

Recent Developments in European Contract Law
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Interpretation of Contracts

Introduction

Situation in the national laws:

- the Nordic laws, French, Belgian, Luxembourg, German, Austrian, Italian, Greek, Dutch and Spanish law: "Interpretation according to the common intention" (Similar to Art. 5:101 PECL, see later)
- English and Irish Law used to be different: not permitted to search for the intention outside the document; nowadays:
 - if meaning of the words used in document is not clear: commercial certainty and factual matrix of the contract
 - in general: interpretation in favour of commercial sense even if contrary to literal meaning of the words used
- Scottish law: "Interpretation according to common intention as expressed in contract". See the later discussed CASE 1.

Article 8 CISG

- (1) For the purposes of this Convention statements made by and other conduct of a party are to be interpreted according to his intent where the other party knew or could not have been unaware what that intent was.
- (2) If the preceding paragraph is not applicable, statements made by and other conduct of a party are to be interpreted according to the understanding that a reasonable person of the same kind as the other party would have had in the same circumstances.
- (3) In determining the intent of a party or the understanding a reasonable person would have had, due consideration is to be given to all relevant circumstances of the case including the negotiations, any practices which the parties have established between themselves, usages and any subsequent conduct of the parties.

Article 4.1 UNIDROIT-Principles

- (1) A contract shall be interpreted according to the common intention of the parties.
- (2) If such an intention cannot be established, the contract shall be interpreted according to the meaning that reasonable persons of the same kind as the parties would give to it in the same circumstances.

For the interpretation of contracts, the PECL provide in CHAPTER 5 several rules (Art. 5:101 – 5:107). Especially their Art. 5:101 is similar to the mentioned rules in CISG, UNIDROIT Principles and most of the European national laws:

Article 5:101 PECL: General Rules of Interpretation

- (1) A contract is to be interpreted according to the common intention of the parties even if this differs from the literal meaning of the words.
- (2) If it is established that one party intended the contract to have a particular meaning, and at the time of the conclusion of the contract the other party could not have been unaware of the first party's intention, the contract is to be interpreted in the way intended by the first party.
- (3) If an intention cannot be established according to (1) or (2), the contract is to be interpreted according to the meaning that reasonable persons of the same kind as the parties would give to it in the same circumstances.

Especially in Paragraph (1) we see:

- combination of subjective and objective method
- in conflict between words written and the common intention, the common intention prevails.

Illustration 1:

The owner of a large building employs a painting firm to repaint the "Exterior window frames". The painters repaint the outsides of the frames of the exterior windows and claim that they have finished the job. The owner claims that the inside surfaces of the frames to exterior windows should also have been painted. It is proved that the owner and the representative of the painting firm had clearly contemplated both surfaces being done.

Is the owners' claim right?

Illustration 2:

A, a fur trader, offers to sell B, another fur trader, hare skins at € 1 a kilo; this is a typing error for € 1 a piece. In the trade hare skins are usually sold by the piece and, as there are about six skins a kilo, the stated price is absurdly low. B nonetheless purport to accept.

What contract have the two of them agreed?

Illustration 3:

A clause in an insurance contract provides that the policy covers the theft of jewellery only if there has been "clandestine entry" into the place where the jewellery was. An individual, A, pretends to be a telephone repairman and presents himself to Madam B's home repair to her telephone. A distracts B with some pretext and takes the opportunity to steal her jewels. The insurance company refuses to pay up on the basis that there has been no "clandestine entry".

Does the insurance company have to pay under the contract?

CASE 1:

Bibby Factors Ltd. (Bibby) obtained a guarantee from J. Brady (Brady) to secure Bibby's rights arising from a Factoring Agreement between Bibby and another company. The guarantee stated the following:

"B. In consideration of your agreeing to conclude an agreement with the Company ("the Factoring Agreement")... " Brady

"2. Undertake to pay you (Bibby) on demand all money now or at any time owing to you (Bibby) by the company."

Later Bibby sought to recover from Brady, in terms of the guarantee, all sums which were owed to them by the company. Brady maintained that, on a proper construction of the guarantee, its scope was restricted to sums properly payable by the company to Bibby under the Factoring Agreement, and that he, Brady, was not liable in respect of certain sums advanced by Bibby to the company without any relation to the Factoring Agreement.

Who is right?

The Scottish Inner House of the Court of Session held - similarly to the provision Art. 5:101 para 1 PECL - :

Common intention is to be derived from the particular contractual context in which the guarantee was given; this intention prevails plain and unrestricted meaning of the words.

(Bibby Factors Scotland LTD v. Joseph Brady (Scottish Inner House of the Court of Session, 18 May 2005, see: ERPL 2005, 897)).

The unified laws (UNIDROIT Principles, CISG and PECL) provide also details concerning the relevant circumstances that shall be regarded in interpreting the contract:

ARTICLE 4.3 UNIDROIT Principles:

In applying Articles 4.1 and 4.2, regard shall be had to all the circumstances, including

- (a) preliminary negotiations between the parties;
- (b) practices which the parties have established between themselves;
- (c) the conduct of the parties subsequent to the conclusion of the contract;
- (d) the nature and purpose of the contract;
- (e) the meaning commonly given to terms and expressions in the trade concerned;
- (f) usages.

Article 8 CISG

... (3) In determining the intent of a party or the understanding a reasonable person would have had, due consideration is to be given to all relevant circumstances of the case including the negotiations, any practices which the parties have established between themselves, usages and any subsequent conduct of the parties.

Article 5:102 PECL: Relevant Circumstances

In interpreting the contract, regard shall be had, in particular, to:

- (a) the circumstances in which it was concluded, including the preliminary negotiations;
- (b) the conduct of the parties, even subsequent to the conclusion of the contract;
- (c) the nature and purpose of the contract;
- (d) the interpretation which has already been given to similar clauses by the parties and the practices they have established between themselves;
- (e) the meaning commonly given to terms and expressions in the branch of activity concerned and the interpretation similar clauses may already have received ;
- (f) usages; and
- (g) good faith and fair dealing.

Illustration 1:

A German manufacturer (A) of office supplies has engaged B to represent A in the north of France. The contract is for 6 years but it may be terminated without notice if B commits a serious non-performance of its obligations. One of these obligations is to visit each of the 20 universities in the area "every month".

Assuming that this obligation applies only to the months when the universities are open and not to the vacations, B only visits each university 11 times a year. A knows this from the accounts which are submitted to him by A.

After 4 years A purports to terminate the contract for serious non-performance. Does the contract allow this?

Illustration 2:

The manager of a large real estate development makes a fixed price contract with a gardening company for the maintenance of the “green spaces”. The manager later complains that A has not repaired the boundary wall.

Does the contract allow this?

Illustration 3:

A has made a franchise contract with B. One of the clauses provides that B shall pay for goods that he receives from A within 10 days. For a three month period B pays within 10 working days. Then A demands payment within 10 days including holidays.

Does the contract entitle him to this?

Illustration 4:

A wine merchant from Hamburg buys 2,000 barrels of Beaujolais Villages from a co-operative cellar B. In Beaujolais a barrel contains 216 litres, whereas a Burgundian barrel contains more.

Illustration 5:

A film producer A and a distributor B make a distribution contract in which there is a clause providing for payment of a certain sum if the number of exclusive screenings (i.e. screenings only in a single cinema or chain of cinemas) is less than 300,000. A meant exclusive for the whole of France, B only for the Paris region. According to usages in the French film industry, exclusivity means exclusivity only in the Paris region.

Situation in the national laws:

- Similar to these rules: French, Belgian, German, Austrian, Italian, Greek, Portuguese, Spanish, Danish, Swedish and Scottish law (see QUESTION).
- English and Irish Law are different: no consideration of pre-contractual negotiations and subsequent conduct of the parties (see CASE 2).

QUESTION:

- How should email statements be interpreted, as written communication or as face-to-face / telephone communication?
- See: Outer House, Scottish Court of Session, Opinion of Lord Clarke in *Spring Salmon and Seafood Limited v. Wisco Processing Limited and others*, 29 September 2004:

Lord Clarke:

-cautious approach, in view of the immediacy of such communications, and the fact that senders may ignore standard rules of grammar and vocabulary.

-e-mail messages should not be invested with an importance beyond that which would be given to words exchanged during a phone call.

Why? Because:

"The notion is what the parties had in mind, and the Court is entitled to know what was going on around them at the time when they were making the contract. This applies to circumstances which were known to both parties, and to what each might reasonably have expected the other to know". (dictum of Staughton L J in the case of *Youell v Bland Welch* (1992)).

"It is, however, trite that in interpreting a provision in a contract the Court may 'enquire beyond the language and see what the circumstances were with reference to which the words were used ..." (dictum of Lord President Rodger in *Bank of Scotland v Dunedin Property Investment Company Limited*).

CASE 2:

Bride Ltd. (Bride) sold a property to St. George Ltd. (St. George), who were required to build flats and sell them; Bride was entitled to a payment - 'overage' – based on the price the flats were sold for.

Concerning the payment: Was St. George entitled to deduct amounts paid for car parking spaces, when he sold them together with the flats?

1. Decision by the High Court (the Deputy Judge):

- "I infer that all 40 permitted parking spaces were in fact sold with individual flats under agreements expressing the flat and the parking space to be sold for a single price and that where a parking space was included in the sale both flat and parking space were conveyed by a single lease."
- In those circumstances St. George could not justify deduction from those prices or the elements representing the parking spaces.

2. St. George appealed against this decision because the Deputy Judge had given undue weight to "the events which have happened"

3. Decision by the English Court of Appeal (LJ Maurice Kay):

- To some extent the subsequent events may well be no more than illustrative of the factual background of which the parties were aware.
- Since however, evidence to this assumed factual background was not before the Court or before him he disregarded it.
- The Deputy Judges reliance on subsequent events "was unnecessary and misplaced"

(Court of Appeal (Civil Division), 18th February 2004, Bride Hall Estates Limited Openboard Limited - and - St George North London Limited)

→ English law does still not consider subsequent events; St. George was not entitled to deduce the prices for the car spaces.

Thank you for your attention!