

Teaching the Choice Between Vagueness and Precision in Contracts

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PROFESSOR THOMAS: Hello, everybody. My name is Naveen Thomas. I am a professor at Brooklyn Law School, where I teach doctrinal courses in contracts and business law. I also teach a contract drafting course on the side at NYU, which I have been teaching that since 2016. Before this year, I was also full-time clinical director at NYU, where I directed the business transactions clinic along with a colleague. What I'm here to talk about today is something I've taught in both that contract drafting simulation course and in that transactional clinic that I co-taught. I've also written a law review article about this specific topic, about teaching the choice between vagueness and precision in contract drafting. I think a lot of us may consider this one of the challenging topics in this subject. I think that one of the reasons I wrote this article, and why I'm here today to present on this topic, is that we don't have enough systematic, useful resources to teach this topic.

Today I've talked to some of you about this in anticipation of this presentation. Some people in the past have given me off the cuff answers. It's one of those skills you develop over time with experience. But it's hard to convey in the classroom. One of my main goals here is to provide a tool that I've developed and used and to see if you guys have any thoughts on how to improve it. Of course, I also want to convey that you can use it yourselves if you're interested, and continue to improve it and adapt it to your own purposes. By a show of hands, who here teaches a dedicated contract drafting course? Who here teaches a transactional clinic? It seems a number of the people in the room do. Great. Out of those of you who raised your hands, who has taught, or at least tried to teach, students how to make this choice between vague and precise language? Yeah, many of you. Great.

Now, I imagine that some of you are already familiar with some of the baseline fundamental concepts here. But I want to clarify what I mean by vagueness and precision. The first thing I'm going to do is draw a distinction between vagueness and ambiguity. Many of you may already be familiar with this distinction. If you use Tina Starke's contract drafting textbook, she makes the distinction clear. But not everybody is familiar with it. Many people, including lawyers, Supreme Court justices and law professors use the

words vagueness and ambiguity interchangeably, as if they are synonyms. Although, I've seen court opinions where that conflation is problematic. But for contract drafters this is a useful distinction. In this presentation, I am talking about vagueness, not ambiguity. Ambiguity is when language is susceptible to multiple, mutually exclusive interpretations and it's not clear which one is intended. If only one of the interpretations is reasonable and the other is ridiculous, it's not problematic. But when there are multiple, reasonable interpretations and they're mutually exclusive, we're talking about a genuine ambiguity. In contrast, vagueness is when the meaning of a word or phrase depends on the context or could fall anywhere along a spectrum. In other words, there may be overlapping meanings.

To illustrate, if I say that a person is blue, that could be ambiguous because you don't know whether I'm talking about their emotional state or their color. There are at least two mutually exclusive meanings here. This word blue could also be vague. What shade of blue am I talking about? There are overlapping meanings. They're not mutually exclusive. There's a spectrum here. That's a vague term. This distinction between ambiguity and vagueness doesn't always matter in everyday life, where people often conflate the concepts. However, in contracts the distinction is useful. Ambiguity should be avoided because it's a recipe for confusion and disputes. There's little tangible benefit to be had from ambiguity, and if there are any benefits that one can perceive, the costs outweigh them. The classic example that you may recall from contracts involves a contract that referred to a ship called *Peerless*, and there were two different ships that fit this description. That's a classic case of ambiguity and that was the source of a dispute. However, ambiguities can lead to disputes in less theatrical ways as well.

Now, vagueness, on the other hand, where you're talking about a spectrum of possible meanings, can sometimes be useful. Most of us realize this, although not all contract drafting textbooks acknowledge it. Vague words, like material and reasonable, appear throughout all kinds of contracts, from the simplest to the most sophisticated. And that's not always a bad thing. The purpose of the discussion here is to determine when vagueness is useful. That's the skill that we're trying to teach here. How do you know when to use vague language and when to use precise language? I was saying,

the opposite of vagueness is precision. In both contracts and in statutes, people often call vague terms “standards” and precise terms “rules.” If you’ve heard of rules versus standards, we’re talking about the same thing. But despite those two categories, these concepts are not binary, they’re scalar. There’s a spectrum of vagueness and precision. A term is precise to the extent that the drafter provides that context when drafting it. You put the context into the language itself. A term is vague to the extent that one has to provide that context when interpreting it.

Take, for example, a license agreement between a trademark owner and a manufacturer that’s going to make products bearing that trademark. Pretty typical type of contract. Now, the manufacturer’s obligation to market the products could be stated in different ways. A common, vague formulation would be “reasonable efforts,” or some variation of that. And transactional lawyers fight over those variations between best and reasonable efforts. But courts tend not to make those distinctions. Now, a precise alternative could be a milestone requiring the manufacturer to spend a specific amount of money on marketing. Now, before we dive deeper, let’s break into some small groups for discussion.

Now, everything that you all brought up leads into segments of what I am going to talk about. I wanted to talk a little bit about contract theory on this point, because I think this is something that a lot of us as practitioners and clinical professors are not as familiar with. Contracting textbooks devote little, if any, attention to this choice between vagueness and precision. I mentioned earlier, Tina Stark’s textbook, which I think is still the leading one, devotes about half a page to it. Several others that I’ve seen don’t talk about it at all, or if they do, they say, in general, that you should aim for precision. However, as we were describing, vagueness can sometimes have benefits. Contract scholars have been writing about this choice on a theoretical level for decades. These scholars tend to view this choice between vagueness and precision through the lens of economic efficiency. A better known concept is that of incomplete contracts. It is one of the central issues in contract theory. It’s impossible to write complete contracts. A complete contract

would be one that addresses every possible future contingency. That would be beyond the limits of human imagination and clairvoyance. It would also be costly.

So, contracts in are incomplete. Now this sounds obvious to all of us, but fifty years ago a lot of economists assumed that people drafted complete contracts, which was incorrect. The theory behind why contracts are incomplete in reality, from an economics perspective, is that parties should stop drafting when the marginal costs of additional work on the contract equal or exceed the marginal benefits. This general idea of incomplete contracts gave rise to the prevailing model and contract theory of the choice between vagueness and precision. This model similarly focuses on the costs and benefits of various language choices. We already began to talk about this earlier—some of the costs of precision. Let's talk about that in a little more detail. Now, a provision's benefits are often described in the literature as the party's resulting incentives to perform the contract. The benefit of drafting a contract provision is that it gets somebody to do something or not to do something. And I realize that's truer of covenants than other types of contract concepts. But unfortunately, in contract theory, they tend to think everything is conditions and covenants, and don't realize there are other types of provisions out there. It's a bit of a simplification.

What about the costs? A provision's costs are divided into front-end or *ex ante* transaction costs and back-end or *ex post* performance and enforcement costs. Let's break this down. Imagine a scale showing our front-end and back-end costs. On the front-end, we have predicting future contingencies, addressing them in the contract, bargaining with counterparties and drafting the language that memorializes the deal. On the back-end, you have performance and dispute resolution. Now, dispute resolution applies to enforcement efforts with or without litigation. As we all know, disputes do not always result in litigation, but the language choices could affect the cost of dispute resolution. Another back-end cost could be judicial error. Language choice affects the risk of judicial error.

In the academic literature there's a widespread generalization that vague terms cost less at the front-end because you don't have to formulate

and negotiate customized language. It costs less at the front-end. For example, in that license agreement example I mentioned earlier, you can say a standard phrase like “reasonable efforts,” and be done with it, rather than argue over the type and level of the milestone, whether to use a marketing budget, and how high it should be. And in the example that you gave earlier, there is the added cost of educating yourself if you’re unfamiliar with the concept of using milestones. These are all front-end costs that you can avoid with a vague term rather than a precise one. On the other hand, vague terms are said to cost more at the back-end. They’re heavier. They cost more at the back-end for a couple of reasons. One, if the parties misunderstand their rights and obligations vague terms could increase the likelihood of disputes. The manufacturer may be less likely to do what the trademark owner expects, and more likely to disappoint them. When we’re talking about the range of interpretations of a vague term, a party chooses the interpretation that favors itself. If that disadvantages the other party that will be more likely to lead to a dispute. It also makes performance more costly because the party is not performing according to what they were expected to do. Then, if you do have a dispute, it may be more expensive to resolve with a vague term because the parties would argue over the vague term’s proper interpretation and what level of expenditure is reasonable under the circumstances. If a court misinterprets the vague standard, then it can make an erroneous decision. The risk of judicial error is higher.

In contrast, for the opposite reasons, a precise provision costs more at the front-end and less at the back-end. That’s the generalization in contract theory regarding vagueness and precision. According to traditional contract theory, parties choose between vague and precise options by trading off between front-end and back-end contracting costs or by balancing them. This is a pervasive concept in a lot of contracts literature. Let’s talk about what that means to balance these costs because it seems a little hard to imagine that, for example, if a term is almost never involved in disputes, then it’s an expected back-end costs. When I say expected, I mean, discounted by the low probability that they would occur, and the time-value of money the expected back-end costs would have is lower. In that case it wouldn’t make sense to incur higher front-end transaction costs to make the term more precise. In that case a vague standard is more efficient.

Now, how are you going to balance these different costs, front-end and back-end, across a whole contract? The academic literature suggests that the parties would do a cost-benefit analysis of each term and each language option under consideration. But that's not practical in the world for many reasons, but in large part because of the differences in litigation risks. Back-end costs based on choices of contract language alone are quite uncertain and unpredictable. Where does that leave us? We have this theory, which has, I think, valuable insights for the contract drafters in the world. But there's no practical way to implement it. As I said earlier, these insights are known to contract scholars, but unknown to practitioners, and even to many contract drafting professors. And contract drafting textbooks don't address this theory at all. The little guidance that they do provide on vagueness and precision, says nothing about balancing front-end and back-end costs, or even paying attention to back-end costs. As a result, law students and lawyers have no principled way to make this critical decision. Some experienced lawyers can do this consistently and accurately based on intuition. I imagine that includes many of you. But what about our students, and the junior lawyers that they'll eventually become? You can't teach them intuition. That's something you develop only over time. In the meantime, what are we going to do for those people? We need an educational tool now.

Some of you have already come up with some of your own tools, but I'll share with you what I've come up with. To address this need, I looked to recent developments in behavioral science regarding heuristics. Now, I'm talking about a lesser-known form of heuristics, that's a bit more recent, which I call deliberate heuristics. These are situation-specific, simplified decision-making strategies that people employ intentionally, not instinctively. It's a different category of heuristics. It's a decision-making tool. Now, research has shown that, when designed properly, deliberate heuristics tend to be not only faster, but also more accurate than optimization methods, in performing a cost-benefit analysis in complex and uncertain situations. Contract formation is often one of those situations, in part because litigation risk is hard to assess at the front-end. Accordingly, I've developed a heuristic approach to making this decision in the form of a decision tree.

I want to note a few general concepts before we talk about this in detail. According to the heuristics literature that I was describing, this is known as a fast and frugal tree, which is a funny phrase. The idea is that each question in this decision tree has only one exit, except the last question, which has two exits. You may be familiar with huge web decision trees from computer science, that artificial intelligence could use but a person couldn't. This is intended for a human audience and human use. The tree helps you choose between two options that you've already identified. This is something we talked about earlier. Sometimes it's hard to identify a precise option in the first place. In this case, this assumes that you've already identified a precise option which is not always realistic because it takes work to identify that. But the tree doesn't formulate an option for you. If you're choosing between a vague term and a precise term that you've come up with yourself, then you can look to this to help decide between them.

This tree tells the parties the terms to which it should aspire. That is, the term that it hopes to achieve. It's not the one to which the parties will agree. And I should also point out this is written from each party's individual perspective, not from the parties choosing collectively, but sometimes parties do work together in a relational contract to choose contract language. In those cases, this tree could be adapted to apply to a joint decision as opposed to an individual preference. The term to which the parties would agree is not just a function of each party's aspiration, but also other factors, like each party's negotiating leverage and their different priorities in the contract. And the questions in my decision tree don't answer themselves. I feel I'm replacing one complex question with a bunch of less complex questions. They still require legal and factual research and communication with your client, to understand their circumstances, their goals, their concerns, and their risk tolerance. Even then, there's often no one answer to each of these questions. Reasonable people could sometimes disagree about the answer. It's not going to guarantee you an economically efficient result in every instance. Instead, it's going to make your decision making more principled, and more accurate in general. It's not supposed to be automation. Instead, it's a systematic approach for responsible lawyers to make complex decisions. It's not infallible. I don't want to overstate its promise or potential. I do want to explain and demonstrate this tool.

I will explain that with an example. Let's recall that these were the two language options under consideration in the trademark license agreement. Let's analyze these questions from the trademark owner's perspective. Starting with the first question: would the vague term provide you with this material strategic advantage? What am I talking about there? This is often where the contract drafting textbooks end with this inquiry. Sometimes vagueness can provide a party with a strategic advantage in a dispute by permitting a potential interpretive argument that a precise rule would preclude. I think some of you earlier, after our group discussions brought up this point. I think many of us are familiar with this concept, although it often does need to be explained to students. To exemplify, if you're the trademark owner, you would be the party bringing any claim under this covenant, and it's easier to establish a breach of a precise covenant than a vague one. Often you don't need to make the interpretive argument that the reasonable efforts clause requires a certain level of expenditures. Vagueness would not provide the trademark owner with a strategic advantage here. In fact, it would do the opposite. The answer to this question is no.

That leads us to question two: would the precise term convey material, confidential information or material negative signals? In other words, does it matter to you? Is it something that is important enough to you to affect your decision? The idea is, if there's a slight strategic advantage, but it's remote that it would ever materialize, you're not going to make a decision based on that. Of course, that's a complex judgment call that I'm not making for you. Sometimes you'd avoid a precise term, because either the term itself, the language of the term, or the anticipated negotiation over that term would convey confidential or sensitive information that your client doesn't want to disclose to the other party. If that information is important to them, this alone might be a reason not to pursue a precise term, and to go with the vague standard instead.

Now, the marketing budget that we're talking about here doesn't entail confidential information. Let's assume that it doesn't. But does it send a negative signal. Now, what does that mean? If the dollar amount is high, then the manufacturer may worry that the trademark owner is going to be

demanding and difficult to work with. In some cases that risk could be material. The trademark owner may not want to send that signal because they want to convey a sense that they're cooperative and easy to work with. If it's material, it would deter them from the deal. In that case, let's assume it's not material, because the dollar amount here is industry standard. That's an assumption we'll make to further demonstrate this concept. The answer here is, no, but it could be yes, if it would send a negative signal, as I described.

The third question here is: would the precise term entail material errors or omission, or enable the counterparty to materially circumvent rules? This is a common explanation in contracts literature for why parties include vague terms. They're worried that if they include precise language, then they leave something out that a vague term would capture. Here there is a risk of errors and omissions with the precise term. If we require only a dollar amount, we miss other important aspects of marketing. For example, if this product is intended for teenagers, and the manufacturer spends the entire budget on print newspaper ads, we won't achieve our main objective of publicizing the products to potential customers. Arguably that marketing strategy would be unreasonable under the circumstance under the vague standard, but it wouldn't violate the precise rule that requires only a marketing budget, and otherwise gives the manufacturer the discretion to spend it however, they want. The answer here would be, yes.

Now question four: would the precise term materially increase transaction costs? Remember, I said, contract theory generalizes that the precise terms cost more to draft than vague terms do. But sometimes that's not true. Sometimes you have a precise term from a template or precedent that fits the current context and doesn't cost more to draft. That's, I think, an exception to the general rule, but it does exist. Think about a notices provision in the back of the contract that tends to have precise rules for the methods of communication between the parties. It's not a vague term, it's a precise one. But you can draft this and agree on it with little added front-end cost, copying language from a template and filling in blanks. In that case you're better off using the precise term than a fake one. But here the situation's different. In the current marketing example, the precise term would cost more, because the parties would have to agree on both the type

and the level of the metric to use for marketing efforts. They first have to agree that we're going to have a marketing budget, and then they have to agree on what the amount of the budget should be and that would be an increase in transaction costs. And let's say that is material.

That brings us to question number five: is the provision central to the party's intended performance? Now, some provisions are clearly central to performance. But whether this particular provision on marketing obligations is central in our hypothetical depends on further details. If it's an exclusive trademark license, then the manufacturer may be the only source of marketing in the specified territory, and that would make the marketing provision even more important to the trademark owner and central to the deal. Let's assume that's the case here. These marketing obligations are super important. They're central to the deal.

So, all of these answers on the decision tree lead you to "vague with precise illustrations." In other words, it tells us we should combine a vague catch-all "reasonable efforts" with precise illustrations, such as a marketing budget. That would be the trademark owner's preference according to this tree, and according to some additional facts that I stipulated. But notice that there is a sixth question on the decision tree: is the provision likely to result in a dispute based on general trends and specific circumstances? Now, this is the hardest question in the tree. This issue is hard to assess at the front-end, at the contract formation stage. That's why the optimization theory that I was talking about earlier is hard to implement in practice. But this tree has that question at the end. If you can reach a decision between the precise and vague term without getting to that last question, it's a big efficiency gain because you can avoid that difficult question. But, if the other five questions don't give you a clear answer, then you do have to move into that sixth question. I encourage you all to consider the sixth question only when it is dispositive, because we save a lot of time and money by avoiding it.

In class, I would walk students through that example or something similar, and then I'd show them another fact pattern. I'd show the students another fact pattern with a different choice of language, a different choice between vague and precise language. For instance, consider a termination for

cause provision in an executive employment agreement. The vague approach track is the common law definition of cause, which is misconduct or malfeasance that is not defined in the employment agreement. A precise approach may consist of a precise list, including language like “engaging in relationships with coworkers.” To round this out, I would divide the class into pairs, assign half the groups to represent the employer, the other half to represent the executive. And then, I’d say, “From your client’s perspective, walk through the decision tree with your partner and find out which option you’d prefer.” I tell them that if they find that they need additional information to answer certain questions, they can note that information and identify what you do to find that information, such as research or asking the client. Then I have them make an assumption about the missing information and continue through the process. Afterward, I discuss findings from each half of the class. Now we are out of time, so without further ado—it is lunchtime. Thank you.

