Kluwer Arbitration Blog

Textual, Contextual, Good Faith, or Common Intent: The Need for a Baseline for Evidentiary and Interpretative Standards in International Arbitration

Kabir A.N. Duggal (Columbia Law School), Michael A. Fernández (Rivero Mestre LLP), and Justin M. Loveland · Monday, June 6th, 2022

Generally, the choice of substantive law applicable to a particular contract will affect the outcome of a case. It is common, however, for the evidentiary and interpretive rules to also have important implications for a case's outcome. Arbitral rules leave such matters to a tribunal's discretion that can be exercised in different ways. For instance, suppose that two disputes arise under the terms of a form agreement and that parole evidence points to a particular interpretation of the contract. Let us further suppose that one dispute is heard by an arbitrator in a jurisdiction where parole evidence is admissible as a matter of course, and the other dispute is heard in a jurisdiction where such evidence is generally inadmissible. The outcome of the arbitrations is likely to diverge even though the arbitrators are interpreting the same agreement. Regrettably, this is not an isolated example of how the choice of evidentiary and/or interpretative rules can affect the outcome of a given dispute.

We argue that greater uniformity in evidentiary and interpretive rules in international arbitrations would ensure that outcomes turn on the choice of substantive law and—unless the parties prefer otherwise—not, for example, on the vicissitudes of how an arbitrator reads a contract. To that end, we survey the different approaches to interpreting contracts in California, New York, and a few select civil law jurisdictions. We then propose some potential reforms to evidentiary and interpretative approaches that will reduce subjectivity in outcomes irrespective of the substantive law that the parties have chosen.

Textual v. Contextual Debate in Common Law Countries

Contract interpretation in the U.S. is by no means monolithic. Indeed, there is significant disagreement amongst U.S. states as to the centrality of contractual text when interpreting the parties' agreement.

Generally speaking, New York courts, and a majority of other jurisdictions in the United States, focus on the "plain meaning" of the terms within the "four corners" of a contract: the so-called "textual" approach. The rule in the U.S. is most clearly stated in *Greenfield v. Philles Records*, in which New York's highest state court held as follows:

'The best evidence of what parties to a written agreement intend is what they say in their writing.' Thus, a written agreement that is complete, clear and unambiguous on its face must be enforced according to the plain meaning of its terms … Extrinsic evidence of the parties' intent may be considered only if the agreement is ambiguous …

In practice, New York courts will consider the words of a contract next to each other and in light of the overall document; the query is not of their literal dictionary definitions strictly devoid of other context. However, if the contract "on its face is reasonably susceptible of only one meaning," New York courts cannot alter or read other ideas into it.

In California and a handful of other jurisdictions in the United States, courts *preliminarily* consider all credible evidence of the parties' intent in addition to the language of the contract under the so-called "contextual" approach. The California approach is premised on the notion that we have not yet attained an adequate "degree of verbal precision and stability" in our use of language, and what may appear clear to a judge, based on their read of the text, may not be clear among the parties or be their intended meaning at the time of drafting. California state courts maintain that "rational interpretation requires at least a preliminary consideration of all credible evidence offered to prove the intention of the parties. Such evidence includes testimony as to the 'circumstances surrounding the making of the agreement … including the object, nature and subject matter of the writing …' so that the court can 'place itself in the same situation in which the parties found themselves at the time of contracting.'"

A majority of U.S. jurisdictions follow New York's textual approach, though the UCC Sales and Restatement (Second) of Contracts recommend the contextualist approach. Importantly for arbitration, a majority of corporate parties to arbitrations have historically preferred textualist jurisdictions, as seen in choice-of-law provisions that still generally favor New York over California.

Although New York and California were chosen for discussion in this blog post as jurisdictions that best epitomize this split within the common law tradition, such debate between textualism and contextualism also exists in other common law jurisdictions such as the United Kingdom (textualist) and New Zealand (contextualist), among others.

Good Faith and Common Intent in Civil Law Countries

In contrast to the U.S. and other common law jurisdictions, civil law jurisdictions are more uniform in their interpretive approach. At the heart of the civil law tradition are the principles of good faith and common intent. The idea of good faith is both objective—used to enhance fairness and level the playing field in contractual relations—and subjective—a person acts with the belief that what they are doing is right or lawful. Common intent simply refers to the natural meaning of words, rather than some inferred meaning. But whereas the common law focuses mainly on objective intent, using a reasonable-person or reasonable-business (trade usage) standard to determine meaning, civil law approaches tend to focus on a subjective inquiry: the provisions of a contract mean what the parties intended them to mean. In case of doubt, provisions are generally construed against the author of the clause (see Italian Code Art. 1370, French Code Art. 1190).

For instance, under the French Code, "a contract is to be interpreted according to the common intention of the parties rather than by stopping at the literal meaning of its terms" (Art. 1188), but

"clear and unambiguous terms are not subject to interpretation as doing so risks their distortion" (Art. 1192). While on first brush seemingly contradictory, this approach can be understood as essentially encapsulating the common-law divide, albeit with a more subjective flair: if the words are clear and unambiguous, the inquiry stops there; if they are not, the court turns to other factors (which may be described as contextual by a California court), in order to ascertain the parties' intent. Put another way, all courts will first look to the natural or plain meaning of the words in a contract, and then, depending on the legal tradition, turn to a consideration of either objective or subjective factors, and ultimately extend or confine their consideration of the underlying context to varying degrees.

Soft Law Instruments May Not Always Provide a Clear Answer

Common law and civil law jurisdictions also diverge in how they may respect evidentiary approaches in contract disputes. On an international level, proponents of the civil law system have recently developed the Rules on the Efficient Conduct of Proceedings in International Arbitration ("Prague Rules") as a response to what was seen as the common law assumptions underlying the IBA Rules on the Taking of Evidence in International Arbitration. Both sets of rules and comparative analysis have been the subject of extensive writing (see here, here, here, and here). While it is true that both sets of rules, which concern the *taking* of evidence, have certain fundamental differences based largely on the inherent systemic divergences of the adversarial vs. inquisitorial approaches, as concerns the *interpretation* of evidence both sets of rules are silent.

As a prior blog post (coauthored by one of the present authors) has pointed out, "both sets encourage tribunals to take initiative in identifying relevant factual or legal issues; exclude witness testimony considered irrelevant to the case; … and draw adverse inferences." Yet, identification of relevant issues and powers to admit or exclude certain evidence is where the rules leave off: there is very little direction as to which factors to take into account in the weighing of evidence to identify those relevant issues and make an informed decision. Indeed, the selection of a substantive law may not always suffice for interpretative matters as these are within a tribunal's discretion. Article 9 of the IBA Rules, concerning "Admissibility and Assessment of Evidence," merely states that an arbitral tribunal shall "determine the admissibility, relevance, materiality and weight of evidence" and then sets forth the grounds for exclusion, privilege, and production. It is silent as to grounds for assessing the weight of evidence. The Prague Rules do not even contain this type of provision. The need for a more uniform, objective approach in interpretative practices is thus clear irrespective of the common law or civil law background of the tribunal or arbitrators.

Closing the Gap

As this piece has signaled, there is a lacuna in both the common law and civil law approaches to contract interpretation, especially on evidentiary matters that can lead to multiple, competing interpretations between fora—and sometimes even multiple meanings under the 'one plain meaning rule.' While a measure of discretion in arbitration is generally unavoidable, at present, practitioners cannot help but feel that there is a randomness to the manner in which a contract is interpreted, and even the outcome of a case, is dependent on the arbitrator and their background, which may suggest a degree of arbitrariness in the system. The development of a soft law to assist

the various courts and arbitrators spanning both common law (including the NY and CA approaches) and civil law to apply a contract would reduce arbitrator discretion and increase objectivity. While Chapter 4 of the UNIDROIT Principles 2016 and the Vienna Convention on the Law of Treaties provide a good foundation regarding the rules for interpreting instruments at the international level, we believe that a *lex specialis* that provides guidance as to international evidentiary ***and*** interpretive guidelines in international disputes is desirable. This can be done by arbitral institutions themselves or through international bodies, such as UNIDROIT, tasked with developing international norms. These could be developed in consultations with all stakeholders which we propose to develop in subsequent posts.

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