail to draft an express term on point. Because there are many instances in which a court protects against such behavior (as by implying terms of good faith to prevent parties from acting opportunistically to recapture foregone opportunities,\(^82\) they may assume that no specific clause is needed.

The alternative approach which the Restatement and the case law have accepted instead supplies a default rule which bars revocation once part performance has begun.\(^83\) \textit{Ex ante} when the parties are crafting their transactions and deciding whether to proceed and to begin performing when performance has been requested as the exclusive mode of acceptance, the offeree knows that he can safely begin performing. This reduces one type of interpretive risk. Similarly, the offeror himself \textit{ex ante} would be interested in having the court announce the rule of irrevocability in advance in order to encourage offerees to rely on unilateral contracts and to avoid offerees engaging in costly preventative measures.

The collective intervention solves a recurring problem of the potential opportunistic exploitation of sunk costs by offerees in unilateral contracts. Although it is possible to think that

\(^{81}\) See § 45 (1).


\(^{83}\) See § 45 (1)
the market might solve the problem on its own by having promisees screen for reliable offerors and pay less for offers that denied protection for partial performance, the pricing of such offers might be difficult, making protection difficult. This scenario presents a case in which a court can safely assume that the majority of parties would prefer to save on transaction costs by supplying a default rule that would protect against opportunistic behavior at a low cost. Those offerors who want to opt out of such protection can do so, giving offerees an opportunity to negotiate a lower price for such reduced protection.

VII. Further Applications: The Chrysler Bankruptcy

Analogous questions of how courts should proceed when interpreting a term arising in the context of the interpretation of bankruptcy statutes. In the Chrysler case, after Chrysler entered Chapter 11, several courts deciding the case had to grapple with how the word “sale” should be construed when the particular term is not crisply clear enough to determine whether what was done was a permissible sale or not. The intractability of that term required a court to interpret the term in the context of several provisions of the Bankruptcy Code.

The bankruptcy code governs what happens to companies that go into bankruptcy. It provides a mechanism for those companies to reorganize under Sections 1121 through 1129. If a company chooses to reorganize, it secures protection from its creditors from the bankruptcy court. If reorganization rather than liquidation occurs, a company must comply with the provisions of Section 1129, the most significant of which “requires that the plan complies with the usual priorities, absent creditor consent to a plan deviating from those priorities.” Those

84 William Whitford provided this insight.
85 Id.
87 The Chrysler bankruptcy addressed the question of whether a sale of Chrysler’s assets was a permissible sale under 11 U.S.C. 363 (2006) or whether it was impermissible under the statute because it failed to afford certain classes of secured creditors the protections afforded creditors by the bankruptcy law under Chapter 11. The rising popularity of 363 sales has engendered a sharp debate in the scholarly and popular press. See, e.g., Todd J. Zywicki, Chrysler and the Rule of Law, WALL ST. J., May 13, 2009, at A19, available at LEXIS (discussing the divergence from the rule of law in the Chrysler case and how it may affect future businesses); Mark J. Roe & David Skeel, Assessing the Chrysler Bankruptcy (INST. FOR LAW AND ECON., U. OF PENN. LAW SCHOOL, Research Paper No. 09-22, 2009), available at http://ssrn.com/abstract=1426530 (arguing that the Chrysler bankruptcy does not comply with good bankruptcy practice); Mike Spector, The Quickie Bankruptcy --- More Companies Enter Court, and Exit, in a Flash, WALL ST. J., Jan. 5, 2010, at C1 (discussing the affect that the Chrysler bankruptcy has had on bankruptcy law).
88 A sale under section 363 of the Bankruptcy Code allows for “[t]he trustee, after notice and a hearing, may use, sell, or lease, other than in the ordinary course of business, property of the estate. 11 U.S.C. § 363(b) (2006).
89 11 U.S.C. §§ 1121-1129 (2006) (covering who may file a plan, classifications of claims and interests, the contents of the plan, impairments of claims and interests, post-petition disclosure and solicitation, acceptance of the plan, modification of the plan, the confirmation hearing, and confirmation of the plan).
90 Note that if liquidation occurs under Chapter 7 rather than reorganization, the usual priorities must be complied with under section 726. See 11 U.S.C. § 726 (2006).
91 11 U.S.C. § 1129(a) (2006) (noting that a court shall only confirm a reorganization plan if all of the requirements of section 1129 are met).
92 Roe & Skeel, supra note x, at 6.
priorities give preference to secured creditors over unsecured creditors and to unsecured creditors over bondholders.\textsuperscript{93}

At the same time the Code does permit a bankrupt entity to sell assets under Section 363\textsuperscript{94} of the Code without the consent of creditors as long as the bankruptcy court approves the sale.\textsuperscript{95} The idea behind Section 363 is that there should be some instances in which a bankrupt debtor should be allowed to sell an asset for cash, particularly if that asset is deteriorating in value and its value might be dissipated if all of the creditors had to agree on the sale.\textsuperscript{96} Presumably, it would be better to permit such sales rather than to totally deprive the bankrupt estate of the asset, which might happen if consent had to be obtained given the exigencies of a deteriorating asset.\textsuperscript{97}

The danger with Section 363 sales is that if they are significantly broadened, companies could use a Section 363 sale as a way of avoiding compliance with the priorities among creditors that would otherwise be required under Section 1129.\textsuperscript{98} That concern led courts to develop doctrine that prohibited sales that were reorganizations in fact and part of an effort “to short circuit the requirements of Chapter 11 for confirmation of a reorganization plan in connection with the sale of assets.”\textsuperscript{99}

The Chrysler bankruptcy involved a sale under Section 363. “Old” Chrysler sold substantially all of its assets to a new corporation, “New Chrysler”, for $2 billion.\textsuperscript{100} This sale resulted in secured creditors receiving only 29 cents for every dollar of debt they held.\textsuperscript{101} “New Chrysler . . . then assumed the old company’s debts to the retirees, most dealers and trade creditors. The unsecured claims of the retiree’s benefits plan were replaced with a new 4.6 billion note as well as 55% of the new company’s stock.”\textsuperscript{102}

\textsuperscript{95} Roe & Skeel, supra note x, at 6; 11 U.S.C. § 363 (2006)
\textsuperscript{96} See Ind. State Police Pension Trust v. Chrysler L.L.C. (In re Chrysler LLC), 576 F.3d 108, 113 (2d Cir. 2009) (citing Holders v. Lionel Corp. (In re Lionel Corp.), 722 F.2d 1063, 1066-1068 (2d Cir. 1983)) (noting that § 363 originated from the Bankruptcy Act of 1867, which allowed a debtor’s assets to be sold if the assets were perishable, liable to deteriorate in value, or would otherwise be wasted).
\textsuperscript{97} “[T]here are times when it is more advantageous for the debtor to begin to sell as many assets as quickly as possible in order to insure that the assets do not lose value.” Chrysler, 722 F.2d at 133-114 (quoting Fla. Dep’t of Revenue v. Piccadilly Cafeterias, Inc., 128 S. Ct. 2326, 2342 (2008) (Breyer, J., dissenting).
\textsuperscript{98} Id. at 114 (“Pushed by a bullying creditor, a § 363(b) sale might evade such requirements as disclosure, solicitation, acceptance, and confirmation of a plan.”); Roe & Skeel, supra note x, at 9 (arguing that section 363 sales could circumvent Chapter 11 protections); Richard A. Epstein, The Deadly Sins of the Chrysler Bankruptcy, FORBES ONLINE, May 12, 2009, available at http://www.forbes.com/2009/05/11/chrysler-bankruptcy-mortgage-opinions-columnists-epstein.html (arguing that “[u]psetting this fixed hierarchy [of priority] among creditors is just an illegal taking of property from one group of creditors for the benefit of another, which should be struck down on both statutory and constitutional grounds”).
\textsuperscript{100} Chrysler, 576 F.3d at 111-12.
\textsuperscript{101} Roe & Skeel, supra note x, at 5; Specter, supra note x. Note that under a § 363 sale, assets may be sold “free and clear of any interest” in the assets if the interest holder consents to the sale. See 11 U.S.C. §363(f) (2006). Although the petitioners in the Chrysler case did not personally consent to the release, the Second Circuit found that the consent was given by a collateral trustee who had such authority. See Chrysler, 576 F.3d at 119-20.
\textsuperscript{102} Roe & Skeel, supra note x, at 5. See also Spector, supra note x.
The Indiana Pensioners objected to the plan and sought an immediate stay of the bankruptcy court’s approval of the sale of Chrysler’s assets. The Indiana Pensioners argued that the transaction was a “sale” in name only, amounting to an “impermissible, sub rosa plan of reorganization.” After hearing arguments on the expedited appeal, the Second Circuit affirmed the judgment of the lower bankruptcy court. After weighing the need in some instances for section 363 sales and the concerns that such sales may sidestep key features of the Chapter 11 process, the court relied on its prior holding in Lionel that required a “good business reason” for a sale under section 363. The Second Circuit held that the bankruptcy court’s findings that “the only possible alternative to the sale was an immediate liquidation that would yield far less for the estate—and for the objectors” constituted a good business reason by “prevent[ing] further, unnecessary losses.”

The Indiana Pensioners then petitioned for a writ of certiorari. In an interesting turn of events, the Supreme Court granted certiorari but then vacated the judgment of the Second Circuit and further ordered the appeal dismissed as moot, presumably since the sale had already closed.

In construing what Section 363 allowed and whether the Chrysler sale was permissible under Section 363 and existing case law, the various courts had to determine whether the sale violated the purpose of other provisions in bankruptcy law regarding the necessity for the approval of plans of reorganization. An ambiguity is created by the context, in the sense of the other text of the Act.

When such ambiguity in a statute exists, at least if the statute becomes part of the terms of every creditor/debtor contract, this Article suggests that a court should employ a

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103 Chrysler, 576 F.3d at 111.
104 Id. at 113. The Indiana Pensioners argued that the new Chrysler will be the old Chrysler in almost every respect, including its name, its employees and management, as well as the types of vehicles it produces. Id.
105 Id. at 112, 127. The Second Circuit entered a written order affirming the Bankruptcy Court’s decision on June 5, 2009 and scheduled the stay to be lifted on June 8, 2009 or upon a denial of a stay by the Supreme Court. On June 8, 2009, Justice Ginsberg issued a temporary stay but on the following day the Supreme Court issued a per curiam denial of the petition for emergency stay. The Second Circuit issued a formal opinion of the case on August 5, 2009. See Id. at 111-12; Petition for Writ of Certiorari at 2, Ind. State Police Pension Trust v. Chrysler L.L.C., No. 09-285 (U.S. 2009), 2009 WL 2864378 (generally describing procedural history).
106 Holders v. Lionel Corp. (In re Lionel Corp.), 722 F.2d 1063 (2d. Cir. 1983)
107 Chrysler, 576 F.3d at 114.
108 Id. at 118-19.
110 Ind. State Police Pension Trust v. Chrysler L.L.C., No. 09-285, 2009 WL 2844364 (U.S. Dec. 14, 2009). “Chrysler could become the template for the next generation of large scale corporate reorganizations. … If it becomes the pattern, Chrysler could displace the traditional chapter 11 process, potentially affecting both lending markets and vulnerable nonfinancial creditors adversely.” Roe & Skeel, supra note x, at 4. See also Ashby Jones & Mike Spector, Creditors Cry Foul at Chrysler Precedent, WALL ST. J., June 13, 2009, at B1, available at LEXIS (stating that if the Chrysler trend is followed it could “make investors demand higher interest rates on debt amid uncertainty over how they might fare should the firm encounter financial difficulties”); The Changing Face of Bankruptcy, CFO MAGAZINE, August 11, 2009, available at 2009 WLNR 16169064 (noting that other companies facing Chapter 11 may be following Chrysler’s lead with General Motors, Midway Games, Nortel, and Tropicana Atlantic City Casino all initiating 363 sales since the beginning of 2009).
consequentialist interpretation of the statute. The court should consider the *ex ante* effects on the origination of debtor-creditor transactions in the future, not to mention the wealth distribution for already existing relationships.

The Chrysler case and the statutory interpretation of Section 363 and Section 1129 should not be resolved without a consideration of how such interpretation will affect and encourage assent based lending relationships in the future. Yet, in deciding whether the exception for 363 sales should encompass the precise facts of the Chrysler situation when the sale was for substantially all of the debtor’s assets, where the government was a creditor with a self interest which may have led it to ignore the claims of the secured lenders with priority, where the resulting bankruptcy would result in the unsecured creditors who were favored by the US Treasury (the UAW) faring better than secured creditors in contravention of long standing bankruptcy priority rules, the court should have considered those *ex ante* effects on future debt transactions. Unless those effects are accounted for by courts, future creditors will not know how to assess the risk involved in lending. There will be great uncertainty which about the extent to which the government will in the future upset traditional priority rules. That uncertainty will add to future risk for creditors and it will dampen the willingness or future lenders to lend or it will incentivize them to impose harsher terms to account for the increased risk.

**Conclusion**

When contracts remain ambiguous or incomplete, courts and scholars must confront the inevitable question of when intervention in private contracts is justified. To deal with the unresolution or residual uncertainty, the Austrian economists and the new textualists suggest that any intervention would be a fool’s errand. Their position amounts to an unvarying posture that any party asking for an additional term or a broad interpretation will always lose.

Recognizing that there is an interpretive risk in all contracts, the court should adopt an interpretive methodology that parties would be willing to adopt and that would enhance the willingness of both parties to engage in exchanges. To achieve that goal, courts as interpreters should focus on how the interpretation adopted would increase or decrease interpretation risks (costs) over time to different classes of transactors. By tailoring and applying interpretive rules, courts can (and do) promote increases in net welfare in a range of cases and contexts examined in this article. If the prospect of adding a term or even overriding a term would prevent opportunistic behavior or catastrophic consequences to both parties, then courts can intervene in a way that maximizes surplus and would be preferred.

The essay concludes that the same economic considerations informing contract interpretation should be applied outside the contracts context to the interpretation of federal statutes in the Chrysler bankruptcy in a way that had been neglected by the Second Circuit.
Essay