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**Policy considerations in contract interpretation:
the contra proferentem rule from a comparative
law and economics perspective**

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HUNGARIAN ASSOCIATION FOR LAW AND ECONOMICS

**POLICY CONSIDERATION IN CONTRACT INTERPRETATION:
THE CONTRA PROFERENTEM RULE FROM A COMPARATIVE
LAW AND ECONOMICS PERSPECTIVE**

Péter Cserne

Deviations from the common intentions of the parties in contract interpretation is sometimes attributed to “an appetite for benefiting whichever of the parties is perceived to be in a weaker bargaining position”. In this paper I argue that there is more reasonable explanation (justification) for at least some of these deviations. The contra proferentem doctrine is an information-forcing rule that can promote optimal completeness and clarity in contracts. Whether the contract is standardized or not, other things being the same, the risk of ambiguity in contractual language should be borne by the party who could more cheaply avoid it, and that is usually the party who selected or drafted the clause rather than the party to whom it was presented. On the other hand, it is argued that interpretative presumptions are ill-suited for ambitious policy purposes.

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Introduction	1
The “default rule paradigm”	1
Policy purposes and incentive effects of contract interpretation	4
Comparative contract interpretation in a nutshell	5
The contra proferentem rule	7
Comparative overview	7
Origins and Continental development	7
Common law development	9
Standard form contracts	9
Consumer contracts	11
The contra proferentem rule as a policy instrument	11
Protection of the weak?	12
Regulation of standard forms and consumer contracts	12
Optimally clear drafting	14
An example: insurance policy interpretation	16
Conclusion: against paternalism through contract interpretation	17
References	18

Introduction

The “default rule paradigm”

Freedom of contract implies the principally non-mandatory nature of contract law. Parties are free to determine their mutual rights and obligations; provisions of contract law only apply when explicitly referred to or when a gap is to be filled. Mandatory rules are the exception, when not in a quantitative, at least in a qualitative or structural sense.

We can see this in many legal systems. For example, in American law the UCC provides: “The effect of provisions of this Act may be varied by agreement, except as otherwise provided in this Act and except that the obligations of good faith, diligence, reasonableness and care prescribed by this Act may not be disclaimed by agreement but the

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parties may by agreement determine the standards by which the performance of such obligations is to be measured if such standards are not manifestly unreasonable.”¹

A breach of contract case in front of a modern Western tribunal is handled typically like this. “The court must (1) determine whether contract formalities are satisfied; (2) if so, determine whether there was real consent (no fraud, duress, mistake), (3) if so, determine what the contract says; (4) if there is a gap (that is if the contract does not address the contingency that caused the dispute), apply a default rule; and (5) if an explicit or implied term was violated, award a remedy.”²

Although analytically different, step 3 (contract interpretation) and step 4 (gap-filling) are closely linked in practice. In fact, in many cases it is not self-evident what a contractual gap means: it is often a matter of judicial interpretation whether the dispute is about interpreting a contract clause or supplementing a term in an incomplete contract. When filling gaps in a contract, judges sometimes refer to “implied terms”. Gap-filling can happen either by implications of terms by law (statutory default rules) or by constructive interpretation (using general clauses and other legal principles). In Germany, Switzerland and Austria the judge supplements the contract by constructive interpretation, saying: “where the parties have omitted to say something the judge must discover and take into account what, in the light of the whole purpose of the contract, they would have said if they had regulated the point in question, acting pursuant to the requirements of good faith and sound business practice.” French courts decide in essentially the same way but they invoke the rule that the gap has been filled by the common intent of the parties.³

Some commentators even deny the usefulness of a theoretical distinction.⁴ Contract interpretation and supplementation (gap-filling through default rules) are closely linked to each other. Not only the conceptual limit between them is blurred but the reasons for choosing different rules to solve these problems follow essentially the same principles.

There are several reasons why a contract might be unclear or incomplete.⁵ These different kinds of incompleteness justify different legal responses and possibly argue for different methods of interpretation and supplementation. Contractual incompleteness may be unintended or strategic. Largely corresponding to this distinction⁶, gap-filling rules can be either majoritarian (market-mimicking) or information-forcing (penalty) defaults. And “the approaches used to interpret contracts have much in common with the approaches used to select default rules. In many cases, for example, vague or ambiguous language is interpreted so as to fit whatever the parties probably would have agreed to if they had discussed the matter, thus producing the same result as the majoritarian or market-mimicking default rules (...). In other cases, vague or ambiguous language is interpreted against the party who drafted it, just as in the case of a penalty or information-forcing default rule designed to induce more careful and explicit communication.”⁷

One way to look at the problem of incompleteness is in analogy with tort law. From a consequentialist point of view, liability rules give incentives to people to take optimal precaution, i.e. to invest in the prevention of accidents up to the point when the last dollar spent on precaution reduces losses by one dollar. If contractual incompleteness is unavoidable and/or desirable due to transaction costs (limitations of money, time, comprehension or foresight), courts should supply terms that would maximize the joint value of the contract, i.e. terms that the parties hypothetically have intended. This majoritarian interpretative rule assumes that the court is the cheapest contract

¹ UCC § 1-102 Sec. 3.

² Eric Posner 2006: 565.

³ Kötz – Flessner 1997: ch. 7

⁴ While Americans typically refer to default rules, the French term is *règles supplétives*, Germans have *dispositives Recht*, and English lawyers refer to implied terms. Also, the English often speak about construction instead of interpretation. “English law has three principal techniques for ascertaining the meaning of the contract: interpretation of the express terms, filling the gaps by implication, and rectification of any documents which fail to record accurately the parties’ intentions.” McMeel 2005: 278 n.75.

⁵ Alan Schwartz (1992: 278-280) distinguishes five reasons: the inevitable limitations of language; party inadvertence; the costs of creating contract terms; asymmetric information; a preference for anonymity (pooling) by one party. On incomplete contracts see also Schwartz 1998.

⁶ As we will see in section 4.7, information-forcing rules are not only used in case of strategic incompleteness, i.e. when one party opportunistically withdraws information but also in cases when this party is simply the ‘cheaper drafter’.

⁷ Craswell 2000: 15.

drafter. Indeed, for certain terms courts have a cost-advantage in providing efficient terms (either by using a statutory default or by referring to standard, pre-formulated meanings).⁸

As a practical matter, this may justify a contextualist approach in interpretation (reference to course of performance, course of dealing, trade usage and other external evidences). To be sure, if a court insures parties against incompleteness through flexible interpretations and implied terms, it creates a moral hazard problem: parties have less incentive to write good contracts themselves. In each contract regime various doctrines set limits to the kinds or amount of extrinsic evidence a court can consider (e.g. parol evidence rule in common law). Functionally, these limits can be seen as judicial instruments to give incentives to parties to reduce interpretive risks themselves. From an efficiency perspective, it makes sense to encourage parties to make such precautions to the extent that they are able to do it cost-effectively.

There are, however other cases where one of the parties is in the best position to clarify a term or identify what should happen in the event of some contingency. This is often the case with a repeat contractor or one represented by legal counsel. Imposing liability on the “cheaper contract drafter” might make sense. Also, if this party has an informational advantage, gap-filling viz. interpretative rules can force him to reveal this information in future contracts. To be sure, there are a number of other factors that should be taken into account. The homogeneity or heterogeneity of the parties determines whether a single majoritarian default rule (e.g. one that determines the place of delivery in a sales contract) is desirable. Even more importantly, there is a risk of court error. These factors should be considered in searching for the optimal mix of express and implied contracting terms and thus the optimal contractual completeness.

In a further class of cases the main reason for incompleteness is not transaction costs (the imprecision of language, inadvertence of the parties etc.) but asymmetric information between the parties. By filling in a gap with the default rule unfavorable to the informed party (penalty default), law and economics suggests that contract law should force her to reveal this information either to the other party or to the court.⁹

In the last one or two decades, many law and economics scholars argued that gap-filling rules can be either majoritarian (market-mimicking) or information-forcing (penalty) defaults. But just after coming close to the status of a received view, several aspects of this “default rule paradigm” have been criticized from different directions. In fact, this opposition is somewhat misleading. As Ian Ayres noted, “If we go far enough back behind the veil of ignorance, all information-forcing rules are majoritarian. From this perspective, the dichotomy between majoritarian and penalty defaults is false.”¹⁰ According to the received law and economics view, contract default rules should be justified by “hypothetical consent” of the parties concerned (hence the reference to the veil of ignorance). Here hypothetical consent is a shortcut term for Pareto efficiency.¹¹ Thus when contracting parties are homogeneous, both “regular” market mimicking rules and information-forcing rules should be majoritarian in the sense that they should impute terms that the two parties would have agreed upon. “A ruling that fails to interpolate the efficient term will not affect future conduct; it will be reversed by the parties in their subsequent dealings.”¹² – provided transaction costs of such deviation are not prohibitive. When this ex ante perspective is applied to both types of default rules, it relativizes their difference. Partly related to this, recently the usefulness of the concept of penalty default rules has been questioned.¹³ More generally, Robert Scott has suggested that the entire “default rule project” should be rethought. He provides several reasons to “question whether the state can create efficient default rules to supplement the relatively small number of simple, binary rule that have evolved through the common law process.”¹⁴ The economic analysis of contract interpretation, both in its positive and its normative variant remains thus controversial.

⁸ Cf. Goetz - Scott 1985.

⁹ See e.g. Ayres – Gertner 1989, Bebchuk – Shavell 1991.

¹⁰ Ayres 2006: 612.

¹¹ Craswell 1992.

¹² Posner 1998: 98

¹³ Posner 2006, Ayres 2006, Baffi 2006.

¹⁴ Scott 2004: 90. Instead, he suggests a new policy, at least with regard to business contracts: “The project of the law should be to replicate those terms (and only those terms) that individual parties would choose not to bargain over if they knew that the state would provide them.” (94.)

Policy purposes and incentive effects of contract interpretation

Much has been written in the doctrinal legal literature on the modes of contract interpretation – explaining their historical background, comparing various jurisdictions, interpreting and systematizing case law or arguing for a particular interpretative method.¹⁵ It seems probable that there is no single method that would be overall desirable, thus a pluralist approach is preferable.¹⁶ This insight alone, however, is too general to be useful in institutional design or as a theory of adjudication. It should be fleshed out with empirical hypotheses and normative criteria for the prediction and evaluation of the likely consequences of the use of different methods under different circumstances. To build such a full-fledged theory, however, much more information would be necessary than is currently available. It is thus not surprising that most theorists merely suggest a couple of heuristics, i.e. relatively simple rules. These heuristic rules should guide interpretation for groups of cases that show certain characteristics; but they usually leave the domain of application and the “rules of conflict” between heuristics unspecified. They look like this: “when X prevails, follow a more formalist interpretation, other things being the same”.¹⁷

Still, there is one important (though elementary) insight that should inform every normative theory of contract interpretation that aspires to practical import: the method of interpretation influences how parties write their contract. More generally, rules of interpretation are not simply tools in an ex post epistemic (hermeneutic) exercise – they have a profound effect on party behavior ex ante, both on the drafting of individual contracts and more widely on the changes in business standards and trade usages. A theory of contract interpretation should take these incentive effects into account.¹⁸

In the doctrinal legal literature the common intention of the parties is considered the “natural” or straightforward starting point of contract interpretation.¹⁹ This is mainly due to the fact that the implicit or often explicit contract theories behind the rules of Western legal systems (bargain theory, will theory, party autonomy) are reflected in contract interpretation. As we have seen in chapter 2, there are both deontological and consequentialist arguments supporting the view that the main function of contract law is to enforce promises (if certain conditions are fulfilled) and thus provide legal assistance to private parties in realizing their goals in a cooperative way.

But this connection of contract theory and method of interpretation applies to the exceptions as well. Freedom of contract is a general principle in contract law; still many substantive rules are not supposed to enforce the parties' intentions, actual or hypothetical, rather they set limits to freedom of contract. Similarly, while contract interpretation has the enforcement of the parties' bargain at least as its ultimate goal, in some cases the purpose of contract interpretation is not to find and give effect to the intentions of the parties but to achieve other goals.²⁰ The question whether and how interpretation can be used in contract regulation has been constantly raised in contract law scholarship since its beginnings.

¹⁵ A useful overview of the contract interpretation scholarship in common law countries (with main focus on England) is McMeel (2005); for the US see e.g. Farnsworth 1967, Scott – Kraus 2003: chapter 6; for France see Ghestin – Jamin – Billain 2001: 18-75; on European contract interpretation see Kötz 1997: ch. 7.

¹⁶ Cf. Greenawalt 2005. As George Cohen (2000: 97) says, “courts do not – and never will – use pure interpretive methodologies, but tend to switch back and forth depending on the circumstances.” Of course, legal scholars have a lot to say on the question which pattern this “switching” should follow. From a law and economics perspective, Cohen suggests that the choice between textualism and contextualism should depend on (1) the transaction costs of drafting, (2) the relative likelihood of court error and (3) the risk of opportunistic behavior (Cohen 2000: 78).

¹⁷ For instance, textual-formal interpretation is relatively more important for experienced commercial parties while contextual (substantive) interpretation is better suited to transactions involving consumers and other non-sophisticated parties (Katz 2004: 538). Katz lists several simple heuristics for the choice between formal and substantive contract interpretation. For alternative suggestions see Schwartz – Scott 2003: Pt. IV (569-594), Kostritsky 2007.

¹⁸ For the law and economics literature on different aspects of contract interpretation see e.g. Goetz – Scott 1985, Ayres – Gertner 1989, E. Posner 1998, Cohen 2000, R. Posner 2005, Shavell 2006, Hermalin – Katz – Craswell 2006: 63-94, Kostritsky 2007.

¹⁹ Besides national legal systems (Art 1156 French Civil code; §133, 157 German BGB; Art 1362 Italian Codice Civile; Art 18 Swiss Law of Obligations; §1425 Quebec Civil code; 2-202 UCC; Restatement (Second) of Contracts, etc.) various international agreements and “soft” legal instruments contain rules on contract interpretation (CISG Art 8; UNIDROIT Principles Art 4; Ch 5.101 Principles of European Contract Law.) For a useful overview see Kötz – Flessner 1997: ch. 7.

²⁰ “It is striking that some interpretative rules of construction take as their starting point not the intent of the drafting parties (which would resemble majoritarian gap-filling), but instead the interpretation which is least favorable to the drafter. Such rules are strong evidence that common law lawmakers have long understood the value of information-forcing rules. The *contra* in *contra proferentem* rightly suggests a penalty; the interpretative presumption is not chosen because we think that the most negative interpretation is what the drafter or even the draftee normally wants, but rather because the rule of construction is a stick to force drafters to educate non drafters.” Ayres 2006: 596. I discuss the information-forcing function of the *contra proferentem* rule below in detail.

In the following I analyze the different versions of the contra proferentem doctrine, a group of contract interpretation rules that divert from the general concern with parties' intentions and reflect policy considerations. This doctrine says, shortly, that ambiguities in the language of a written contract should be construed against the drafter of the unclear contract clause. On the explanatory level, I discuss the origins and different versions of the contra proferentem rule as an element of the interpretative canons in these contract law regimes and the ways the rule has been used in the service of various policy purposes, including paternalism. Normatively, I analyze the potential justifications for the contra proferentem rule. I argue that the contra proferentem rule should be conceived and used as a penalty default: an instrument to incentivize the drafting of contracts in an optimally clear language.

The structure of the paper is this. First, I give a cursory comparative overview of the theories and methods of contract interpretation in modern legal systems. Then I discuss the origins and different versions of the contra proferentem rule as an element of the interpretative canons in these contract law regimes. Third, I analyze the potential justifications for the contra proferentem rule. Finally I discuss the case of the interpretation of insurance policies as an example and briefly conclude.

Comparative contract interpretation in a nutshell

Although common law and civil law show large systemic differences and the doctrinal starting points for contract interpretation differ in each national codification, the practical working of the rules of contract interpretation show a striking similarity across modern Western legal systems.²¹

Objective and subjective interpretation. One basic dichotomy in contract interpretation is between the subjective and the objective theory. The subjectivist view stresses party autonomy and the free will of the individual. When intention and its expression diverge, the subjectivist gives precedence to the intention of the parties. The objectivist view, in contrast, gives precedence to the external fact of the expression, mainly because social and economic intercourse requires reliance to be protected. As the objectivist argues, reliance is placed on what others actually say not on what they meant to say. Early legal systems were, to be sure, formalistic and "objectivist" for other reasons. This ancient formalism, linked to magical thinking, was characteristic for the early period of Roman law. The subjective method of interpretation, supported by Christian doctrine, held sway in the 6th century with Justinian's codification. Until the late 19th century subjective interpretation dominated legal literature on the Continent. Whether it was equally dominant in practice is less certain. Nevertheless on the Continent, the doctrinal starting point of the interpretation is, in general, the common intention of the contracting parties.

This rule figures explicitly in the French civil code (Art 1156).²² The subjective interpretation which nominally directs French courts is, however, qualified in several ways. It is interpreted in an objectivized sense and constrained by "law, usage and good faith".²³ Unexpressed unilateral intentions do not count. What matters in practice is how the meaning was understood by the other party or how a reasonable partner would understand the term. There are often other objective rules to be applied as well.

Similar to the French rule, the German civil code (BGB §133) provides that in interpreting an expression of will "the real intention is to be ascertained without clinging to the literal meaning of the statement." But the objective view is reflected in BGB §157 which provides that contracts are to be interpreted "in accordance with the dictates of good faith in relation to good business practice." The Austrian code (ABGB §914) puts these two together: "one is not to cleave to the literal sense of the expression, but to ascertain the intention of the parties," nevertheless the contract is to be understood compatibly with decent business practice.

Common law, although it refers to the meeting of the parties' minds, starts contract interpretation in an objective fashion. To some extent, the objective meaning of the contractual language is still contextualized. The extent of contextual evidence allowed is larger in the US than in England. The UCC and the Restatement (Second) of

²¹ This overview largely follows Kötz – Flessner 1997: ch. 7. Besides national legal systems (Art 1156 French Civil code; §133, 157 German BGB; Art 1362 Italian Codice Civile; Art 18 Swiss Law of Obligations; §1425 Quebec Civil code; 2-202 UCC; Restatement (Second) of Contracts, etc.), various international agreements and "soft" legal instruments contain rules on contract interpretation: CISG Art 8; Unidroit Art 4; Ch 5.101 Principles of European Contract Law.

²² Art. 1156: "One must in agreements seek what the common intention of the contracting parties was, rather than pay attention to the literal meaning of the terms." The French Civil Code contains an entire section on the interpretation of agreements (Art.1157-1164).

²³ See Art 1134 (3) (good faith), 1135 (equity, custom and usage, statutory law), 1160 (usage). Cf. Ghestin et al. 2001: 18 n.21.

Contracts allows for various kinds of extrinsic evidence. The practical difference between a highly contextualized objective meaning and the subjective meaning can be very small.²⁴

In most Continental legal systems and the US as well the Roman legal maxim *falsa demonstratio non nocet* applies. Thus a consensual deviation from the ordinary meaning of a word is valid: the common intention of the parties trumps the plain (objective) meaning.²⁵ But parties who actually agree on a non-ordinary meaning usually do not go to court - there is thus not much need for judicial interpretation in these cases.

Disputes more usually arise because parties attach different meanings to the same word – here we cannot look for the common intention of the parties as an actual historical fact. Rather, in this case most of the civil codes use a variant of the following general interpretative rule: the word has “the meaning that would be given to it by a reasonable person in the position of the addressee who understands the word used in a context.” For example, Art. 207 of the Hungarian Civil Code provides: “The words in a contract are to be construed as the other party would understand them, given the generally accepted meaning of the words used, and taking into account the probable purpose of the person using them and the circumstances of the case.”²⁶

While German, French and English scholarly writers start from different doctrinal positions, the courts reach essentially the same practical results. When statutes and court decisions speak about the common intention of the parties, this does not refer to a psychological fact but rather to the objective sense of the words as deduced by an evaluative process. This is behind the traditional objective view of the common law courts. In France, courts nominally speak about the common intention but they also agree that when it does not exist, the judge must ascertain a hypothetical will of the parties.²⁷ That the interpretation is only nominally subjective in France, can be seen from a doctrinal rule of the Supreme Court (Cour de cassation) as well.²⁸

On the other hand, the traditional hostility of English judges towards contextual interpretation seems to be over.²⁹ According to a recent overview, modern English contract interpretation can be characterised by the following five principles: objective principle, loyalty (to the contractual language), holistic approach, the relevance of context (going beyond the four corners of the document), purposive approach. There remain two exclusionary rules of evidence:

²⁴ Greenawalt 2005: 581-582.

²⁵ The Spanish [Art 1281(2)] and the Portuguese civil codes [236(2)] explicitly provide for this. The exception, at least traditionally, is England, where the joint intention of the parties is not relevant if it deviates from “the intention attributable to reasonable parties.” For a critique of the English rule see Barak 2005: ch. 13.

²⁶ This rule has its more extensive formulation in the 1980 Vienna Convention on the International Sale of Goods (CISG):

“Art 8 (1) For the purposes of this Convention statements made by and other conduct of a party are to be interpreted according to his intent where the other party knew or could not have been unaware what that intent was.

(2) If the preceding paragraph is not applicable, statements made by and other conduct of a party are to be interpreted according to the understanding that a reasonable person of the same kind as the other party would have had in the same circumstances.

(3) In determining the intent of a party or the understanding a reasonable person would have had, due consideration is to be given to all relevant circumstances of the case including the negotiations, any practices which the parties have established between themselves, usages and any subsequent conduct of the parties.”

²⁷ Historically, French judges have been obliged by Art. 1156 to search for the parties' common intention. But if the contract was silent, they had to search for what parties probably would have stipulated, referring to this as a search for a “virtual will”. As early as 1905 scholars have considered it absurd to look for a “virtual” or “absent will”. The common intention is thus still the starting point but the majority of the French jurisprudence holds that when it is only fictitious, usage, good faith, justice, and the effectiveness of the contract are the criteria of decision. The Cour de Cassation argues in an ambivalent way: sometimes still hiding behind a stretched subjective interpretation (to find a meaning that exists but its expression is defective: ambiguous or absurd), sometimes abandoning the reference to parties' will and arguing either that the obligatory force of the contract is based on objective (i.e. statutory) law; or that its own purpose is to find an appropriate legal solution, taking into account the interests that should be satisfied, the social utility of the contract or the requirement of justice.

²⁸ According to the doctrine “*clause claire et précise*”, if a clause as written is clear and precise, the court treats it as a matter of fact. Thus any search for the common intentions of the parties is disallowed. This doctrine works similarly to a combination of the plain meaning and parol evidence rules of the common law; the declaration (expression) of the will prevails over the subjective intent. One of the critiques against this rule is also similar to the common law discussion on latent ambiguities. The fact that the words of the written contract are not obscure or ambiguous does not necessarily mean that the intentions of the parties were clear and plain and coincided with the words of the contract. Some critics refer to the idea that the clear and precise meaning can be determined at all as a “rationalistic illusion, based on a Cartesian model.” What is called latent (in contrast to patent) ambiguity in common law is called extrinsic (in contrast to intrinsic) in French doctrine. It might be interesting to further compare the French arguments with those in the common law.

²⁹ According to McMeel (2005) this is in part due to a few influential judges of the house of Lords who are familiar with works in modern philosophy of language.

declarations of subjective intent (and generally, prior negotiations) on the one hand and subsequent conduct on the other are excluded from evidence on the meaning of the contract. Thus in contrast to the US and the Continent, in England subsequent conduct of the parties does not count for contract interpretation.³⁰

In virtually every legal system, contract interpretation starts with the meaning of the terms in ordinary language. If special circumstances indicate, an unusual sense of the term may become relevant. If parties are in the same business, commercial special meaning is used.³¹ If even a reasonable person would find that either of two meanings are equally plausible and the clause relates to an essential point in the contract, the contract fails for lack of consent.³²

The contra proferentem rule

Comparative overview

In the Romanistic legal systems, there are several maxims of interpretation in the respective civil codes. One maxim provides that terms shall be interpreted in the light of the whole contract or statement in which they appear; another that contract terms shall be interpreted so as to give effect to all the terms rather than to deprive some of them of effect.³³ These maxims are rooted in Roman law, as collected in Justinian's Digest and further commented during the late Middle Ages and the early modern period. The Roman law rules themselves can be traced back mostly to the period when Greek philosophy (dialectics and rhetoric) had a large impact on Roman legal thinking. Nowadays, the general opinion about these maxims is that they are of little practical use as codified rules: they merely state what common sense would tell the judge anyway.³⁴

Origins and Continental development

Among these maxims is Art. 1162 of the French Code, the rule “contra stipulatorem” which originates from the Roman jurist, Celsus.³⁵ This rule is also codified in a number of legal systems but, as we shall see, it is of a very different nature than other interpretative maxims. In modern contract law, the contra proferentem rule means that an ambiguous contract term should be construed (interpreted) against the drafter (more precisely against the party who “proffers” it or who wishes to rely on it in a contract dispute). Some version of this rule can be found in common law jurisdictions (UK, USA, Canada, India), the Romanistic legal family (French, Belgian, several Latin American civil codes) as well as the Austrian civil code as a general contract law rule.³⁶ Starting with Italy in the 1940s, the rule has been codified for standard form contracts in many countries. From the 1970s, contra proferentem rule has been explicitly used as a means of consumer protection – it figures thus in various legal instruments (civil codes, consumer protection acts and other regulatory instruments) which regulate consumer contracts. According to a modern American commentator, the “rule is not actually one of interpretation, because its

³⁰ McMeel 2005: 262-263, 285.

³¹ Chapter 4 of the UNIDROIT Principles for international commercial contracts provides a quite elaborate system of interpretative rules which are based on a combination of the rules in various national contract laws.

³² This is the ratio of the famous Peerless case [Raffles v. Wichelhaus 2 Hurl & C. 906. (1864)].

³³ See French Code civil Art. 1157, 1158, Spanish Código civil Art. 1284, 1286, Italian Codice civile Art. 1367-1369, UNIDROIT Principles Art. 4.4-4.5. In the Middle Ages, these maxims were transmitted to and became known in English law as well. During the drafting of the German BGB the codification or otherwise of these non-substantive rules was explicitly considered and rejected. Later codifications, like the Hungarian (1959) or the Dutch Civil code (1992) do not contain maxims of interpretation either.

³⁴ In France, this list of maxims is sarcastically called “*guide-âne*” in commentaries. Indeed, their relevance is minor as the *Cour de Cassation* has decided very early that these interpretative rules do not have a normative (obligatory) character - they simply serve as facultative rules or recommendations to judges. In practice, this means that the judgment of a lower court cannot be revised based on the violation of the maxims. Similar applies to England (McMeel 2005: 262): “The ‘canons of construction’ and the Latin maxims which most lawyers associate with the exercise of interpretation are almost redundant in practice.”

³⁵ D 34, 5, 26 (Celsus). On the origin of the *contra stipulatorem/ contra proferentem* rule see Troje 1961, Wacke 1981, Krampe 1983, 2004, Honsell 1986. These accounts subscribe to different (partly incompatible) theories regarding the original function and meaning of the rule.

³⁶ Characteristically, the rule was included in all the European codifications until the end of the 19th century, e.g. in the 1794 Allgemeines Landrecht in Prussia (I 5 §266), the 1865 Civil code of Saxony, and the civil codes based on the French one (Italian Civil Code of 1865, old Dutch Civil Code) but not in the general contract law rules of the later ones, like the German BGB (1900), the new Italian (1942) or Dutch Civil Code (1992). As I will discuss later, these countries have codified the *contra proferentem* rule for standard form contracts only. Later, mainly in accord with the European directive, every (non-negotiated) consumer contracts became subject to the rule too.

application does not assist in determining the meaning that the two parties gave to the words, or even the meaning that a reasonable person would have assigned to the language used. It is chiefly a rule of policy, generally favoring the underdog.”³⁷

According to Art. 1162 of the French civil code, “in case of doubt, an agreement shall be interpreted against the one who has stipulated, and in favor of the one who has contracted the obligation”.³⁸ According to Art. 1602 (2), in a sales contract “any obscure or ambiguous agreement shall be interpreted against the seller.” The first rule, called *contra stipulatorem* rule, works in a tricky way. Within a typical bilateral contract, it can favor either party. Reading the rule literally, in case of doubt every contractual duty is to be interpreted against the promisee (creditor) and in favor of the promisor, i.e. the party who is obliged to fulfill the duty (debtor). In contrast, the presumption for sales contracts always works against the seller. At first sight, both of these rules seem to be at odds with the ascertainment of the common intention of the parties. Especially the first one looks too complicated to serve any clear purpose. In order to understand the original meaning of these rules, one has to go back to their Roman law origins.³⁹

³⁷ Corbin 1998: 306.

³⁸ Although historically Art. 1162 derives from the Roman rule *contra stipulatorem*; the drafters of the Civil code (Domat and Pothier) understood the rule as a special case of Art. 1315 which allocates the burden of proof to the party who is claiming the fulfillment of an obligation. Thus if the non-drafting party wants to take advantage of a clause, in the codifiers' view it should be interpreted against him. Alternatively, we can interpret Art. 1162 as a rule against the drafter (with reference to the function of the rule in the Roman *stipulatio*). Ghestin et al. argue (2001: 47) to cut short the dispute between the two historically rooted interpretations of Art. 1162 and understand it as a mandatory interpretative rule for the courts in favor of the consumer. But this pragmatic solution is neither necessary nor sufficient. It is not necessary because the Consumer Code already provides a rule in favor of the consumer. And it is not sufficient because it does not tell how to use Art. 1162 when both parties are professionals or both private. In my view, Art. 1162 should be interpreted as an against-the-drafter rule; the burden-of-proof issue being regulated by Art. 1315.

³⁹ The *contra stipulatorem* rule is only mentioned in a small number of places in the Digest and nowhere else in Roman law sources: D. 34, 5, 26 (Celsus), D. 45, 1, 38, 18 (Ulpianus), D. 45,1,99pr (Celsus). The rule applied to an ancient formal verbal contract called *stipulatio*. In order to make a promise binding and enforceable, one of the parties, the stipulator asked a question (“do you promise me X?”), immediately after which the promisor had to answer with the exact same words (“I do promise you X”). In this way, a unilateral obligation was created in favor of the stipulator. As by the construction of the ritual the stipulator was the one who formulated the words of the obligation and the other party was not able to modify or supplement the terms, Roman jurists argued that any ambiguity should work against him. This is the standard understanding of the *contra stipulatorem* rule.

Among historians of private law, there are numerous competing theories about the origin and/or rationale of the *contra proferentem* rule. (Often, these two are not distinguished.) Some argue that it is an exception to the rule that in lack of consent the contract is void. Others hold that it is a specific case of a principle of restrictive interpretation, preventing dominant parties from exploiting others. They also disagree about the rule's practical importance in different periods of the civil law development. For me as an amateur in this field, it seems probable that the rule has changed functions several times during the past centuries. It is easily possible that the rule has been understood and justified in later centuries in ways incompatible with its original meaning (Troje 1961: 96). If we consider that many legal constructions have been ubiquitously used and interpreted for different purposes than what their origin would suggest (cf. Watson 1974), this change in function and justification is not very surprising.

A most interesting hypothesis about the origin of the *contra stipulatorem* rule comes from the German private law scholar Heinrich Honsell. In his theory, the origin of the rule goes back to old sacral formalism. The magic binding force ancient Romans attributed to words both in religion and law made them very scrupulous about the exact wording of prayers, vows and dedications. For instance, the animals promised to gods as a sacrifice had to be specified in a very detailed manner. As the offerer's being bound was a precondition for binding the gods, any ambiguity was interpreted against the offerer / stipulator and in favor of the gods. The magical binding by words made it necessary that the prayer be bound even to the interpretation of his vows and dedications most unfavorable for him, in order to be sure that the gods are bound through his words.

Whatever the truth about the origin of the rule, Roman law became secular very early and less and less formalistic during the centuries of the republic. Roman legal thought came under the influence of Greek rhetoric and dialectics. The so-called consensual contracts emerged and contract interpretation moved from the exclusive focus on the words towards the search for the intention of the parties. As Troje (1961) and Honsell (1986) argue, in the classical period of Roman law the *contra proferentem* rule had almost no practical importance. Although there was an elaborate scholarship in grammatic and rhetoric about ambiguity (e.g. the distinction between obscure (vague) and ambiguous words have been well-known to Roman lawyers), ambiguous cases were decided without reference to the formal *contra stipulatorem* rule. The jurists referred rather to substantive criteria of equity, reasonableness, or the intention of a typical party (Cf. Honoré 1973). At the same time, several other interpretative presumptions have been used, many of them being in favor of a humane decision. The various presumptions that in doubt obligations should be interpreted in the less burdensome way (*favor debitoris, in dubio mitius, in dubiis benigniora*) have made the *contra proferentem* rule obsolete and superfluous. But it did not disappear forever. Based on the few scattered mentions of the rule in Digest, the rule has been generalized and reinterpreted by the *glossators* and *commentators* in the late Middle Ages and become used in practice again.

Later, in classical Roman law, several less formal (consensual) contracts emerged, *emptio-venditio* and *locatio-conductio* among them. In both *emptio-venditio* (sales contract) and *locatio-conductio* (a catch-all term for various labor, service, lease and rental contracts) the essential terms of the contract have been usually supplemented by so-called additional agreements (*pacta*) regarding additional special provisions. These agreements were in practice formulated by the vendor. The interpretative presumption *contra venditorem/locatorem* which also figures in a few Digest rules worked thus against the drafter of ambiguous *pacta* and has been justified by Roman jurists Papinianus and Paulus as “the vendor could have spoken more clearly”. D. 2, 14, 39 (Papinianus), D. 18, 1, 21 (Paulus), D. 50, 17, 172pr (Paulus).

In the middle Ages, along with other fundamental changes in contract law doctrine and theory, these two specific rules (*ambiguitas contra stipulatorem* and *ambiguitas contra venditorem/locatorem*) have been generalized and given the current common name: *ambiguitas contra proferentem*, meaning “in doubt against the drafter”. The Medieval jurist Bartolus interpreted (supplemented) the rule in the sense that it also applied “to the party in whose interest the ambiguous term has been added to the contract”. The usual justification of the rule was that he who has caused an ambiguity could (and should) have spoken more clearly. During all these ages, the rule was a last resort rule. At least rhetorically, judges argued that the rule comes to application only when all regular interpretative methods were insufficient to clear the ambiguity.⁴⁰

Common law development

In common law countries the age-old maxim *verba chartarum fortius accipiuntur contra proferentem*, already referred to by Francis Bacon, Blackstone and Coke, has been used not only in contract interpretation (closely linked to the law of evidence) but in the law of deeds as well.⁴¹

In Britain the *contra proferentem* doctrine has been primarily applied for several centuries to contract clauses that purport to limit or exclude liability.⁴² As a rule of contractual construction, it provides that terms designed to exclude or limit a party's liability are to be construed against him, i.e. restrictively. The policy purpose is clear: judges construe exclusion terms narrowly as they regard it “inherently improbable that one party to a contract should intend to absolve the other party from the consequences of his own negligence”. Courts do not apply the rule with the same rigor to clauses which merely limit (instead of exclude) liability. This limitation of freedom of contract is in most exclusion cases rather “procedural”: they turn on the question whether the intention of one party to limit or exclude liability has been made sufficiently clear to the other. Traditionally, there has been only very few absolute (mandatory) limits in English contract law, the most important being that liability for a fundamental breach of contract cannot be excluded.⁴³

In the United States, “disclaimers and other limitations of liability” are also subject to judicial scrutiny and restrictions under common law. As Allan Farnsworth notes, a drafter of such exclusion clauses should keep five different kinds of restrictive doctrines in mind: public policy, unconscionability, contradictions in drafting, judicial insistence on informed consent and narrow interpretation.⁴⁴ These rules are not only characteristic to the case law of recent decades. Some of them figure in the Uniform Commercial Code and the Restatement (Second) of Contracts as well. Some of them are procedural, others substantive. As to the fourth limitation (informed consent), in the UCC this rule amounts to a statutory requirement of conspicuousness for disclaimers of warranty and the requirement of a separate signature of clauses that might otherwise cause surprise to the non-drafting party. As to the fifth limit (narrow interpretation), like in the UK, it has produced an almost unending string of cases. In the US, narrow interpretation is especially characteristic to clauses that limit the liability for negligence, those that restrict remedies to repair or replacement and those which exclude compensation for consequential damages. In all these cases, ambiguities lead to the invalidity of exclusionary clauses. But when formulated unambiguously, these claims are enforceable, as a general rule.

Standard form contracts

Strictly speaking, the *contra proferentem* rule can be applied only when it is clear which party formulated the clause in question. This is rarely the case when the deal was negotiated between the parties.⁴⁵ At any rate, from the late

⁴⁰ As most clearly explained in a 1619 treatise by Antonius Faber, the rule had to be conceived as a subsidiary or tie-breaker rule, i.e. it can only be applied when neither party can prove what they agreed upon. For references see Krampe 1983, Honsell 1986.

⁴¹ Note 1897, McMeel 2005: 258-259, Treitel 1999: 202-204.

⁴² Treitel 1999: 202-3.

⁴³ It is unclear, however, whether this rule is a substantive doctrine or a doctrine of construction only. In the latter case, it merely amounts to a refutable presumption that liability for a serious breach of contract is not excluded.

⁴⁴ Farnsworth 2002, vol I. §4.29a

⁴⁵ There are examples for this though. One is related to Article 4.6. of the UNIDROIT Principles which provides that “If contract terms supplied by one party are unclear, an interpretation against that party is preferred.” The Official Comment remarks that this is not an all-or-nothing rule: the extent of its applicability depends on how much the contract term was the subject of further negotiations. “The extent to which this rule

19th century, the rule has been applied typically to standard form contracts (general conditions of business, boilerplates).

As mass-production made standard form contracts necessary and more and more generally used, courts started regulating them through different indirect ways. Under codified law, this started without statutory basis and with semi-covered reference to policy purposes. To be sure, codified legal systems were more in trouble than others. Still, through general clauses and interpretative techniques they effectively started regulating standard forms. An important intervention tool was the reasonable expectations doctrine.

For instance, in Germany *contra proferentem* has been codified only in 1977 for standard form contracts. But courts interpreted standard form contracts against banks, insurers, railway companies etc. (and policed their contracts in other ways) for many decades before.⁴⁶ They justified it with the Roman law maxim that the drafter could have formulated the contract more clearly. Any doubt about the meaning of standard terms was resolved against the party who drafted them or chose them by adopting a form drafted by someone else. German courts have witnessed considerable inventiveness and flexibility in the use of other doctrinal techniques as well (e.g. by using the general clauses in §138 and §242 of the BGB) for the regulation of standard forms and in general to put contracts under substantive control.

Later, regulation turned more direct. An interesting sign of the abandonment of the indirect policy use of the *contra proferentem* rule in favor of more direct intervention is the following. Already in 1953 in some cases the general business conditions of an insurance policy were interpreted in favor of the insurer. As Krampe argues, the reason for this is not that there was no ambiguity; rather the substantive control of insurance contracts rendered the indirect way of interpretation unnecessary. The court felt free, so to say, to return to the original narrow use of the rule.⁴⁷

The interpretation *pro adherentem* (in favor of the party “adhering” to a standard form) has been used in a judge-made fashion in Anglo-American, Scandinavian and in French and Belgian law as well.

The two countries mentioned lastly are interesting as they show both the difficulties judges face when they try to apply the archaic formulation of the *contra stipulatorem* rule to standard form contracts and the different solutions the two systems found. In France and Belgium, courts apply *contra proferentem* to standard forms as a judge-made rule: there is no clear legal basis for this rule.⁴⁸ Standard clauses should be interpreted against the drafter or the party who makes use of them for his own account, e.g. by taking them from a professional organization. This *contra proferentem* rule is not to be confused with the *contra stipulatorem* rule (Art. 1162 of the Code Civil; Belgium has an identical rule).⁴⁹ The two only lead to the same result when the clause to be interpreted refers to the obligation of the adhering party. For an ambiguous clause containing the obligation of the drafter, *contra stipulatorem* would decide in favor of the drafter. And indeed, in France, at least in insurance contracts, courts apply the *contra stipulatorem* rule both ways, i.e. eventually also in favor of the insurer (as drafter). In Belgium, in contrast, courts give clear precedence to the judge-made rule over the statutory provision in Art. 1162. Legal scholarship approves this *contra legem* practice.⁵⁰ This means that also the insurer's (drafter's) obligations are interpreted against him if the clause of the standard form in question is deemed to be ambiguous.

As early as 1910, a special provision has been enacted in Switzerland for the interpretation of insurance contracts. This provision extended insurance coverage to certain events (dangers) that have the same characteristics as the danger against which insurance was provided, unless the contract excluded these events from coverage in a

applies will depend on the circumstances of the case; the less the contract term in question was the subject of further negotiations between the parties, the greater the justification for interpreting it against the party who included it in the contract.” (Official Comment on Art. 4.6 of the Unidroit Principles). The flexibility is even greater. There is at least one reported case where the contract was drafted by one party, the rule was nonetheless applied in a gradual manner (Arbitral Award by an Ad hoc Arbitration Court in Buenos Aires on 10.12.1997, www.unidroit.org)

⁴⁶ Krampe 1983.

⁴⁷ Krampe 1983: 40.

⁴⁸ Delvaux (1996) argues that the legal basis of the rule could be *culpa in contrahendo* (Art. 1382).

⁴⁹ To make things even more complicated, there is a potential conflict between *contra proferentem* and Art. 1602 (*contra venditorem*) as well. The rule applied is that when the buyer drafted a sales contract, ambiguities should be decided in favor of the seller. Art. 1602 is overridden by the *contra proferentem* rule.

⁵⁰ Kullmann 1996: 375-381.

determinate and unambiguous way.⁵¹ This rule is, in essence, a transparency requirement which reminds one more recent disclosure (information-forcing) rules. At present, there are statutory provisions that mandate contra proferentem interpretation of any standard form contract (also those between professionals), among others in Austria, Germany, Italy and Spain.⁵²

Consumer contracts

In the European Union, since 1994 there has been an interpretive presumption in favor of consumers. The 93/13/EC Directive on Unfair Terms in Consumer Contracts has a provision to this effect: “Where there is doubt about the meaning of a term, the interpretation most favorable to the consumer shall prevail.”

The Directive is based on the idea that consumers should be empowered through information provision. It includes a transparency requirement in Art 5 (1), providing that “in the case of contracts where all or certain terms offered to the consumer are in writing, these terms must always be drafted in plain, intelligible language.” As this transparency requirement for written⁵³ consumer contracts appears in the same Article as the contra proferentem rule, this would at first suggest that the latter is a kind of sanction for not-plain or unintelligible language. But commentators argue rather convincingly that it is not.⁵⁴ Ambiguity is only one kind of intransparency (another would be unambiguous terms in small print or in technical language). The contra proferentem rule does not provide sanction for all kinds of intransparency.⁵⁵ On the other hand, the contra proferentem rule is not merely a sanction for a specific type of intransparency. The requirement of unambiguity can be stricter than “plain and intelligible”. As Treitel puts it: “language which is plain and intelligible may nevertheless be ambiguous; the fascination of oracular statements lies precisely in the fact that they combine these qualities”. This makes one wonder whether the term “plain and intelligible” itself is plain and intelligible enough, at least as it relates to “ambiguity”. The former discrepancy does not seem to raise serious problems when, as we have seen in case of warranty disclaimers in the US, clauses that are not transparent (conspicuous) enough, cannot be enforced against the consumer. As to the latter discrepancy, when the contra proferentem rule requires something more than plain and intelligible language, this is not problematic either: if the stricter rule is violated, the stricter sanction is justified.

In sum, the contra proferentem rule had a long and varied career from ancient, magic-laden formalistic contracts to mass-scale standardized contracts in 21st century e-business. This interpretative doctrine applies in three contexts: as a general contract law rule against the party who has proposed or takes benefits from the ambiguous clause; against the drafter or user of an ambiguous standard form; in favor of the consumer. In many legal systems these three interpretative presumptions were been formulated in different ages and wordings; this makes complicated meta-rules of precedence and hierarchy necessary.⁵⁶ In more recent codes, legislators combine all three rules more easily. For instance, Article 6.193 Section 4 of the Lithuanian Civil Code provides: “In the event of doubt concerning contractual conditions, these shall be interpreted against the contracting party that proposed such conditions, and in favor of the party that accepted them. In all cases, the conditions of a contract must be interpreted in favor of consumers or a party who concludes a contract by way of adherence.”

The contra proferentem rule as a policy instrument

After this lengthy overview of the legal nature and uses of the rule, our question is what are the policy purposes the contra proferentem rule justifiably serves in any of these cases? Legal commentators refer to various rationales behind the rule:

1. Nobody should benefit of his own wrong. Failure to make clear to the other party the meaning and effect of a

⁵¹ Versicherungsvertragsgesetz (1910) Art 33.

⁵² Austria: ABGB §915, Italy: Codice Civile Art. 1370, Spain: Código civil Art.1288, Germany: BGB §305c II.

⁵³ Thus the transparency requirement does not apply to oral contracts.

⁵⁴ For the contrary view, see Whittaker 2002: 215. To note, Whittaker shows convincingly how in England the transparency rule as a formality became an instrument for regulating substance.

⁵⁵ Ferrante 2005, Hondius 1996.

⁵⁶ On the complex doctrinal difficulties in Quebec see Lluellas 2003.

contract clause is a wrong.

2. A party may be responsible for the formulation of a particular contract term, either because that party has drafted it or otherwise supplied it, for example, by using standard terms prepared by others. Such a party should bear the risk of the ambiguity of the term chosen.⁵⁷
3. The ambiguity might have misled the other party and induced him to conclude the contract.
4. There is unequal bargaining power between the parties.⁵⁸

Protection of the weak?

Courts sometimes rhetorically refer to the former reasons, when the case before them is about standard forms or consumer contracts, courts justify the interpretation against the drafter by the last two reasons. In certain categories of contracts the *contra proferentem* rule has been applied almost automatically in cases between a consumer and a large business firm. In the insurance context, for instance, even the meaning of the rule went through a change and “ambiguity rule” started to refer to an unqualified interpretation of ambiguities against the insurer.

As we have seen, one possible technique for substantive control of the contract is through the *contra proferentem* rule, i.e. to interpret the clause as ambiguous and read it in an artificial and unexpected manner in favor of the consumer.⁵⁹ In this case the judge only construes the clause so artificially because he regards it substantially unfair *ab initio* and wishes to protect the consumer from it. But he tries to do this without openly invalidating the clause and directly infringing the principle of freedom of contract. As interpretative presumptions serve primarily at reducing ambiguity, they presuppose unclear meaning. But “in their eagerness to protect the consumer from unfair standard-form terms, courts have proved remarkably clever at discovering (or divining) 'ambiguities' in them.”⁶⁰ This was especially true when courts had no statutory power to strike down clauses which were unfairly prejudicial to consumers. Now that such provisions are enacted in most Western countries, there seems to be no need to do indirectly what is better done directly by controlling the substance of standard forms in an open manner. Even if open control is possible, courts still tend to justify the interpretation of standard form contracts against their drafter or user by market power or fairness arguments.

This practice became more nuanced only in later decades. Although there are significant differences between states, some common tendencies can be found in the cases. American case law has refined the conditions under which the *contra proferentem* rule is applicable.⁶¹ Thus the parties' mutual participation in drafting of their contract makes the rule inapplicable. Interpretation of a contract against its author is also considered inappropriate if both parties are equally sophisticated in the use of language.

Regulation of standard forms and consumer contracts

Why are standard form contracts so widespread? The short answer is that in a mass-production economy, transaction costs are reduced significantly in this way. Contrary to public beliefs, by themselves, standard forms do not imply superior economic or bargaining power. “Simply observing the fact of standard form contracts yield no meaningful implications as to the underlying structure of the market. Indeed, we observe them being used in many settings where manifestly the market is highly competitive. [...] [E]ven in the absence of standard form contracts, we

⁵⁷ *Interpretatio contra eum qui clarius loqui potuit*. In the early 19th century (when Roman law has still been valid (subsidiary) law in many German-speaking territories, Savigny saw in the rule a sanction against culpable behavior of the party who has expressed himself ambiguously, intentionally or negligently.

⁵⁸ According to Hein Kötz, interpretative presumptions “represent a legal value judgment and seek to promote the meaning most consonant with that value judgment.” They reflect the widespread but inaccurate belief that creditor and seller are always rich and powerful, debtor and buyer weak and poor and therefore in need of protection. To that extent they are unpersuasive, but they make good sense where the creditor or seller actually drafted the clause in issue. It is right that the risk of ambiguity in a contract should be borne by the party who could more cheaply avoid it, and that is usually the party who selected or drafted the clause rather than the party to whom it was presented. (Kötz – Flessner 1997: 114-115).

⁵⁹ For English, French, German cases using this technique see Kötz – Flessner 1997: 141.

⁶⁰ Kötz – Flessner 1997: 115.

⁶¹ Corbin 1998, vol 5. 282-306 (§24.27)

see many goods being offered on a take it or leave it basis in some of the most competitive retail markets in the economy."⁶²

Nevertheless, combined with asymmetric information and certain characteristics of the market, standard form can harm non-drafting parties (both businesses and consumers) by being both inefficient and unfair. Entrepreneurs do not compete with regard to those contract terms (product or service characteristics) that consumers (for good reasons) do not observe – only with regard to observable dimensions, such as price and a few (observable) quality features.⁶³ There are good economic reasons why standard forms are subject to judicial (ex post) as well as regulatory (ex ante) control.⁶⁴

Are there efficiency arguments for the use of the contra proferentem rule for this kind of “semi-covered” regulation? “Interpretive presumptions that favor consumers and insureds encourage sellers and insurers to draft detailed and explicit contracts, which increases the chances that the less sophisticated party will understand her contractual obligations.”⁶⁵ At least, this is how many economically minded lawyers understand the effects (functions) of the contra proferentem rule on standard forms and consumer contracts at first glance.

At second glance, these effects seem less certain. The arguments are similar to those discussed in the economic literature on information disclosure. In fact, they apply more generally to the decentralized ex post control of standard form consumer contracts. The contra proferentem rule is also such a mechanism of state intervention.

The core of the problem is rational ignorance and costly information processing. To begin with, the mechanism by which the penalty default rule would operate is to reduce the cost of processing the information on the part of the receiver. It functions only if the contracting party reads the contract. But this rule cannot reduce these costs to such an extent that the typical receiver reads the contract. If the consumer does not devote time and effort to reading contract forms, the penalty default rule is not able to perform its function of making the consumer informed. Second, information disclosure in itself does very little to improve consumer protection unless consumers are able to make sense of the information and process it appropriately. Many consumer contracts are technically complex. Thus even a consumer who is able to read his rights and obligations in an optimally clear language, may still not be aware of the implications of the text.

To interpret an exemption clause restrictively in the spirit of the contra proferentem rule, or even to deprive it of legal validity for unfairness may be a wholly ineffective means of control. If a contract contained such an ambiguous or invalid clause, the consumer might believe that he was bound by it and so not pursue his claim. Even if he did make a claim, the supplier might settle with the consumer out of court so as to avoid a judicial declaration of invalidity, and then continue to use the clause.⁶⁶ A further difficulty is that the benefits from pro-consumer interpretation are very short-lived. The firm whose contract clauses were interpreted against him can draft other clauses to the same effect which are clear enough to withstand detrimental interpretation. Clarity, in itself, does not guarantee either efficiency or fairness.

For these reasons the covert control of substance should be changed to an open control of standard (preformulated) terms.

The clarity and the substance of the clause are two different issues. In the judicial practice they are often mixed or linked: when the term is unclear, it can be interpreted in a welfare-increasing (or a receiver-friendly) way. That is

⁶² „It is an easy step from the observation that there is no negotiation to the conclusion that the purchaser lacked a free choice and therefore should not be bound by onerous terms. But there is an innocent explanation: that the seller is trying to avoid the costs of negotiating and drafting a separate agreement with each purchaser. (...) Consistent with the innocent explanation, large and sophisticated buyers, as well as individual customers, often make purchases pursuant to printed contracts.” (Posner 1998: 127)

⁶³ “When confronted with an oppressive contract, one must ask why and how did the market arrive at the production of a “bad” or nonoptimal good. Conventional economic theory has few models of product selection. One model suggest the difficulty is an informational one: the ordinary consumer cannot distinguish between good quality and bad quality goods. Since it’s more expensive to produce high quality goods and purchasers cannot distinguish the good from the bad, the market will produce low quality merchandise. Complex, fine print standard forms might be viewed as goods whose quality people cannot determine (...) As consumers are making decisions upon price grounds, a seller offering a better warranty must either suffer a lower profit margin at the same price or charge a higher price and attempt to disseminate information to prevent a loss of sales because of the raised price. Dissemination of information might be difficult.” Kornhauser 1976: 1097.

⁶⁴ For a succinct overview see Katz 1998.

⁶⁵ Posner 2006: 580

⁶⁶ Treitel 1999: 258.

what the contra proferentem rule actually does: as a sanction of unambiguity, it interprets the clause in favor of the consumer. This is not necessarily the most welfare-increasing way to interpret the clause.

There is a somewhat similar interaction between the rules of the Directive, at least as implemented in England. The transparency rule and the fairness test work together. As already noted, the EU Directive on Unfair Terms in Consumer Contracts puts under fairness control all types of contract term, with the exception of terms which are required by law, terms which are 'individually negotiated' and so-called 'core terms', i.e. the substance of the main obligation and the price. In each member state, the court has a duty as well as the power to raise the issue of fairness of a contract term within the ambit of the regulations. Also, the written term should be in a plain and intelligible language. This implies the extension of the fairness test. When the subject matter of the contract or the price is not written in plain and intelligible language, these terms are not exempted from fairness control. But the intransparency may also lead to the intervention of public authorities or private bodies who can ultimately seek an injunction against the use of the terms in question, just like in case of the term's unfairness. Furthermore, somewhat in the shadow of this rule, preventative control is also done by negotiations with businesses whose terms have been the subject of complaint. In the result, the requirement of transparency attracts a system of control of considerably more normative impact than merely rendering a term not binding against the consumer.

It seems that when this regulatory control is effective, the term in question will be clear enough so that the contra proferentem rule becomes superfluous. When does it come to play a role anyway? Only when something turns out wrong and the non-drafting party seeks remedy or modification. Ambiguity itself, without regard to the substance, does not bring a case before court. This implies that when the contra proferentem rule has a rather minor role as an instrument of substantive control.

Optimally clear drafting

Although in many cases the contra proferentem rule is apparently “protecting the weak”, it would be mistaken to think that the use of interpretative presumptions only make sense when there is “structural inequality” or “unequal bargaining power” between the parties. In contrast as a remedy for asymmetric information makes more sense.

As we saw, the UNIDROIT Principles which is designed for international commercial contracts also include the rule. In this context, the power imbalance is implausible. But the contra proferentem rule may make good economic sense in this context: by filling in a gap with a default rule which is unfavorable to the better informed party (penalty default), the law forces her to reveal this information either to the other party or to the court.

My claim is that the contra proferentem rule should be understood as an incentive on the drafting efforts of (one of) the contracting parties. Functionally it is equivalent to an information-forcing (penalty) default rule. It “might encourage the drafter to be more explicit and to provide more details about obligations. This may reduce the chance that the other party will misunderstand the contract; it also may facilitate judicial interpretation of the contract.”⁶⁷

This argument is based on the empirical generalization that usually the drafting party is the cheaper ambiguity (risk) avoider. Despite obvious similarities, the rule should be distinguished from information disclosure rules. The main difference is that while the former rule regulates the language of the contract and information about the rights and obligations of the parties, the latter has to do with information about the behavior of the parties or the quality of the good or service transferred. The first is aimed at individual transactions, the second at the market level. Also, in many cases, the information to disclose is non-observable or at least non-verifiable, consequently not covered by contract language. Another difference is that in many cases the asymmetric informational advantage is by the non-drafting party. Such cases can be subject to an information-forcing rule as well, but in the reversed direction.

In economic sense, there is an optimal degree of clarity in contract language. The optimal degree of clarity would minimize the sum of ambiguity costs (the losses resulting from frustrated reliance expectations) and drafting costs (the costs of drafting that reduces ambiguities). By definition, the drafter has control over the language used in the contract. This notion of control can be the basis of making the drafter responsible for unclear drafting.⁶⁸

There are several problems that complicate the determination of optimal language clarity. First, human language remains inherently imperfect. It is hard to define what complete clarity would mean.

⁶⁷ Posner 2006: 579. See also Hermalin-Craswell-Katz 2006: 93, Ayres 2006: 596.

⁶⁸ See Abraham 1996: 433-434.

Second, unambiguous contract language not only provides information for the non-drafting party; it economizes on public resources as well. As parties using the court system externalize the costs of their dispute to some extent (adjudication is subsidized by public funds) they should be encouraged to solve interpretative difficulties by eliminating ambiguities *ex ante*, to the extent that it can be done cost-effectively. The optimal degree of clarity also depends on whether one wants to provide clarity in favor of the non-drafting party or for third parties (the judge).

Third, if the *contra proferentem* rule is understood in an absolutist sense, this is similar to making the drafter strictly liable for ambiguities. On the other hand, when only a reasonable degree of clarity is required, this is similar to a negligence rule.⁶⁹ The choice between the two depends on considerations extensively discussed in the economic analysis of tort law.⁷⁰

Fourth, contract language often uses standard terms, the meaning of which is different from ordinary language meaning (e.g. trade usage). In many industries and trades, the currently used formulas contain standardized language. Sometimes these are unclear to incomprehensibility for “ordinary people” or contracting partners outside the network. If courts understand ambiguity with respect to ordinary language, they systematically interpret standardized contract terms against the firm in the industry. But such decisions do not necessarily give enough incentives to the firm to “clear” its language. This has economic reasons. From an economic perspective, standardization is usually accompanied by network externalities and learning effects. Each individual firm has an incentive to stick to the standard term because of the sheer fact that its meaning is now standardized and the consequences of its use predictable. Individual deviation is costly. Setting up new standards is even more difficult; it is almost impossible without coordinated common efforts of the firms. In general, network effects increase the level of ambiguity and make it less responsive to the incentive effects of the *contra proferentem* rule.⁷¹ These network effects are especially important in the insurance industry. In case of insurance, the calculation and pricing of various risks depends crucially on the predictability of court decisions. Insurers are reluctant to change language even if courts systematically decide against them.

All this does not mean that the interpretative presumption should be abandoned. It should be used to induce unambiguous drafting. But being a rule of last resort, unconscionability and other formal or substantial policy limitations, if applicable, should have priority over the *contra proferentem* rule.

If the contract term has only one reasonable meaning, ambiguity should not be inserted *ex post* in order to void the clause or the contract. In this case the court can refuse to give effect to the clause directly. But what if the term has several possible meanings, some desirable some undesirable? In this case the substantive fairness or unconscionability test can be in conflict with the *contra proferentem* rule. Which is the more punitive interpretation: the one which favors the consumer but renders the clause non-abusive or the one which apparently favors the professional but exposes him to the gravest sanction, the removal of the clause from the contract?

Some authors suggest that substance of the terms should be tested first, by evaluating the fairness of the term in its interpretation most unfavorable to the consumer. If the term passes this test, only then can the most favorable interpretation be implemented.⁷² At first sight, this is an odd way to protect consumers, especially if the interpretation most unfavorable to them is not the most plausible reading of the language. But there is at least one argument for this apparently unreasonable approach.

This argument is related to the abstract control of standard forms. According to the EU Directive on Unfair Terms in Consumer Contracts, in each member state standard forms should be subject to some “abstract” control. This occurs in various ways in each country: through class action by consumer associations, administrative control by regulatory bodies, consumer ombudsman etc. In these “abstract control” cases the fairness of the standard form is examined in a relatively acontextual way, i.e. not in the context of the specific facts of a litigated case. Here, when the language is ambiguous, the clause in the standard form is presumed to be prejudicial to the consumer (the non-professional, non-drafter party) – the burden of proof that the clause is not unfair is with the drafter. This “duplex interpretation rule” serves thus the same purpose as *contra proferentem*, only through a reversed means.

⁶⁹ On the analogy to strict liability versus negligence, see Abraham 1996.

⁷⁰ See e.g. Shavell 1987.

⁷¹ See Goetz-Scott 1985, Hill 2001, Boardmann 2006.

⁷² Coderch – Garcia 2001: 14.

An example: insurance policy interpretation

The contra proferentem rule plays an especially interesting role in insurance law. Insurance policies are written in a notoriously incomprehensible language; they are to a large extent standard form contracts; insurance is economically significant for consumers and other unsophisticated parties as well. Insurance law is probably the legal area where the contra proferentem rule has been most frequently invoked. In the US, a large volume of case law and much scholarly commentary have been produced on this topic.

In the US and in several European countries as well the contra proferentem rule (also called ambiguity rule) has played a crucial role in deciding insurance policy coverage cases in the last few decades. It is often mentioned in the case law that the purpose of the rule is to aid a party whose bargaining power was less than that of the draftsman. American courts often hold that disparity of bargaining power is likely to exist when a person applies for an insurance policy. In the US the fact that a policy is in the form required by statute is not held to render the contra proferentem rule inapplicable. Part of the reason for this is that insurers may have had a large hand in the drafting of the statute.⁷³ Insurance law provides thus a rich field of study where the economic effects of the contra proferentem rule can be analyzed.

The contra proferentem rule (ambiguity rule) can be understood either in a narrow or a broad sense. The narrow sense is the traditional use of the rule as a last resort or a tie-breaker rule: after the usual methods of contract interpretation have been all applied but the term is still ambiguous, the term should be construed to have the meaning least favorable to the drafter. In the second half of the last century, US courts started to use the presumption against the drafter right at the start, without actually or seriously interpreting the exclusion clause. They understood the rule to serve as a protection for uninformed insureds against substantive unfairness. They (implicitly or explicitly) argued that an ambiguous insurance policy disappoints the reasonable expectations of the insured and is difficult to understand. It is unfair that the text is not provided until the contract is concluded and not subject to bargain. Insureds were to be protected against terms they have not received before purchase. Even if they had, they could not have read the policy because of the fine print. Even if they could have read it, they could not practically have understood the technical language in which it had been written.⁷⁴ Based on these arguments, ambiguity in insurance policies has been interpreted broadly and courts granted coverage to the insured very easily.

The broad interpretation of the contra proferentem rule is problematic. What the rule can offer is some degree of language precision and transparency – but even this is only possible if the network effects are not strong. All the other benefits are only temporary or bring more costs with them. The rule does not protect against inefficient terms. Or if it is stretched to be used for that, it results in uncertainty. It does not necessarily promote efficient risk allocation either. This would not only require that insurable risks are covered but that non insurable risks are excluded from coverage.

The contra proferentem rule should be attached to who is the writer. It should not be used to wide-ranging policy purposes. There are good reasons to think that it is ineffective or has unintended side-effects. An elementary insight of the economic approach is that in all cases of regulatory intervention in favor of the “weaker party” there is a trade-off. This trade-off is between the protection of the disadvantaged party in individual cases (the ex post perspective) and the negative incentive effect of the rule from an ex ante perspective.

Of course, there is an economic argument for the ambiguity rule as well. Between the two parties, the insurance company may be the superior bearer of the risk the insurance coverage will turn out to be less extensive than it appeared to be. This will imply higher premium rates. “But all this means that the insured is buying some additional insurance, and probably insurance that he wants.”⁷⁵ This might be the correct solution in usual cases. But the detrimental effects mentioned above remain.

Some of these effects have been observed and identified as the consequence of insurance regulation. Arguably this has also contributed to later developments in the interpretation of insurance policies. With time there have been some changes in the case law: in some cases, sophisticated policyholders were exempted from this protective rule and

⁷³ Corbin 1998, vol: 295.

⁷⁴ Miller 1988, Rappaport 1995, Abraham 1996, Chandler 2000: 848-850, Johnson 2003, Duncan 2006.

⁷⁵ Posner 1998: 120.

the rule was not applied in the rare cases where the policy was drafted by the insured. Currently, although there is some diversity, the tendency is to use the contra proferentem rule in the US again only as a tie-breaker.⁷⁶ This evolution, however, has been simultaneous with more direct regulation of insurance policies.

One such development was the emergence of the so-called “sophisticated policyholder defense” which excluded certain business-like insureds from this over-protective rule.⁷⁷ But is there a reason to abandon the contra proferentem rule altogether in case of sophisticated policyholders? The answer is probably no: in its traditional narrow understanding, the contra proferentem rule is still useful as a last resort rule of contract interpretation.

There is another obvious consequence of the abandonment of the upfront use of the rule. If one accepts that the main function of the contra proferentem rule is to give incentives for optimal clarity in language, then this should also apply in the rare cases where the insured (or her broker) is the drafter of the policy. Although there has not been any American case decided on this reason in favor of the insurance company, there are some European cases – and numerous US cases where the claim of the insured was rejected and the fact that she drafted the contract was mentioned among the reasons for this.⁷⁸

Currently, although there is much diversity among states, the contra proferentem rule is in many cases again only a tie-breaker.⁷⁹ The story of the rise and decline of the indiscriminate upfront use of the contra proferentem rule in the US provides an example of the ex post paternalistic view of judges. While they see the individual cases where the policyholder suffered losses they do not easily see the costs of the rule which are increased premia and potentially the non-availability of insurance in certain areas or (due to the increased premium) for certain potential policyholder groups.

To be sure, the insurance market is also characterized by standard form contracts, information asymmetry and anticompetitive effects.⁸⁰ An ambiguous policy might disappoint the reasonable expectations of policyholders; it is often difficult to understand. Arguably it is unfair as well as inefficient that the text of the policy is not provided until the contract is concluded. Contract terms that are optimally clear, can nonetheless be inefficient or unfair and exploitative. On the other hand, not everything that seems unfair ex post is inefficient ex ante. Arguably, if courts do not apply the interpretative rule, they have other doctrines at disposal for procedural and substantive control: unconscionability, duress, undue influence, unilateral mistake. As it has been argued in the law and economics literature since long, judicial policymaking comes at a high price. There are many other market and non-market mechanisms (comparison shopping, brochures, agents, reliance on reputation, self-regulation via industry standards; statutory and administrative regulation) that help uninformed consumers.

Conclusion: against paternalism through contract interpretation

Deviations from the common intentions of the parties in contract interpretation is sometimes attributed to ideological concerns and “an appetite for benefiting whichever of the parties is perceived to be in a weaker bargaining position”.⁸¹ There is, however, a more reasonable explanation (justification) for at least some of the deviations. The contra proferentem doctrine is an information-forcing rule that can promote optimal completeness and clarity in contracts. Whether the contract is standardized or not, other things being the same, the risk of ambiguity in a contract should be borne by the party who could more cheaply avoid it, and that is usually the party who selected or drafted the clause rather than the party to whom it was presented. But the interpretative presumptions are ill-suited for ambitious policy purposes. Whatever the role of not strictly efficiency-based policy considerations like paternalism is or should be in law generally, these purposes are not effectively promoted by

⁷⁶ To be more than anecdotal, this statement should be substantiated with statistical data. As Eyal Zamir suggested to me, judicial references to the “tie-breaker” character of the rule are still rather rhetorical.

⁷⁷ Stempel 1993, Johnson 2003: 28-29.

⁷⁸ Johnson 2003: 23-27.

⁷⁹ See Johnson 2003 and (for Ohio) Duncan 2006.

⁸⁰ In addition, there are specificities in the insurance industry. The information asymmetries have special nature. The market is not fully competitive. In the US, the policy language is jointly drafted by insurance companies in certain lines, by the Insurance Services Office (ISO). The committees of the ISO draft insurance policy language which tends to be standardized among the industry. In the early 90s there was an antitrust lawsuit against ISO – then special legislation was enacted.

⁸¹ McMeel 2005: 258, 259.

contract interpretation. Nevertheless, policymakers and courts should be aware that contract interpretation has far-reaching consequences for contractual behavior.

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