

Chancery Court Explains Principles of Contract Interpretation

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In a recent Delaware Court of Chancery decision, the court explained several useful principles of contract interpretation and also provided insight into the methods the court uses to resolve ambiguous contract provisions. [Cyber Holding v. CyberCore Holding](#), C.A. No. 7369-VCN, one of Vice Chancellor John Noble's last decisions, resolved a contractual dispute related to a post-closing purchase price adjustment in connection with the sale of a company. The specific contractual dispute involved the seller's claim that it was entitled to payments that benefited the company, but were created prior to the closing. The seller claimed entitlement to the amount of tax liability that was reduced based on certain pre-closing deductions.

Basic Principles

The court applied several principles of contract interpretations and shared several uncommon musings that have practical application. In

a prior ruling in this case, the court denied cross-motions for summary judgment based on ambiguities in the applicable agreement. That determination permitted the introduction of extrinsic evidence. Although there was ambiguity in the agreement, the court reminded the parties that even when an agreement is "fairly susceptible to at least two interpretations," that does not exclude the possibility that one reading may be a more compelling interpretation. The court observed the truism that Delaware follows the objective theory of contract construction. This requires the court to construe an agreement according to the meaning, "which would be understood by an objective, reasonable third party." The court attempted to assess the agreement as a whole and to give each provision and term effect, so as not to render any part of the contract mere surplusage. The extrinsic evidence considered in order to ascertain the shared intention of the parties in this case included pre-signing negotiations, the drafting history of critical provisions, and the structure and context of the agreement.

The court referred to discussions between the two tax lawyers who negotiated the agreement's tax provisions. The day before the closing they discussed how they had differed on the interpretation of one of the provisions now in dispute, but the attorney for the buyer did not press the point. That fact is important because of the contract analysis concept known as the "forthright negotiator principle." That principle allowed the court to "adopt to the subjective understanding of one party that has been objectively manifested and is known, or should be known by the other party." Based on the facts of this case, however, the court determined that that principle did not apply because the "record does not support a finding of the type of disingenuous (or worse) conduct that is the foundation for the forthright negotiator principle." The court explained that the parties may have "agreed to disagree" because sometimes parties can accept words in an agreement while recognizing that there may be disagreements later about the meaning of those words. The court indicated that there must be some disingenuous (or worse) conduct in order for the forthright negotiator principle to apply.

The court also refused to apply the doctrine of contra proferentem. The court's reasons for not applying that doctrine included the fact that the parties specifically agreed not to use that doctrine as part of the agreement, and based on the court's finding that the parties were sophisticated and their equal bargaining strength made an application of the doctrine unnecessary.

Court's Reasoning and Musings

Importantly, the court reasoned that: "Although parties are not required to support their reading of a contract with a logical basis, courts should not aspire to an illogical interpretation, unless that accurately incorporates the parties' intent." The court also added what can be referred to as "contractual musings":

"Contract principles that guide the court—such as the tenet that all provisions of an agreement should be given meaning—do not necessarily drive the outcome. Sometimes apparently conflicting provisions can be reconciled, but in order to prevail on a contract claim a party is not always required to persuade the court that its position is supported by every provision or collection of words in the agreement. Such pervasive success may be what a party aspires to achieve and such success may make the court's task easier, but it is not essential."

The court added: "The meaning inferred from a particular provision cannot control the meaning of the entire agreement if such an inference conflicts with the agreement's overall scheme or plan." The court in this case found that "the meaning of the entire agreement" and the particular provision at issue supported the seller's claim.

After finding that the seller was entitled to the amount requested, the court held that prejudgment interest is a matter of right, and although the parties can waive that right by agreement, the provisions in the agreement in this matter did not waive that right.

Post-closing adjustments are frequently the source of contractual disputes and the decision in this case provides a helpful application of basic contract principles and related practical commentary that can be useful in similar disputes. •

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