What do the words mean: Different approaches to the interpretation of contracts

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ABSTRACT

Disputes about the meaning of contractual clauses are a common issue on construction projects. This is the case when dealing with bespoke contracts, but even standard forms of contract can give rise to such issues. All the more so in an international context when the parties' own native languages are not the ones used to draft, and operate, the contract. Different legal systems will have different ways of identifying what the words mean and whether, for example, it is possible to look at pre-contractual communications, the parties' conduct or whether the words make commercial sense. Clear drafting can help avoid such uncertainty, but there are differences on what constitutes good practice in drafting. This paper discusses the different approaches in different jurisdictions to interpreting contracts and what can be done to ensure that contracts are clear.

> *"Everyone outside a court …recognises that words are imprecise instruments for communicating the thoughts of one man to another"*
> (Lord Diplock in *Slim v Daily Telegraph* [1968] 2 Q.B. 157)

Introduction

Regardless of the legal system chosen, the words used by parties when writing their contracts form the basis for contractual relationships and if the words are not clear then the parties risk disputes as to their rights and obligations. Even when the words are clear disputes will often arise, simply due to the nature of words and the fluid nature of the meanings they can give rise to.

In 1984, Lord Goff stated that "*In point of fact, if not the meat and drink, then at least staple diet, of the Commercial Court can be summed up in one word – "Construction". Commercial lawyers – Solicitors, Barristers and Judges – spend a very substantial part of their time interpreting* contracts". This demonstrates one possible ambiguity with the use of the word construction and Lord Goff was certainly correct in highlighting the role that contract interpretation plays in disputes but he went on to say "*It is difficult to over-estimate the importance of standard forms in litigation which comes before the commercial court. It is not quite like the construction industry, with its handful of standard forms in use, often incorporated un-amended. But the construction industry, although perhaps the most important industry in this country, is perhaps the Cinderella of the Law Court…*"[1].

In that regard, the experience of those involved in the construction industry would suggest that the use of standard form contracts does not necessarily mean there are no disputes as to what contractual provisions mean. Even the best drafted standard forms cannot address all possible scenarios and the nature of words is such that once there is a dispute a party's advisers will often come up with arguments to support a party's position. The situation is exacerbated by the common practice of amending standard forms, which unless done with great care, will often increase the risk of inconsistent or unclear drafting.

[1] Commercial Contracts and the Commercial Court (1984) L.M.C.L.Q. 382

In addition, when projects are international and parties come from different backgrounds and do not share the same language, this will increase the risk of disputes about what the terms mean. This could be the result of a party failing to appreciate the meaning of contractual provisions and legal terms which are not in its native language or it could be the result of relying on inaccurate translations.

It should not be surprising that arguments about the interpretation of contracts are a common source of construction disputes and it is therefore important to understand how such disputes get resolved and what approach a tribunal would take. In that regard, there are some key differences between legal systems as to how such issues should be determined and, for example, whether contracts should be interpreted on an objective or subjective basis and is it allowed to look at drafts and other external documents or facts. This paper will consider the approaches of different legal systems, focusing on common law and civil law systems.

The common law

Under English, the interpretation of a contract is very much an objective exercise based on the identifying the meaning of the words the parties chose to express their intentions. That exercise is assisted by a number of rules, the 'cannons of construction' which provide, for example, that specific terms have priority over general terms and that clauses are not interpreted in isolation but in their context and as part of the overall document.

Being an objective exercise means that it is not necessary to consider what the parties intended or wanted the contract to mean or indeed what they think or believe it means. It is about the meaning of the words as understood by a reasonable person. That, however, is not always as simple as it sounds and as words are not precise instruments identifying the reasonable person's understanding is not a straightforward exercise.

While the words of the contract are always the starting point, in the late 20th century English law began to consider the context in which the contract was entered into as relevant to construction.

This move to a less literal interpretation was in the case of *Prenn v Simmonds*[2] where the House of Lords made the following statement "*In order for the agreement of July 6, 1960, to be understood, it must be placed in its context. The time has long passed when agreements, even those under seal, were isolated from the matrix of facts in which they were set and interpreted purely on internal linguistic considerations.".* The same sentiment was expressed later on in the decision in *Antaios Compania SA v Salen AB (The Antaios)*[3]. It was held in that case that "*If detailed semantic and syntactical analysis of words in a commercial contract is going to lead to a conclusion that flouts business common sense, it must be made to yield to business common sense*".

The leading House of Lords decision which put the emphasis on context and background as a move away from previous principles was the judgment of Lord Justice Hoffman in *Investor Compensation Scheme v West Bromwich Building Society*[4], where Lord Hoffmann stated that "*Almost all the old intellectual baggage of 'legal' interpretation has been discarded*" and identified five key principles to govern the interpretation of contracts, based on " …*the ascertainment of the meaning which the document would convey to a reasonable person having all the background knowledge which would reasonably have been available to the parties in the situation in which they were at the time of the contract.*"

The move away from literalism was demonstrated by the House of Lords in its later decision in *Sirius International Insurance v FAI General Insurance*[5] where it was stated that "*The standard of the reasonable commercial person is hostile to technical interpretations and undue emphasis on the niceties of language*" and an example was given by reference to the story of the tyrant Temures and the promise that no blood would be shed if the garrison of Sebastia surrendered. Temures kept his promise and buried them all alive.

The decision in *ICS v West Bromwich* put the emphasis on the factual background but also very much on the commercial context and the courts determining what would make commercial sense. Judges, who rarely come from a commercial background, may not however be suited to determine what makes commercial sense. Indeed, parties will sometimes enter into agreements that on their

[2] [1971] 1WLR1381
[3] [1985] AC 191
[4] [1997] UKHL 28
[5] [2004] UKHL 54

face make no commercial sense but are due to reasons known only to the parties (such a desire to enter a new market or an urgent need for revenue). The courts have acknowledged this and in *Skanska Rashleigh Weatherfoil Ltd v Somerfield Stored Ltd*[6], it was stated that "*judges are not always the most commercially-minded, let alone the most commercially experienced, of people, and should, I think, avoid arrogating to themselves overconfidently the role of arbiter of commercial reasonableness or likelihood*.". This was also acknowledged in *BMA Special Opportunity Hub Fund Ltd v African Minerals Ltd*[7] where it was stated that "*…parties should not be subjected to "…the individual judge's own notions of what might have been the sensible solution to the parties' conundrum".*

It is therefore perhaps not surprising that in recent years the English Supreme Court (which replaced the House of Lords in 2009) appears to have moved towards a more literal approach and less emphasis on the commercial context, while maintaining the overriding principle of interpretation as an objective exercise in determining the intention of the parties. This was discussed by the Supreme Court in *Rainy Sky SA v Kookmin Bank*[8] where Lord Clarke held that that where the language used by the parties is unclear the court can properly depart from its natural meaning where the context suggests that an alternative meaning more accurately reflects what a reasonable person with the parties' actual and presumed knowledge would conclude the parties had meant by the language they used but that this did not justify the court searching for drafting infelicities in order to facilitate a departure from the natural meaning of the language used.

The same principle was reaffirmed in *Arnold v Britton*[9], a case where leaseholders argued against a literal interpretation of a clause in a 99 year lease where the service charge would increase by 10% every year, which meant that by the end of the lease the charge would increase to £1,000,000 from the original amount of £90. Lord Neuberger identified seven factors that affected interpretation and stated that the reliance placed in some cases on commercial common sense and surrounding circumstances should not be invoked to undervalue the importance of the language of the provision which is to be construed. He went on to make the point that a lack of clarity does not

[6] [2006] EWCA Civ 1732.
[7] [2013] EWCA Civ 416 at paragraph 24, referring to *Jackson v Dear* [2012] EWHC 2060.
[8] [2011] UKSC 50
[9] [2015] UKSC 36

justify the court embarking on an exercise of searching for, let alone constructing, drafting infelicities in order to facilitate a departure from the natural meaning. He also observed that, while commercial common sense is an important factor to take into account when interpreting a contract, a court should be very slow to reject the natural meaning of a provision as correct simply because it appears to be a very imprudent term for one of the parties to have agreed, even ignoring the benefit of wisdom of hindsight.

The tension between the two approaches was described by Lord Hodge in *Wood v Capita Insurance Services Limited*[10] as follows:

> *"Textualism and contextualism are not conflicting paradigms in a battle for exclusive occupation of the field of contractual interpretation. Rather, the lawyer and the judge, when interpreting any contract, can use them as tools to ascertain the objective meaning of the language which the parties have chosen to express their agreement. The extent to which each tool will assist the court in its task will vary according to the circumstances of the particular agreement or agreements."*

Overall, the English approach to contract interpretation remains an objective exercises where the courts are not interested in the parties' subjective notions as to what the parties intended or thought they agreed, but what the words would mean to a reasonable third party. The fact that this could result in a meaning which may seem to lack commercial sense is not a reason to depart from the clear meaning of the words. As was held by Lord Justice Jackson in *Grove Development v Balfour Beatty*[11] "*…this is a classic case of one party making a bad bargain. The court will not, indeed cannot, use the canons of construction to rescue one party from the consequences of what that party has clearly agreed. There is no ambiguity in the present case which enables the court to reinterpret the parties' contract in accordance with "commercial common sense",…".* The same approach was reinforced recently by Lord Sumption who has suggested that the loose approach to the interpretation of contracts has done a disservice to commercial parties and that the time has come to reassert the primacy of language in the interpretation of contract[12].

[10] [2017] UKSC 24
[11] [2016] EWCA Civ 990
[12] A Question of Taste: the UK Supreme Court and the Interpretation of Contracts, The Rt Hon Lord Sumption, UK Supreme Court Yearbook 2016-22017 Vol 8 pages 74-88

Looking at another common law jurisdiction, American jurisprudence is a carry-over from the common law system of England; as such, it makes sense that contract interpretation under the law of the United States operates in an equally objective manner as that of English law.[13] Under US law, the language within a contract is given its plain grammatical meaning.[14] A court will determine the intent of the parties by looking at the words that are expressed within the contract documents, regardless of the parties' subjective intentions. If the contract language is unclear, a court may look to evidence of custom and usage.[15] But even with this objective review, there is some other intangible interpretation going on as "*courts construe contracts from a utilitarian standpoint bearing in mind the particular business activity sought to be served, and will avoid when possible and proper a construction which is unreasonable, inequitable, and oppressive.*"[16] If the contract language is unclear, a court may look to evidence of custom and usage.[17] When the plain and literal reading of the contract words does not make sense, or does not make commercial sense, a court may "*carry out the intention of a contract by transposing, rejecting, or supplying words to make the meaning of the contract more clear.*" Though, according to New York state law, carrying out the intention of the contract in this manner is done only when the absurdity would make the contract "*unenforceable in whole or in part.*"[18]

If the contract language is susceptible to more than one meaning or interpretation, the language is considered ambiguous.[19] Whether contract language is ambiguous is a question of law for a court to decide, but precisely what those ambiguous words mean, is a question of fact for a jury.[20] There are two primary types of ambiguity that American courts address: patent ambiguity and latent

[13] North American Rescue Products, Inc. v. Richardson, 769 S.E.2d 178 (S.C. 2013) ("Interpretation of a contract is governed by the objective manifestation of the parties' assent at the time the contract was made, rather than the subjective, after-the-fact meaning one party assigns to it.").
[14] *See* Baker v. White, 92 U.S. 176 (1875) (considering the meaning of an agreement, the Court reasoned, "It is possible so to construe the language of the instrument, if the surrounding circumstances demanded it. But to one who saw the paper for the first time, and knew nothing more, it would seem a forced, and not a natural construction.").
[15] Fifteenth Ave. Christian Church v. Moline Heating & Const. Co., 265 N.E.2d 405 (Ill. App. 1970).
[16] Hackberry Creek Country Club, Inc. v. Hackberry Creek Home Owners Ass'n, 205 S.W.3d 46, 56 (Tex. App.—Dallas 2006, pet. denied).
[17] Fifteenth Ave. Christian Church v. Moline Heating & Const. Co., 265 N.E.2d 405 (Ill. App. 1970).
[18] Jade Realty LLC v. Citigroup Commercial Mortg. Trust 2005-EMG, 980 N.E. 2d 945 (N.Y. App. 2012).
[19] Sky Angel U.S., LLC v. Discovery Communications, LLC, 885 F.3d 271 (4th Cir. 2018).
[20] Parkside Center, Ltd. v. Chicagoland Vending, Inc., 552 S.E.2d 557 (Ga. App. 2001).

ambiguity. Whether an ambiguity is patent or latent will determine whether an American court will consider evidence outside of the contract to determine the contract's actual meaning.[21]

A patent ambiguity is that which is obvious just by reading the contract. For example, where a contract's clauses conflict, permitting a method of construction and later forbidding the same, the document is patently ambiguous. A latent ambiguity is that which is not apparent by the words of the contract, but is that which becomes ambiguous due to external factors. For example, in the classic case *Raffles v. Wichelhaus*, a latent ambiguity was created when a contractual provision indicated that goods would arrive via a ship named *Peerless*, but at the time of the contract's execution, the parties were unaware that two ships of the same name were sailing on the specified day.[22]

When an American court determines that a latent ambiguity exists, depending upon the jurisdiction, the court may consider parol evidence (extrinsic evidence) to establish the parties' intent.[23] The Parol Evidence Rule prevents the introduction of evidence outside of the written document when that document is intended to be a complete and final expression of the parties' agreement.[24]

Additionally, American courts follow a cannon of construction that requires contractual provisions to be construed against the drafter. This means that ambiguities that are created in the contract language will be interpreted in the favor of the party who did not create the ambiguity.[25] This is similar to the English law principle of *contra proferentum*.

Due to the variety of contract documents that may exist on a typical construction project, and the likelihood that conflicts will exist between the many contractual provisions, it is typical for parties to include in their contracts an Order of Precedence Clause which attempts to alleviate the results of any ambiguities in a controlled manner. As an example, a typical project may include the

[21] MDS (Canada), Inc. v. Rad Source Tech., Inc., 822 F.Supp.2d 1263 (S.D. Fla 2011).
[22] 159 Eng Rep 375 (1864).
[23] National Union Fire Ins. Co. of Pittsburgh, PA v. CBI Industries, Inc., 907 S.W.2d 517 (Tex. 1995).
[24] Galmish v. Cicchini, 734 N.E.2d 782 (Ohio 2000).
[25] Klapp v. United Ins. Group Agency, Inc., 663 N.W.2d 447 (Mich. 2003).

following contracts between the owner and contractor: an agreement, a set of general conditions, a set of special conditions, drawings, specifications and perhaps other contract documents. In the contractual arrangement between the contractor and a subcontractor a subcontract agreement incorporating the preceding documents may also be present creating ample opportunity for clauses which appear to conflict. An Order of Precedence Clause is one that prioritizes the documents in a particular order. By specifying the precedence and priority of a specific contract document, it is clear on the face of the document how to resolve an ambiguity as between documents.

Although many jurisdictions within America follow the common law system, relying on precedence of prior judicial decisions, there are still areas of the country that follow a system of civil law, which relies on codified legal codes. These remnants of civil law, left over from colonial Spanish and French holdings of North American territories, remain relevant primarily in the American state of Louisiana. As an example, Louisiana Civil Code 2046 states that when it comes to contract interpretation, no further interpretation is needed or allowed when intent is clear.[26]

Therefore while the American system has the same emphasis on the objective meaning of the words as the English system, the use of the patent and latent ambiguity means that in some circumstances the court will look at extrinsic evidence. Further, in some parts the approach will be more similar to civil law than common law.

Civil law - Germany

German contract[27] law is governed by the German Civil Code, or Bürgerliches Gesetzbuch (the BGB). Codification of law means that the legislator provides the basic structures of an area of law followed through with very detailed set of legislated legal rules. There is also a strong tradition of detailed commentaries that are generally considered to be authoritative sources on the application of the law[28]. For example, under German law, the lease of an apartment requires nothing other to

[26] LA CIV. CODE 2046.
[27] Dr Wolfgang Breyer would like to thank Konrad Anderson for his assistance in the drafting of the German sections of this paper.
[28] See, for example; Münchener Kommentar zum Bürgerlichen Gesetzbuch, Munich, C.H. Beck München; Palandt Bürgerliches Gesetzbuch, Munich, C.H. Beck München; J. von Staudingers Kommentar zum Bürgerlichen Gesetzbuch, Berlin, Sellier – de Gruyter.

be agreed than the monthly lease amount and the beginning of the lease period - virtually everything else is regulated by the relevant section of the BGB (§ 535 to § 580a). Court judgments provide another source of interpretation.

The most fundamental provision of the German Civil Code on the interpretation of contracts is § 133 BGB, on the "Interpretation of a Declaration of Will" (Auslegung von Willenserklärung), which states that "when interpreting a declaration of will, the actual will (wirkliche Wille) [of the parties] must be ascertained, rather than the literal meaning of the words used." In German jurisprudence, this principle applies to the interpretation of contracts because contracts are considered to be the result of two corresponding declarations of the parties – offer and acceptance[29].

This apparently subjective approach is qualified, however by § 157 BGB, which stipulates that contracts must be interpreted in accordance with the requirements of good faith, with regard to commercial practice. German courts and legal academics use §§ 133 and 157 BGB together when interpreting contracts and do so on the basis of the objektiver Empfängerhorizont, or the "*objective perspective of the recipient of the declaration*"[30]. However, this test is distinguished to the objective method of interpretation under common law because the reasonable person is one in the position of the parties, including the parties' respective commercial positions, their circumstances and their interests as far as they were (or should have been) known to the addressee[31], rather than a reasonable person in possession of the full "*matrix of fact*"[32].

The first stage of the process of determining the actual will of the parties is to determine whether there is evidence that demonstrates a common intention of the parties as to the meaning of the contractual provisions. As stated by the Federal Supreme Court of Germany (the

[29] RGZ 99, 147 (148); *Armbrüster*, in: Münchener Kommentar, BGB, 2015, § 119 BGB note 59; *Mansel*, in: Jauernig BGB, 2018, § 133 BGB note 9.
[30] *Busche*, in: Münchener Kommentar, BGB, 2015, § 133 BGB note 12; *Mansel*, in: Jauernig BGB, 2018, § 133 BGB note 7 et seq.; BGH Judgement 3. 5. 2011 − XI ZR 152/09, NJW 2011, 2499 note 13.
[31] BGH Judgement 27. 1. 2010 - VIII ZR 58/09, NJW 2010, 2422 note 33; BGH Judgement 5. 10. 1961 - VII ZR 207/60, NJW 1961, 2251, 2253; *Mansel*, in: Jauernig BGB, 2018, § 133 BGB note 10; *Busche*, in: Münchener Kommentar, BGB, 2015, § 133 BGB note 28.
[32] *Investors Compensation Scheme Ltd. v West Bromwich Building Society* at fn 4

Bundesgerichtshof), "*if the true intention of the party who gives the declaration is established or even admitted at the time of issuing the declaration, and the other party has understood it in the same way, then this intention will determine the contents of the legal transaction without regard to anything else*"[33]. Even the principle of good faith in § 157 BGB will not override the shared subjective understandings of the parties of the meaning of the contractual provisions. This principle was most famously illustrated in the Haakjöringsköd case[34]. That case turned on the fact that in Norwegian, Haakjöringsköd means shark meat. The parties contracted for one party to supply Haakjöringsköd to the other. They mistakenly believed that the word refers to whale meat, rather than shark meat. Because the parties both subjectively and mistakenly believed that they had contracted for the supply of whale meat, the court found that the delivery of shark meat constituted a breach of contract.

It is only if no evidence can be found of a common intention of the parties as to the meaning of contractual provisions that the court will move to the second stage analysis that involves construing the imputed contractual provisions objectively in the manner outlined above. German civil procedure law accepts five types of evidence of intention. Those are: the professional opinion of an expert assigned with giving his opinion on a certain matter by the court[35], visual inspection by the court[36], official certificates[37], hearing of the parties in court[38] and hearing of witnesses in court[39]. So, E-Mails and drafts of the contract can be used as evidence, but also the questioning of the parties themselves or possible witnesses of the parties' negotiations. This stage of contractual interpretation is itself considerably different to the common law approach, in that German law does not limit the admissibility of relevant external materials in the process of interpretation, including the parties' previous statements of subjective intent, the previous negotiations between the parties and their subsequent conduct.

[33] BGH Judgement 26.10.1983 - IV a ZR 80/82, NJW 1984, 721, 721.
[34] RG Judgement 08.06.1920 - II 549/19, RGZ 99, 147.
[35] §§ 402-414, Code of Civil Procedure
[36] §§ 371-372a, Code of Civil Procedure
[37] §§ 415-444, Code of Civil Procedure
[38] §§ 445-455, Code of Civil Procedure
[39] §§ 373-401, Code of Civil Procedure;

In interpretation from the objektiver Empfängerhorizont, the following factors apart from the wording of the contract are all considered by the court[40]:

1. The history of the parties' dealings; i.e. pre-contractual communications.
2. The statements of the parties as to their intentions.
3. Current business practice.
4. The purpose of the contract and the interests of the parties.

As can be seen, the German law approach is very different from the common law, in seeking to identify the subjective intention of the parties and being open to review all available evidence.

Civil law - Brazil

The Brazilian Civil Code (BCC 2002) provides for interpretative rules that govern all legal transactions ("negócios jurídicos"), including contracts and wills. The main general rules in this regard are set out in articles 112 and 113 of BCC 2002, which provides as follows:

> *"Art. 112. In declarations of will, more heed shall be given to the intention embodied in the declaration than to the literal meaning of the language."*
>
> *"Art. 113. Juridical transactions shall be interpreted in conformity with good faith and the practice of the place in which they are made."*

The main goal of contractual interpretation is to ascertain the parties' declaration of will as embodied in the terms of the contract. However, the contracting parties' intentions are not to be entirely disregarded. These are relevant to the extent that they can be found in the declarations of will that frame the agreement.

[40] *Busche*, in: Münchener Kommentar, BGB, 2015, § 133 BGB note 28; *Mansel*, in: Jauernig BGB, 2018, § 133 BGB note 3, 10; *Wendtland*, in: BeckOK BGB, 2018, § 133 BGB note 25; BGH Judgement 30.06.2011 − VII ZR 13/10, NJW 2011, 3287, 3288.

In other words, if a certain intention cannot be extracted from the terms of the contractual declarations, such intention is irrelevant from the interpreter's perspective, since it is only the intention embodied in the declaration that matters. This is the opinion expressed by Eduardo Espínola, former Chief Justice of the Brazilian Supreme Court:

> *"It is precisely the regard to good faith and confidence of the parties, and the consequent responsibility of the party for its declaration that mandates, in the case of legal interpretation of the legal act, that the intention embodied in the declaration is to be given weight, instead of seeking the personal understanding of the declarant party."*[41]

The same line of reasoning is shared by Moreira Alves, also a former Chief Justice of the Supreme Court and the scholar in charge of drafting the section of the Civil Code regarding this matter:

> *"On the other hand, when the Project specifies, in Article 110 [which currently corresponds to Article 112 of the Civil Code] that 'in the declarations of will more attention shall be paid to the intention embodied therein instead of to the literal meaning of the language', it aimed to make very clear that the rule determines that attention shall be paid to the intention embodied in the declaration and not to the personal understanding of the declarant party."*[42]

To correctly assess the meaning of a given declaration of will, the interpreter's starting point must be the language adopted in the contract. Under Brazilian law, the term "literal meaning" employed in article 112 of BCC 2002 stands for the natural and ordinary meaning usually attributed to the set of words under interpretation. Pontes de Miranda, possibly the most influential Brazilian legal scholar, seconds this idea:

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[41] ESPÍNOLA, Eduardo. Parte geral – Dos factos jurídicos (arts. 74 a 160), in LACERDA, Paulo de (coord.), *Manual do Código Civil brasileiro*, Rio de Janeiro, Jacintho Ribeiro dos Santos, 1923, p. 186.
[42] MOREIRA ALVES, José Carlos. *A Parte Geral do Projeto de Código Civil brasileiro: subsídios históricos para o novo Código Civil brasileiro*, 2ª ed., São Paulo, Saraiva, 2003, p. 108.

> *"The legal rule of interpretation laid down in Article 85 [of the Civil Code of 1916, which preceded Article 112 in the current Civil Code] requires that the intention or purpose of the declarant party should be seen through the literal meaning. In no way it was said that the literal meaning is unimportant, or that the intention could be sought to understand something different from what was said; it was only explained that the intention would serve with or even exclude the literal meaning, in the interpretation of the expressed intention [...]. What was expressed is the form of what was wanted, although incompletely or deficiently declared. It is not permitted for the legal act to be given any other content than the one it has, such as the will expressed; all the more because the word may have a meaning that only existed between the parties or between the declarant party and the recipient. It is here, at this precise point that more weight shall be given to the intention than to the literal meaning of the language."*[43]

The literal meaning is the sense the word has in current usage; its frequent sense, according to the dictionaries. If commercial practices, or the use notoriously adopted by the declarant party, or its use within the circle of people to whom the declarant party addressed itself which gave the word another meaning, this is the meaning of the word in the legal act, not that given in the dictionary or by the general population.

If the words have a single meaning, without any doubt as to another meaning, no interpretative investigation needs to be done: the clarity and single meaning of the terms employed shall form a barrier against the freedom of interpretation by the parties, or by the judge. The subject of interpretation is not the personal will that the party could have expressed, but the will that was expressed, which demonstrates the real will of the declarant party. The will must be expressed; what was not expressed, does not enter the legal sphere; the mere intention, which was not expressed, cannot be used for interpretation. The in-depth analysis is of what was expressed.

[43] PONTES DE MIRANDA, Francisco Cavalcanti. *Tratado de Direito Privado*, t. III, 4ª ed., São Paulo, RT, 2012, pp. 333/334.

Article 113 of BCC 2002, on the other hand, emphasizes that all legal transactions must be interpreted in conformity with good faith and the uses of the place of where the contract is to be executed.

The relevance of the objective meaning of the declaration is highlighted by Brazilian law, given that both good faith and ordinary uses are objective criteria. In particular, the interpretation in accordance with good faith requires the interpreter to take into account how a reasonable person under normal circumstances would comprehend a given contractual clause:

> *"Interpreting the legal transaction in accordance with objective good faith is, ultimately, replacing the relevant point of view and placing, in a previously defined environment (situational context), not the party or parties of the legal transaction, not the declarant party or the recipient party of the declaration of will, but the model of an imaginary normal and reasonable person, in order to determine the meaning that such abstract person would give to the declaration of will, in the same circumstances that the real declarant party and recipient party were in."*[44]

Therefore, it is safe to conclude that, upon the combined application of articles 112 and 113 of the BCC 2002, a contract is to be analyzed objectively and, in doing so, the interpreter should bear in mind (i) the contract as a whole; (ii) the contract's economic purpose; and (iii) the circumstances that surround the execution and the performance of the contract. In this context, the interpreter must always be aware that it is wrong to adopt an interpretation that deprives part or parts of the contract of any reasonable sense. An interpretation that confers sense to the contract as a whole, as a harmonic set of clauses, should always prevail.

Therefore, interpreting a contract as a whole requires, first, that each clause be interpreted taking into consideration all other clauses agreed by the parties in the same contract, regardless of where they stand therein. This means that a clause cannot be interpreted as if it were independent or

[44] MARINO, Francisco Paulo De Crescenzo. *Interpretação do negócio jurídico*, São Paulo, Saraiva, 2011, p. 185.

isolated from the rest of the contract. Much on the contrary, it must be read and interpreted jointly with all other contractual provisions.

This general orientation also requires the interpreter to give meaning, purpose and effect to each and every single one of the contractual provisions, for all clauses have been agreed to by the parties and, as such, an interpretation that render any clause meaningless is not adequate.

In what concerns the second criteria that the interpreter should bear in mind when analyzing a contract, that is, its economic purpose, we must consider that contracts are the juridical part of an economical operation of free circulation of goods. In this purpose, they have a socio-economic role and the interpreter should look for concreteness in the trading structure.

Finally, in what regards the third criteria, that is the circumstances that surround a given legal transaction, the interpreter should always consider the context in which the contract was entered into and the parties' status and behavior, in order to fully assess the meaning of the declarations expressed by them.

With no intent to circumscribe the list of contextual elements to be taken by the interpreter, it is possible to mention (i) the time and place of the legal transaction(not only the time and place of its formalization, but also the time of the parties' past and future behaviours); (ii) the nature of the parties (especially when it concerns intuitu personae legal transactions) and an eventual relationship between them; (iii) parties behaviours, including past and future behaviours relating to the conclusion of a legal transaction (especially, in the context of contracts, the negotiations and the contract formation); (iv) features of the goods that are the object of the juridical transaction (goods subject of the obligation, goods to be transferred or any goods related to the legal transaction); (v) 'subject matter of the legal transaction' or 'nature of the legal transaction' (characteristics of the legal transaction); and (vi) uses and customs (its interpretative feature).

The status of pre-contractual communications

Most contracts are subject to detailed negotiations in which the parties set out their position and will often explain their reasoning based on the commercial background. Evidence of such discussion would therefore seem directly relevant when seeking to interpret a contract at a later time. As noted above, this is the civil law approach but under English law, however, such evidence

is not admissible. This is a point which often comes as a surprise to parties, who understandably assume that if the correct meaning is clear from such documents then the court would consider that evidence.

This was confirmed as the third principle identified by Lord Hoffmann in *ICS v West Bromwich*, who considered this point again a few years later in *Chartbrook v Persimmon Homes*[45]. When Lord Hoffman considered the question of whether evidence of pre-contractual negotiations could be used in order to interpret a contract, he made it clear that this would require the House of Lords to depart from a long and consistent line of authority but at the same time he accepted that it would be consistent with the English objective theory of contractual interpretation to admit evidence of previous communications as part of the background which may throw light on what the parties meant. However, despite stating that there were no conceptual limits to what could properly be regarded as the background he concluded that there was no basis for departing from the exclusionary rule.

The exclusion of pre-contractual communications remains a valid principle but it is not always easy to distinguish pre-contractual communications from the factual background. This was demonstrated by the Supreme Court's later decision in *Oceanbulk Shipping and Trading SA v TMT Asia Limited*[46]. That case concerned the interpretation of a settlement agreement, which followed without prejudice discussions between the parties. TMT claimed a breach of the settlement agreement and the issue was the interpretation of a specific contractual provision in the settlement.

TMT argued that the meaning would be clear if the previous without prejudice emails and meetings that took place before the parties entered into the settlement agreement were considered by the Court. The trial judge decided that evidence of the pre-contractual discussions was admissible but the Court of Appeal came to the opposite conclusion. When the case came before the Supreme Court, it reversed the decision of the Court of Appeal. This was on the grounds that the interpretation of a settlement agreement was on the same basis as any other agreement and in that regard evidence was admissible as part of the factual matrix. The without prejudice rule is intended

[45] [2009] UKHL 38
[46] [2010] UKSC 44

to protect parties from the courts considering statements made in order to reach settlement, but that consideration was no longer relevant if the parties had reached agreement.
As noted above, whether pre-contractual discussions are admissible in evidence as part of the factual background will depend on the facts but in general, the English courts will consider such evidence as irrelevant when seeking to interpret contracts[47].

In the US, however, the position is less clear cut but for different reasons. Most US jurisdictions will not consider extrinsic evidence to "*add to, detract from, or vary the terms*" of a contract.[48] However, if the terms of a contract cannot be determined, the rules change. As noted above, where the court considers that there is a latent ambiguity, the court will look at extrinsic evidence, including the parties pre-contractual communications. The Supreme Court of California has held that just because the terms of an agreement appear clear to a judge, that the judge's understanding is not indicative of whether the parties to the contract "*chose the language of the instrument to express different terms.*"[49] A contract must be interpreted to give effect to the mutual intent of the parties as much as possible.[50] Where there is clear evidence that a mutual mistake exists, the mistake is material to the agreement, and that the written contract does not reflect the true agreement between the parties, a court may allow reformation of the contract.[51]Obviously, when the court is dealing with a claim of mistake (i.e. the written agreement does not accurately reflect the "deal" that was made) the court must look beyond the terms of the written agreement.

The position under German law is quite different and pre-contractual communications, amongst other evidence extrinsic to the text of the contract, is admissible evidence in contractual interpretation. On the face of it, § 133 BGB appears to clearly require that the wording of the terms will not necessarily override extrinsic factors that could be drawn upon to establish the actual or presumed intention of the parties, since § 133 BGB stipulates that the actual will of the parties must be ascertained, as opposed to the literal meaning of the words used.

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[47] For two recent examples, see *Northrop Grumman Mission Systems Europe v BAE Systems* [2015] EWCA Civ 844 and *Kason Kek-Gardner Ltd v Process Components Ltd* [2017] EWCA Civ 2132
[48] Pacific Gas & Elec. Co. v. G.W. Thomas Drayage & Rigging Co., 442 P.2d 641 (Cal. 1968).
[49] Id.
[50] Universal Sales Corp. v. Cal. Press. Mfg. Co. 128 P.2d 655 (Cal. 1942).
[51] Howmedica Osteonics Corp. v. Wright Medical Technology, Inc., 540 F.3d 1337 (Fed. Cir. 2008).

However, in the interests of legal certainty, it is no simple task for a party that wishes to overturn the written terms of a contract to rely on extrinsic materials to add to or vary the written terms of a contract. Under German law, the text of the contract remains the starting point of the interpretation of the contract, and there is in fact a presumption that the written agreement is complete, as summarized in a judgment of the Federal Court of Justice: "*The presumption of completeness and accuracy of the written instrument is valid if the text of the instrument, according to its wording and internal context and taking into account commercial practice, is a manifestation of a particular content of the transaction.*"[52] Judgments with regards to specific principles bear this principle out. For example, a party that claims that an unequivocal statement was meant in a different way bears the onus of proof for such a contention[53] and in another case it was held that a party that seeks to derive a benefit from the text of a contract bears the burden of proof with regard to any evidence that lies beyond the four corners of the written contract[54]. Hence, external factors, including pre-contractual communications, will rarely add to, vary or contradict the text of the written contract.

The presumption of the completeness and accuracy of written contracts is strengthened where the parties have used writing for formal reasons. In such a case, the courts engage in a two-step process. The first step is the ascertainment of the content of the contract. Rarely, this may lead to a rebuttal of the presumption and lead the court to an interpretation that does not correspond to the literal meaning of the document. This could result in the contract being invalid, as the formal writing requirements have not been met. According to the "theory of indication" (*Andeutungstheorie*), this then requires the court to look to the text to see if the true content of the contract is "at least somehow, maybe even imperfectly indicated", "reflected" or "alluded to" in the written text in order to stave off the invalidity of the contract[55].

The use of standard forms

[52] BGH Judgement 5.07.2002 - V ZR 143/01, NJW 2002, 3164 Guideline 1.
[53] BGH Judgement 31.05.1995 - VIII ZR 193/94, NJW 1995, 3258, 3258; BGH Judgement 22.06.1956 - I ZR 198/54, NJW 1956, 1313.
[54] BGH Judgement 26.10.1983 - IV a ZR 80/82, NJW 1984, 721, 722.
[55] See BGH Judgement 17.02.2000 - IX ZR 32/99, NJW 2000, 1569, 1570.

As an be seen from the above, both common and civil law systems see the written document as the basis for identifying the meaning of a contract and if that document is clear, then the court is unlikely to look at anything else. In that context, the use of standard forms of construction contracts should reduce disputes about the meaning of contractual provisions. Such standard forms are drafted carefully by experienced industry practitioners and are updated to take account of developing legal principles. That is not however to say that the use of standard forms will avoid the risk of disputes about the meaning of contractual provisions and it is the case that the different approaches outlined above for each legal system could result in different outcomes.

By way of example, it is interesting to consider the decision of the Privy Council in *NH International Caribbean Limited v National Insurance Property Development Company Limited*[56] which considered the meaning of clause 2.5 of the FIDIC Red Book 1999 form of contract and held that it amounted to a time bar on the employer, stating that "*"…it is hard to see how the words of clause 2.5 could be clearer. Its purpose is to ensure that claims which an employer wishes to raise, whether or not they are intended to be relied on as set-offs or cross-claims, should not be allowed unless they have been the subject of a notice, which must have been given "as soon as practicable".* This may have come as a surprise to some employers, especially when the requirement to notify as soon as practicable could result in a very short period.

The position under German law, however, would be quite different. First of all, if as is usual, the Employer had been found to have been the issuer of the FIDIC terms, AGB law would not apply, AGB law only protects the consumers of AGB terms[57] and the way would be open to enforcing Clause 2.5 of the FIDIC Red Book 1999. If we were to suppose that the Contractor had been the issuer, AGB law would protect the Employer in the following ways: Firstly, terms that attempt to exclude all set-off are void[58]. Secondly, the requirement under Clause 2.5 is for the Employer to give notice as soon as practicable, and under § 305c II BGB any terms the interpretation of which is uncertain are interpreted in favour of the "other party". Under German law clauses in construction contracts that require the Employer to give notice in two weeks are void[59]. Hence, "as

[56] [2015] UKPC 37
[57] *Grüneberg*, in: Palandt, Bürgerliches Gesetzbuch, 2018, pre § 305 BGB, note 8.
[58] *Grüneberg*, in: Palandt, Bürgerliches Gesetzbuch, 2018, § 309 BGB, note 17-21.
[59] BGH Judgment 28.10.2004 – VII ZR 385/02, NJW-RR 2005, 247, 248.

soon as practicable" might be interpreted as less than two weeks, and because of the operation of § 305c II BGB, and this might also make the term void.

In the UK, the most established form of standard building contract is the JCT form of contract. It has been around since 1932, reflecting an earlier form produced in 1903. But it was only last year that the courts had to look at the question of whether an extension of time is added contiguously at the end of the contractual period for construction or overlaid depending on when the employer's risk event took place. This can make a significant difference were the damages for delay are not at a constant rate over the delay period. This was considered by the Court of Appeal in *Carillion Construction Limited v Emcor Engineering Services Limited*[60], which concerned a claim by a main contractor against a subcontractor and losses due to delay. The Court of Appeal considered that words used in the contract and held that any extension of time is added contiguously. It recognised this could anomalies and over or under recovery, but these were not sufficient to replace the natural meaning the words used.

The other risk with standard forms is that they are often amended by the parties to reflect additional terms agreed or a different allocation of contractual risk. In that respect, it is interesting to note that one of the most common issues in construction disputes, the approach to concurrency of delay events, is not addressed by standard forms of construction contracts[61]. This has led to bespoke amendments that seek to set out an agreed approach to concurrency but bearing in mind the complexity of the legal principles involved, it is not surprising this has also given rise to difficulties.

In *Northern Midland Building Ltd v Cyden Homes Limited*[62] the extension of time clause in the JCT Design and Build 2005 form of contract was amended to add the words "*…any delay caused by a Relevant Event which is concurrent with another delay for which the Contractor is responsible shall not be taken into account…".* The court approached this as a question of interpretation and

[60] [2017] EWCA Civ 65
[61] The 2017 edition of the FIDIC suite of contracts provides at clause 8.5 for parties to set out how concurrency should be dealt with but does not say on what basis
[62] [2017] EWHC 2414 (TCC)

found that the words were crystal clear and there was no rule of law preventing parties from agreeing how concurrency should be addressed.

Similarly, in the United States there are a whole host of standard forms that are used including but not limited to the AIA suite of documents published by the American Institute of Architects, EJCDC suite of documents published by the Engineers Joint Contract Documents Committee, ConsensusDocs suite of documents published by the Associated General Contractors. In addition there are standard forms promulgated relative to particular contract delivery method such as the DBIA suite of documents published by the Design Build Institute of America and standard document forms for particular industries in particular states, such as the Texas Association of Builders suite of documents for various residential construction contracting scenarios. For federal contracting, the federal acquisition regulations provide some standardization, subject to potentially competing interpretations by the various federal circuits.

Given the wide scope of standardized documents and the parties propensities to customize them to address particular risks and reflecting that there are fifty different state jurisdictions and the federal law, each of whom might have a potential twist on their interpretations and their particular construction related legislation, it is hard to achieve any widespread benefit from a standardization of terms with respect to legal interpretation.

In contrast, in Germany there is largely one form of contract which sets out the standard terms and conditions of construction contracts, which is the VOB/B. This needs to be seen in the context of the significant role played by Standard Terms of Contract (Allgemeine Geschäftsbedinungen or AGBs) in German contract law, and the specific legal rules that apply to such contracts that affect how they are interpreted. They also have a specific definition. In the words of § 305 BGB, AGBs consists of "*all those contractual terms which are formulated in advance for a multitude of contracts which one party [the issuer (Verwender)] presents to the 'other party' upon entering into a contract*". Such terms may cover the complete content of the contract or individual parts of the contract. Standard Terms must have been pre-formulated for use in multiple contracts, and it has been considered sufficient for the terms to have been intended to be used in more than two

different contracts for them to be considered to be Standard Terms[63]. Lastly, the terms have to be dictated by the issuer to the "other party", rather than negotiated in detail.

The German courts have set a very high bar with regard to when parties have individually negotiated the terms of a contract. For example, an invitation to make amendments to or reject standard terms does not pass the test[64]. Furthermore, it is not sufficient for the "other party" to be given the choice between choosing variations of conditions or to be merely invited to fill in gaps in price or time.[65] Rather, the court will have to be satisfied that the issuer of the terms made a genuine attempt to consider alternatives to its standard terms suggested by the consumer and gave the "other party" genuine scope to negotiate[66]. FIDIC, NEC4 and other standard form international construction contracts fall under this definition, provided the last requirement is met. Where AGBs form part of a contract, they are generally interpreted using the general rules on the interpretation of contracts, as outlined in the previous sections. However, there are certain particular rules that apply to AGBs.

While the use of AGBs has significant benefits, including dramatically shortening the timeframe of contract negotiation, they are typically, including in the construction industry, drafted by issuers (generally employers) on a "take or leave it" basis, to the detriment of contractors. As a result, German law places particular limits on AGBs. There are two different contexts in which the interpretation of AGBs is affected by these limits: First of all, in proceedings to set aside unfair standard terms (Unterlassungsklage), the court will attempt to construe an interpretation of the terms that is as detrimental as possible to the interests of the "other party"[67]. If, during this process, the court finds it possible to interpret the imputed standard terms in a manner that is unreasonably

[63] BGH Judgement 27.01.2000 - I ZR 241/972, NJW 2000, 2677, 2677, cf. *Helmut Köhler*, id. § 16 note 8
[64] BGH Judgement 05.05.1986 - II ZR 150/85, NJW 1986, 2428, 2429 et seq.; *Helmut Köhler*, id. § 16 note 8
[65] See BGH Judgement 27.04.1988 - VIII ZR 84/87, NJW 1988, 2465, 2466; *Grüneberg*, in: Palandt, Bürgerliches Gesetzbuch, 2018, §305 BGB note 18 et seq; BGH Judgement 20.03.2018 – X ZR 25/17, NJW 2018, 2067 note 12 et seq.
[66] BGH Judgement 03.11.1999 - VIII ZR 269/98, NJW 2000, 1110, 1111; Wiebke Seyffert, id. § 10.08 [2], 10-115; Andreas Stadler/Michael Huber, German terms of Business, in: Wendler, Michael, Tremml/Bernd, Buecker, Bernard, Key Aspects of German Business Law, 3rd ed. Berlin (2006), 88.
[67] *Micklitz/Rott*, Münchener Kommentar, ZPO, 2017, § 1 UKlaG note. 13 (reference to *Basedow*, in: Münchener Kommentar, BGB, 2016, § 305c BGB, note 34, 35); BGH Judgement 18.03.2015 – VIII ZR 185/14, NJW 2015, 1594 note 22; BGH Judgement 29.04.2008 – KZR 2/07, NJW 2008, 2172 note 19; BGH Judgement 23.09.2009 – VIII ZR 344/08, NJW 2009, 3716 Guideline 1.

adverse to the interests of the "other party" (kundenfeindlich), the term will be judged to be void[68]. Outside proceedings to set aside unfair contract terms, the court attempts to interpret standard terms in a different manner.

The court looks at the terms from a neutral perspective, and if no clear meaning is determined, the meaning that is favourable to the "other party" is adopted in order to preserve the condition and carry on with the proceeding[69]. Under proceedings that are not Unterlassungsklage, there are also two rules that affect how AGBs are interpreted. The first is the ambiguity rule (Unklarheitenregel), which applies to AGBs as per § 305c para. 2 BGB where the interpretation of a clause is ambiguous. In this case, the interpretation that favours the "other party" (generally the Contractor in the construction industry) is chosen by the court if the term would be invalid for unreasonably disadvantaging the Contractor under the law as to standard terms if the alternative interpretation is chosen[70]. The second relevant rule is that where the parties have negotiated individual terms and those terms contradict the standard terms, the individually negotiated terms will prevail[71].

In the context of international construction law, the use of FIDIC contracts under German law poses its own set of problems arising from their origins as derivations from English standard form contracts. For example, time-bar provisions have been held to be void under German law, as demonstrated by a case involving the VOB/B (German Standard Terms and Conditions of Construction Contracts). In that matter, the Employer insisted on modifying § 2 Abs. 6 of the VOB/B, which allows the Contractor to claim for unforeseen but necessary works, with a time bar clause of similar character to Sub-Clause 20.1 of the 2017 FIDIC books, and that clause was struck out by the court[72].

Another issue arises with regard to an inconsistency between the English-law process of taking over in the FIDIC books and Acceptance (Abnahme) under German law. Under Sub-Clause 10.1

[68] BGH Judgement 29.04.2008 – KZR 2/07, NJW 2008, 2172, note 19; *Stadler*, in: Jauernig BGB, 2018, § 305c BGB, note 7.
[69] BGH Judgement 23.09.2009 – VIII ZR 344/08, NJW 2009, 3716 note 8; *H. Schmidt*, in: BeckOK BGB, 2018, § 305c BGB, note 55; *Basedow*, in: Münchener Kommentar, BGB, 2016, § 305c BGB, note 35.
[70] *Basedow*, in: Münchener Kommentar, BGB, 2016, § 305c BGB, note 35.
[71] *H. Schmidt*, in: BeckOK BGB, 2018, § 305b BGB, note 9.
[72] BGH Judgement 20.12.1990 - VII ZR 248/89, NJW-RR 1991, 534, 535.

of the FIDIC books, the Works are ready for Taking Over when the Works have been substantially completed in accordance with the Contract (apart from minor defects) and passed the Tests on Completion. This is not the same as the German equivalent of Abnahme, which consists of physical acceptance of the works, coupled with acknowledgement by the Employer that the Works are essentially in accordance with the contract apart from minor defects[73]. Although this theory has not been tested by German courts, it is likely that the Abnahme of Works under FIDIC contracts would not take place until after the Engineer has issued a Performance Certificate, which states that the Contractor has fulfilled its obligations under the Contract. The Performance Certificate is not issued until the end of the Defects Notification Period, which is a contractually specified period under FIDIC contracts for the rectification of defects following Taking-Over.

Parties to FIDIC contracts where German law is the applicable law should be aware that the German Civil Code (BGB) stipulates a warranty period of 5 years following Acceptance (Abnahme) for buildings with regards to any defects[74]. Hence, if a FIDIC contract under German law stipulates a Defects Notification Period of 2 years, the Contractor could possibly be held responsible for defects for 7 years. FIDIC contracts under German law should be amended accordingly.

Conclusions

Having considered various legal systems, it is clear that one should not assume that there is a single approach to interpreting a contract. While it is the case that all legal systems use the express wording agreed by the parties as the starting point, if that does not provide a clear answer, the approach under different legal systems will begin to diverge. This is certainly the case when one considers the civil law emphasis on the actual and subjective intention of the parties, but even between common law systems there are differences as one can see from the application of the doctrines which deal with patent and latent ambiguity in US law as opposed to English law.

[73] Sprau, in Palandt, Bürgerliches Gesetzbuch, 2018, § 640, note 3.
[74] § 438 I No. 2 Bürgerliches Gesetzbuch.

When it comes to a commercial context, the interesting question is whether the end result would be different or would eventually all courts reach the same conclusion. The Hakkjöringsköd case relied on the parties' subjective intentions to determine whether they meant whale meat or shark meat but it is likely that an English court would have come to a similar conclusion, relying on principles such as estoppel by convention or the private dictionary principle[75].

What seems common among all jurisdictions is that the use of standard forms does not mean that there are no disputes as to the correct interpretation of contractual provisions. All the more so when it seems common practice to amend such standard forms and thereby reduce the potential certainty which could be achieved by using such forms. The answer therefore appears to be that parties and their lawyers to continue to ensure that their drafting is as clear as possible.

[75] See for example *Partenreederei MS Karen Oltmann v Scarsdale Shipping Co Ltd, The Karen Oltmann* [1976] 2 Lloyd's Rep 708