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Contracts - New Mexico Adopts the Modern Approach to Interpreting Ambiguities: C.R. Anthony Company v. Loretto Mall Partners

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CONTRACTS—New Mexico Adopts the Modern Approach to Interpreting Ambiguities: *C.R. Anthony Company v. Loretto Mall Partners*

I. INTRODUCTION

In *C.R. Anthony Co. v. Loretto Mall Partners*,[1] the New Mexico Supreme Court adopted the modern approach to interpreting an ambiguity in a contract, rejecting New Mexico cases adhering to the traditional, "plain meaning" rule. This Note sets out the facts and holding of *Anthony* and then discusses the origins and views of both the traditional, "plain meaning" approach and the modern approach to determining whether an ambiguity exists in a contract and to resolving an ambiguity. The Note also examines the supreme court's reasoning in adopting the new rule and the court's analysis of how the rule will operate in New Mexico. Finally, this Note offers a critique of the *Anthony* decision.

II. STATEMENT OF THE CASE

C.R. Anthony Company ("Anthony") leased retail space in a shopping mall from Dartford Company ("Dartford"). Anthony entered into an amended lease for additional retail space in January of 1982. Loretto Mall Partners ("Loretto") became Anthony's landlord in 1984 when Loretto purchased the shopping mall from Dartford.[2]

Under the original lease, Anthony was to pay a minimum annual rent of $9350. Additionally, Anthony was to pay an annual percentage rent equal to 2.5% of Anthony's annual sales, less the amount of the minimum annual rent. Accordingly, Anthony's obligation to pay the additional percentage rent began at the point at which its annual sales reached $374,000, the natural breakpoint, or the point at which $9350 equals 2.5% of $374,000.[3]

Under the amended lease, Anthony was to pay minimum annual rent of $55,611.[4] Additionally, Anthony was to pay an annual percentage rent equal to two-and-one-half percent of Anthony's "Base Net Retail Sales Figure," which was defined to be $2,224,400.[5] Although it was not designated so, the Base Net Retail Sales Figure equaled the natural breakpoint, the point at which $55,611 equals 2.5% of $2,224,400. The amended lease also provided for Anthony's minimum annual rent to be reduced to $18,370 if the anchor tenant, J.C. Penney Company ("J.C.

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1. 112 N.M. 504, 817 P.2d 238 (1991).
2. *Id.* at 505-06, 817 P.2d at 239-40.
3. *Id.* at 506, 817 P.2d at 240.
4. *Id.*
5. *Id.* at 506-07, 817 P.2d at 240-41.

Penney"), left the premises and the Mall was unable to replace J.C. Penney with a new tenant.[6] The amended lease, however, retained the same percentage rent provision as was in the original lease. The amended lease did not provide for a recalculation of the percentage rent to be paid by Anthony if J.C. Penney left the shopping center.[7]

J.C. Penney left the shopping center and was not replaced. In 1983, Anthony began paying the minimum annual rent at the reduced rate. Additionally, from 1983 to 1988, Anthony paid a percentage rent of 2.5% of $734,800, the new natural breakpoint computed upon the reduced amount of minimum annual rent.[8]

During an internal audit in 1988, Anthony discovered an alternative construction of the amended lease: even if J.C. Penney left the shopping center, the breakpoint at which the percentage rent became due was $2,224,400.00, rather than $734,800.00. Thereafter, Anthony sued to recover the excess rent paid.[9]

Finding that the amended lease was unambiguous, the trial court awarded summary judgment to Anthony for the excess rent paid by Anthony.[10] On appeal, the New Mexico Supreme Court held that there was substantial evidence to sustain the trial court's finding that the amended lease was unambiguous.[11] Justice Ransom, writing for an unanimous court, held that "in determining whether a term or expression to which the parties have agreed is unclear, a court may hear evidence of the circumstances surrounding the making of the contract and of any relevant usage of trade, course of dealing, and course of performance."[12] The court also explained that determining whether an ambiguity exists is a question of fact.[13]

In *Anthony*, the supreme court found that the evidence explained the nature of commercial retail leasing in general and the circumstances leading up to Anthony's lease. The evidence, however, did not demonstrate ambiguity in the terms of the lease by showing that the terms were "vague, uncertain, or reasonably susceptible to more than one interpretation," or by clarifying or explaining the terms. Rather, the evidence suggested that the parties would have added a new provision to the contract which would have contradicted existing contract provisions.[14]

Having found that the contract was unambiguous, the court determined that the evidence raised an issue of fact as to whether the parties made a mutual mistake by omitting a provision to reduce the percentage rent if the minimum rent was reduced because a new anchor tenant was not

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6. *Id.* at 507, 817 P.2d at 241.
7. *Id.* at 511, 817 P.2d at 245.
8. *Id.* at 507, 817 P.2d at 241.
9. *Id.*
10. *Id.* at 506, 817 P.2d at 240.
11. *Id.* In New Mexico, an appeal in contract is taken directly to the New Mexico Supreme Court. N.M. CONST. art. VI, § 2.
12. *Anthony*, 112 N.M. at 508-09, 817 P.2d at 242-43.
13. *Id.* at 509, 817 P.2d at 243.
14. *Id.* at 511, 817 P.2d at 245.

found.[15] Accordingly, the supreme court reversed Anthony's summary judgment and remanded the matter to the trial court for further evidentiary hearing on the question of mutual mistake.[16]

III. BACKGROUND OF THE LAW OF RESOLVING AMBIGUITIES IN A CONTRACT

Parties to a contract reduce their agreement to writing "to provide trustworthy evidence of the fact and terms of their agreement and to avoid reliance on uncertain memory."[17] In the process of interpreting a written contract a "court ascertains the meaning that it will give to the language used by the parties in determining the legal effect of the contract."[18] When a court determines the legal effect of a contract, it necessarily determines the meaning of the language used by the parties,[19] including the resolution of any ambiguities.

Courts have utilized two methods for determining whether a contract is ambiguous. Generally, the underlying goal of each approach is to determine the meaning or intent of the contracting parties;[20] however, the two approaches use different mechanisms.

A. Traditional Approach

The search for the existence of an ambiguity in a contract under the traditional approach is "conducted within the 'four corners' of the writing, unaided by any reference to external circumstances."[21] This "plain meaning" rule originated from the primitive view that a word was a fixed symbol with an inherent, objective meaning. Although centuries of intellectual development permitted the rigid view to change, by the end of the eighteenth century, the view was entrenched in the law of the United States, resulting in the rule that the "words of a legal document inherently possess a *fixed and unalterable meaning.*"[22] Even though the rule gradually became less rigid, by the nineteenth century the law still insisted that "*when the meaning is 'plain'*—that is plain by the standard of the community and of the ordinary reader—*no deviation can be permitted.*"[23] The traditional rule survives in many courts today.[24]

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15. *Id.* at 511-12, 817 P.2d at 245-46.

16. *Id.* at 506, 817 P.2d at 240. In addition to the matters raised in the claim by Anthony against the mall, Loretto filed a cross-claim against Dartford for breach of its warranty that Anthony's obligations under the amended lease conformed with Anthony's past payments. The trial court granted summary judgment to Loretto against Dartford. The supreme court affirmed Loretto's summary judgment, reaffirming its prior holding that reliance is not an element for a claim for breach of an express warranty. *Id.* at 512, 817 P.2d at 246.

17. 3 E. ALLAN FARNSWORTH, FARNSWORTH ON CONTRACTS § 7.2, at 191 (1990).

18. *Id.* § 7.7, at 236-37.

19. *See id.*

20. *See* 4 WALTER H. E. JAEGER, WILLISTON ON CONTRACTS § 600 (3d ed. 1961); 3 ARTHUR L. CORBIN, CORBIN ON CONTRACTS § 542 (1960).

21. Ferdinand S. Tinio, Annotation, *The Parole Evidence Rule and Admissibility of Extrinsic Evidence to Establish and Clarify Ambiguity in Written Contract*, 40 A.L.R.3d 1384, 1389 (1971).

22. 9 JOHN H. WIGMORE, EVIDENCE § 2461, at 195 (Chadbourn rev. 1981).

23. *Id.* at 196.

24. *See* Tinio, *supra* note 21, at 112 (Supp. 1992) (citing Student Loan Guarantee Found. v.

Thus, the traditional approach is based on the premise that the written words of a contract represent the definite expression of the agreement between the contracting parties and that the contract's terms are, therefore, conclusive.[25] If the words of the document are "plain and clear," evidence extrinsic to the writing is not admissible to give meaning to the contract.[26] If the court determines that a document is ambiguous, extrinsic evidence is allowed to clarify the ambiguity; the extrinsic evidence may not vary or contradict the agreement.[27]

Procedurally, the "plain meaning" approach requires a two-step process. First, as a matter of law, the court determines whether an ambiguity exists.[28] If an ambiguity is found, it is resolved by the jury as a question of fact. As Professor Williston explains, this division of functions apparently arose out of a "distrust of the jury's ability to answer questions of fact that call for nice discrimination and an educated mind."[29]

The traditional approach has two primary weaknesses. First, words do not have "one correct" meaning[30] and always need interpretation.[31] A word that suddenly appears in empty space, with no history, expresses nothing at all. To have meaning, a word must have a context and a history.[32] Even words that seem "plain and clear" on the face of a contract may have another "plain and clear" meaning when considered in their surrounding circumstances.[33] The meaning of any word can change, depending on factors such as the geographical location in which the word is used; the social, economic, religious, and ethnic group to which the user belongs; and, the change of times.[34]

A word's meaning ultimately depends on the idea it induces in the mind of the one who uses, hears, or reads it.[35] As Justice Oliver Wendell Holmes said:

> A word is not a crystal, transparent and unchanged, it is the skin of a living thought and may vary greatly in color and content according to the circumstances and the time in which it is used.[36]

Professor Corbin also concluded that language is always a defective and uncertain instrument in the law of contracts.[37] Uncertainties in mean-

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Barnes, Quinn, Flake & Anderson, Inc., 806 S.W.2d 628 (Ark. Ct. App. 1991); District-Realty Title Ins. Corp. v. Ensmann, 767 F.2d 1018 (D.C. Cir. 1985); Hanam, B.V. v. Kittay, 589 F. Supp. 1042 (S.D.N.Y. 1984)); *see also* WIGMORE, *supra* note 22, § 2461, at 197. Professor Corbin asserts that the "plain meaning" rule is one of those rules which is "assumed" by courts to exist, but which has a "beginning no man knows when, coming from no man knows where, seemingly universal and unchangeable." CORBIN, *supra* note 20, § 536, at 25-26.

25. RESTATEMENT OF CONTRACTS § 230 cmt. b (1932).
26. Tinio, *supra* note 21, at 1389.
27. *Id.*
28. *See* JAEGER, *supra* note 20, § 616, at 649.
29. *Id.*
30. CORBIN, *supra* note 20, § 535, at 16.
31. WIGMORE, *supra* note 22, § 2470, at 236.
32. CORBIN, *supra* note 20, § 540, at 90.
33. *Id.* § 542, at 101-03.
34. RESTATEMENT (SECOND) OF CONTRACTS § 201 cmt. a (1979).
35. CORBIN, *supra* note 20, § 536, at 27-28.
36. Towne v. Eisner, 245 U.S. 418, 425 (1918).
37. CORBIN, *supra* note 20, § 536, at 27.

ing may be greatly reduced when the context of the word's use is considered.[38]

The second weakness of the "plain meaning" approach is that it allows the court to substitute its own "linguistic education and experience for that of the contracting parties."[39] When a court refuses to consider the surrounding circumstances of a contract when determining whether an ambiguity exists, it will not necessarily be the contracting parties' meaning the court gives to the contract.[40] The "plain meaning," then, is the meaning given to the contract by the judge who did not write the contract.[41] The court may enforce a different contract than the one the parties intended to make.[42] As described by one court:

> [T]he courts [run] the words of the parties through a judicial sieve whose meshes were incapable of retaining anything but the common meaning of the words, and which permitted the meaning which the parties had placed upon them to run away as waste material.[43]

Professor Corbin similarly criticized the "plain meaning" view and its potential for judge-made contracts:

> [A]s all great lawyers have believed since the time of Lord Justice Coke nearly 400 years ago . . . the proper purpose of the law is to carry out the legitimate intent, the underlying purpose, the "spirit" if you will, of the contract . . . . To say that language is to be treated as if it has no purpose is to reduce law to a dice game, whose only purpose is the amusement of its participants. But the law does not exist for the amusement of judges; it assumes that some decisions are right and some are wrong, and that it is possible to tell the difference. And the difference is that right decisions help make it possible for honest people to achieve what they legitimately and fairly intended, and wrong decisions do not . . . . To ignore the "spirit" of the contract is to exalt form over substance.[44]

Nevertheless, the traditional view does have its advantages. It simplifies the interpretation process by limiting the amount of evidence that can

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38. RESTATEMENT (SECOND) OF CONTRACTS § 201 cmt. b.

39. CORBIN, *supra* note 20, § 542, at 111. When a court finds that a contract is "clear and unambiguous" under the "plain meaning" rule, the court may not actually mean that the words had only one meaning and were "clear and unambiguous." The court may have considered the surrounding circumstances and decided not to give the words a meaning urged by the losing party. *See id.* The court may have decided that even if extrinsic evidence were considered, the contract's meaning would be the same as the "normal" meaning given by the court. *See* JAEGER, *supra* note 20, § 609, at 412.

40. CORBIN, *supra* note 20, § 542, at 111-12. This is particularly true because the question of ambiguity under the "plain meaning" rule is a question of law to be determined by the judge and not a question of fact to be determined by a jury. *See* RESTATEMENT (SECOND) OF CONTRACTS § 212(1) & § 212 cmt. d (1979) (the interpretation of a written document has historically been treated as a question of law to be decided by the judge).

41. *See* WIGMORE, *supra* note 22, § 2462, at 198.

42. *See* CORBIN, *supra* note 20, § 542, at 111-12.

43. Hurst v. W.J. Lake & Co., 16 P.2d 627, 630 (Or. 1932).

44. CORBIN, *supra* note 20, § 535, at 20-21 (Supp. 1960).

be offered.[45] It provides predictability and reliability for the interpretation of commonly used words.[46] Finally, the traditional approach avoids the great risk of permitting a party to make a convenient argument that it meant something other than what is written.[47]

The Ninth Circuit Court of Appeals made an impassioned and compelling plea in favor of the "plain meaning" approach when that court criticized California's adoption of the modern rule:

> [The modern approach] casts a long shadow of uncertainty over all transactions negotiated and executed . . . . [I]t leads only to frustration and delay for most litigants and clogs already overburdened courts. It also chips away at the foundation of our legal system. By giving credence to the idea that words are inadequate to express concepts, [it] undermines the basic principle that language provides a meaningful constraint on public and private conduct. If we are unwilling to say that parties, dealing face to face, can come up with language that binds them, how can we send anyone to jail for violating statutes consisting of mere words lacking 'absolute and constant referents'? How can courts ever enforce decrees, not written in language understandable to all, but encoded in a dialect reflecting only the 'linguistic background of the judge'? Can lower courts ever be faulted for failing to carry out the mandate of higher courts when 'perfect verbal expression' is impossible? Are all attempts to develop the law in a reasoned and principled fashion doomed to failure as 'remnant[s] of a primitive faith in the inherent potency and inherent meaning of words'?[48]

B. Modern Approach

In contrast to the "plain meaning" method of contract interpretation, the modern approach permits the court to consider evidence extrinsic to the contract to determine whether an ambiguity exists.[49] To determine the parties' meaning, the factfinder puts itself in the position of the parties at the time the parties made the contract,[50] and considers the surrounding circumstances.[51] According to Professor Farnsworth, the evidence to be considered includes the "circumstances surrounding the making of the contract and . . . any relevant usage of trade, course of dealing, and course of performance."[52] The court, however, may not consider prior negotiations.[53]

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45. FARNSWORTH, *supra* note 17, § 7.12, at 271.
46. *See id.*; WIGMORE, *supra* note 22, § 2462(2), at 199-200 (under the modern approach, a lawyer would not be safe in giving advice about a contract's construction).
47. *See* WIGMORE, *supra* note 22, § 2462, at 199.
48. Trident Center v. Connecticut Gen. Life Ins. Co., 847 F.2d 564, 569 (9th Cir. 1988).
49. Tinio, *supra* note 21, at 1392.
50. *See* RESTATEMENT (SECOND) OF CONTRACTS § 202 cmt. b (1979).
51. *See* CORBIN, *supra* note 20, § 536, at 29.
52. FARNSWORTH, *supra* note 17, § 7.12a, at 279-80.
53. *Id.*

The circumstances to be considered include the "persons, objects, and events to which the words are to be applied and which caused the words to be used" by the contracting parties.[54] A contract's words are given meaning in light of the circumstances.[55]

Unlike the "plain meaning" approach, the modern view does not require a threshold finding by the court that an ambiguity exists.[56] The question of the contract's meaning as a whole is a question of fact to be determined by the jury.[57]

A 1935 case demonstrates how opposite results obtain under the two approaches. An insured man left a life insurance policy to be paid to his wife upon his death. After his death, the insurance proceeds were automatically paid to his wife. As it turned out, the insured had two wives. The court held that the word "wife" meant the second, invalid wife. Everyone who knew the insured knew the second wife as the insured's wife; no one even knew the legal wife existed. All the circumstances indicated it was the second wife who was to benefit from the insurance policy. On its face, the insurance policy appeared to require the proceeds to be distributed to the legal wife; however, after considering the circumstances surrounding the issuance of the policy, the court determined that "wife" did not mean the legal wife.[58] Had the court only considered "wife" as it appeared in the policy, it is entirely possible that the legal wife would have been the beneficiary.

IV. THE NEW MEXICO SUPREME COURT ABANDONS THE "PLAIN MEANING" APPROACH AND ADOPTS THE MODERN APPROACH

In *Anthony*, the New Mexico Supreme Court rejected the "plain meaning" approach, overruling its cases adhering to the traditional rule. The court then adopted the modern view.[59] The court's underlying policy, its reasoning, and its explanation of how the new rule is to be applied in New Mexico are examined in the following paragraphs. This section concludes with a brief critique of the *Anthony* court's decision.

A. Determination of Ambiguity

Justice Ransom, writing for the New Mexico Supreme Court, emphasized that the underlying policy in interpreting contracts is to give a contract the meaning the parties "attached to . . . particular term[s] or expression[s] at the time the parties agreed to those provisions."[60] His-

54. CORBIN, *supra* note 20, § 536, at 28.
55. RESTATEMENT (SECOND) OF CONTRACTS § 202(1) (1979).
56. *Id.* § 202 cmt. a.
57. *Id.* § 212(2) (Supp. 1986); CORBIN, *supra* note 20, § 554, at 219. Of course, the question is one of law if the evidence is so clear that no reasonable person would interpret the contract in any way but one. *Id.* § 212(2) cmt. e (1979).
58. *In re* Soper's Estate, 264 N.W. 427 (Minn. 1935).
59. *Anthony*, 112 N.M. at 508-09, 817 P.2d at 242-43.
60. *Id.* at 509, 817 P.2d at 243.

torically, New Mexico cases have generally followed a "plain meaning" or "four-corners" standard for determining whether a contract is ambiguous and have excluded evidence of circumstances surrounding the transaction to explain the purposes and context of the contract.[61] The *Anthony* court, however, decided that its policy is better supported by the modern approach for interpreting contracts.[62]

The supreme court, in *Anthony*, accepted the reasoning of other states that have rejected the "plain meaning" approach and adopted the reasoning of respected authorities, including Professors Corbin and Farnsworth, and the second Restatement, all of which advocate the modern view.[63]

B. Question of Law or Fact

Justice Ransom concluded that to treat the issue of ambiguity as a question of law would "relegate to judicial review divination the determinative issues of many contract disputes."[64] Apparently, Justice Ransom shared with respected authorities a concern about the potential for judge-made contracts.

The *Anthony* court also explained how the newly adopted modern approach will function in New Mexico. In the past, the determination of whether an ambiguity exists had been a question of law to be determined by the court, and resolution of an ambiguity had been a question of fact to be decided by the fact finder.[65] The discovery and resolution of ambiguities under the newly adopted modern approach, however, are to be treated like any other fact question.[66] Interpretation of a word's meaning in a contract is a question of fact unless the evidence is "so clear that no reasonable person would determine the issue before the court in any way but one."[67] If there were but one interpretation of the issue, the question becomes one of law and it is the court's duty to decide the issue. Whether the evidence is disputed depends on witness credibility, or the existence of conflicting inferences; these issues are to be resolved by the fact finder.[68]

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61. *Id.* at 508, 817 P.2d at 242 (citing Clark v. Sideris, 99 N.M. 209, 213, 656 P.2d 872, 876 (1982); Acquisto v. Joe R. Hahn Enters., Inc., 95 N.M. 193, 195, 619 P.2d 1237, 1239 (1980)).

62. *See Anthony*, 112 N.M. at 504, 817 P.2d at 238.

63. *See id.* at 508-09, 817 P.2d at 242-43; CORBIN, *supra* note 20, § 542, at 101 (Supp. 1992) (the court's duty is to give effect to the reasonable expectations of the parties); FARNSWORTH, *supra* note 17, § 7.7, at 238 (the court's concern is with the expectations aroused in the parties by the contract's language); RESTATEMENT (SECOND) OF CONTRACTS §§ 202, 201, & 201 cmt. c. (1979) (the "primary search is for a common meaning of the parties, not a meaning imposed by law").

64. *Anthony*, 112 N.M. at 510, 817 P.2d at 244.

65. *Id.* at 509-10, 817 P.2d at 243-44 (citing Young v. Thomas, 93 N.M. 677, 679, 604 P.2d 370, 372 (1979); Paperchase Partnership v. Bruckner, 102 N.M. 221, 223, 693 P.2d 587, 589 (1985)).

66. *Id.* at 509, 817 P.2d at 243.

67. *Id.* at 510, 817 P.2d at 244.

68. *Id.*

C. Critique

Today, some respected commentators recognize that it is not possible to determine the parties' intent by merely looking within the four corners of a document.[69] A word's meaning varies according to the circumstances in which it is used.[70] Believing that the traditional approach will yield absolute security in interpretation is a "dream of the impossible."[71]

Although the modern view presents a risk of parties conveniently inventing an intent to fit their current needs,[72] there are limitations on the modern process. First, the words themselves limit how far the fact finder can go in the interpretation process.[73] "[T]here is a critical breaking point . . . beyond which no language can be forced . . . ."[74] Secondly, as Justice Ransom specifically cautioned in *Anthony*, extrinsic evidence is only admissible for the purpose of interpretation; it is not admissible to change, contradict, or expand the contract terms.[75] The *Anthony* court also noted that procedural limitations are available to protect the "integrity of the interpretation process," such as conditionally admitting evidence or making offers of proof.[76]

In New Mexico, contract interpretation is no longer subject to the "judicial sieve"[77] as a matter of law.[78] Rather, contract interpretation is now a question of fact to be decided in the context of all surrounding circumstances.[79]

V. CONCLUSION

In *Anthony*, the New Mexico Supreme Court overruled its previous cases and adopted a modern approach for interpreting contracts. The modern rule permits the court to consider evidence extrinsic to the contract to determine whether an ambiguity exists. The new rule furthers the policy of giving contracts the meaning intended by the contracting parties.[80]

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69. *See* CORBIN, *supra* note 20, § 536, at 27-28; RESTATEMENT (SECOND) OF CONTRACTS § 202 cmt. b (1979).
70. *See* RESTATEMENT (SECOND) OF CONTRACTS §§ 201 cmt. a, 202.
71. *See* WIGMORE, *supra* note 22, § 2462, at 199.
72. *Id.*
73. FARNSWORTH, *supra* note 17, § 7.10, at 259.
74. Eustis Mining Co. v. Beer, Sondheimer & Co., 239 F. Supp. 976, 982 (S.D.N.Y. 1917).
75. *Anthony*, 112 N.M. at 509, 817 P.2d at 242; *see* FARNSWORTH, *supra* note 17, § 7.12, at 272.
76. *Anthony*, 112 N.M. at 509 n.4, 817 P.2d at 243 n.4.
77. *See* Hurst v. W.J. Lake & Co., 16 P.2d 627, 630 (Or. 1932).
78. *See* RESTATEMENT (SECOND) OF CONTRACTS § 212 cmt. d (1979).
79. *Id.* § 212(2); CORBIN, *supra* note 20, § 554, at 219.
80. *See Anthony*, 112 N.M. at 509, 817 P.2d at 243.