Interpretation of Contracts

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Académie des Privatistes Européens (Coordinateur: G. Gandolfi), *Code Européen des Contrats*, 2001 (quoted: CEC); J. Beatson, *Anson's Law of Contract*, 28th edition 2002; C.M. Bianca, *Diritto Civile*, III, Il Contratto, 2nd edition 2000; C. v. Bar, E. Clive, H. Schulte-Nölke (et. al. eds.), *Principles, Definitions and Model Rules of European Law – Draft Common Frame of Reference (DCFR) – Outline Edition*, 2009; G. Cian, A. Trabucchi, *Commentario breve al codice civile*, 2008; J. Ghestin, *Traité de droit civil, La formation du contrat*, 3rd edition 1993; J. Ghestin et al., *Traité de droit civil, Les effets du contrat*, 3rd edition, 2001; W. Flume, *Allgemeiner Teil des Bürgerlichen Rechts*, II, 4th edition 1992; H. Kötz, *Europäisches Vertragsrecht*, vol. I, 1996; O. Lando, H. Beale (eds.) *Principles of European Contract Law*, I and II, 2000 (quoted: PECL); K. Larenz, M. Wolf, *Allgemeiner Teil des Bürgerlichen Rechts*, 8th edition 2004; A. Lüderitz, *Auslegung von Rechtsgeschäften*, 1966; H. Mazeaud et al., Leçons de droit civil, Tome II, vol. I, *Obligations. Théorie générale*, 9th edition, 1998; D. Medicus, *Allgemeiner Teil des BGB*, 9th edition 2006; J. Neuner, *Vertragsauslegung – Vertragsergänzung – Vertragskorrektur*, Festschrift für Claus-Wilhelm Canaris vol. I, 2007, p. 902 et seq.; P.-A. Rodriguez et al., *Comentario del Codigo Civil*, 2nd edition 1993; G.H. Treitel, E. Peel, *The Law of Contract*, 12th edition 2007; R. Zimmermann, *The Law of Obligations, Roman Foundations of the Civilian Tradition*, 1990.

1 Theoretical Background

1.1 General Characteristics – Interpretation as an Element of Hermeneutics

The issue of interpretation arises when there is an ambiguity in the content of a contract. This is an omnipresent phenomenon of contract law: Even a thoroughly drafted and apparently precise contract may, under close scrutiny, prove to be in need of interpretation. Virtually every understanding of a contract presupposes and is – albeit often unsaid – based on interpretation. In fact, the mere statement that a contract does not require or allow interpretation constitutes in itself an act of interpretation and the result of such an interpretation. From a philosophical point of view, the topic of interpretation of contracts forms a part of hermeneutics, i.e. the general theory of understanding human expressions. Indeed, there are some general hermeneutic insights which also guide the interpretation of contracts. The founding principle of hermeneutics, for instance, that the interpretation of a word is influenced by its context, applies to a contract just the same as to a piece of literature. The idea that a text can be "more intelligent than its author" and, accordingly, often has a meaning which the author was totally unaware of sometimes proves as useful for contracts as for other sorts of texts.

More important, however, than such connections with the general theory of hermeneutics are the peculiarities of the interpretation of contracts. For the recipient of a love letter, for example, it only matters whether its author *really* meant his or her words, even if this understanding has found no outward expression but has remained purely inward. On the contrary, a contract could obviously not fulfil its legal and economic function if the purely internal understanding of the author were decisive in every case. A similar statement can be made about the ambiguity of words. For example, a poet may use ambiguities on purpose as a stylistic device so that the interpreter has to highlight them whereas the parties of a contract, and therefore also its interpreter, should avoid ambiguities as far as possible. Finally, the autonomous significance of interpreting contracts as compared to other fields of hermeneutics becomes obvious if one looks at the phenomenon of *lacunae*. While a *lacuna* in a contract may potentially be filled by "constructive" interpretation (cf. 3.3.2), a scholar of literature would thoroughly misunderstand his job if he supplemented a drama by a scene which the author himself failed to write or whose text was lost. The interpretation of contracts is therefore primarily determined by *legal* requirements and value judgments. Consequently, the *legal* principles on which contractual interpretation is based have to be considered first.

1.2 Self-determination and Freedom of Contract as Starting Point

The interpretation of contracts must comply with their function which is primarily to allow the parties to settle their legal relations at their discretion. Nowadays, the principle of freedom of contract

applies as a general rule in all European legal systems.[1] This is aptly expressed in Art. II.–1:102 DCFR: "Parties are free to enter into a contract and to determine its contents, subject to any mandatory rules". Similarly, Art. 2.1. CEC states: "*Les parties peuvent librement déterminer le contenu du contrat, dans les limites imposées par les règles impératives, les bonnes mœurs et l'ordre public*…".[2] While the Treaty of the European Communities does not explicitly guarantee the principle of freedom of contract, it is generally accepted as a fundamental underlying idea[3] because the exercise of the expressly stated Community freedoms is only conceivable on the basis of freely negotiated contracts.

1.2.1 The Justification of Freedom of Contract

The principle of freedom of contract has several roots. From an ethical point of view, it is based upon the idea that the state must respect the autonomy of the individual. This assumption can be derived from the dignity of man and his right of "free development of his personality", of "pursuit of happiness" or similar concepts. These rights are violated if the state does not generally leave it to the individual to regulate their relations themselves, but prescribes every detail of their interaction; by doing so the state turns into a guardian of the individual, and this is irreconcilable with its dignity – a notion that has won nearly complete recognition in Europe since the age of enlightenment. Thus, freedom of contract is an expression of the legal self-determination of the human being and, as such, a sub-category of the autonomy of the individual.

In addition, the principle of freedom of contract has a foundation in political theory. It corresponds both to the ideas of democracy and of separation of powers. *Democracy* and freedom of contract are based upon the same basic values: on legal liberty and on the equality of the citizens. *Hans Kelsen* justly called the contract a "markedly democratic method of creating rights and duties" because the "subjects that are to be bound participate in the creation of the binding rule"[4]. The link to the idea of democracy also becomes quite obvious if one considers the classic wording of Art. 1134 CC: "*Les conventions légalement formées tiennent lieu de loi (!) à ceux qui les ont faites*". The notion of *separation of powers* is strengthened considerably by a free contractual exchange[5] – in particular if free competition is warranted as well. This is because freedom of contract counterbalances the concentration of power in the government by shifting, within its area of operation, the competence to take legal decisions from the government to the citizen.

Finally, modern welfare economics accentuate and describe more precisely the *social* function of free contracting. According to the *Pareto* criterion, the *voluntary* exchange by contract is the paradigm of economic efficiency. The individual exchange and its efficiency correspond on the collective level with the institution of the market: The mechanism of the market brings the independent transactions to perfection and, when operating ideally, creates *Pareto* efficiency. Thus, contractual freedom and the market provide for an efficient distribution of resources and lead to a maximisation of social wealth while, of course, not exhaustively solving the problem of just distribution. Accordingly, the primary postulate of the *Coase* theorem is that a legal system should allow the voluntary exchange of goods and facilitate it by lowering the cost of transactions.[6]

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[1] Cf. the overview in PECL, 2000, p. 99 seq.

[2] A caveat for "the requirements of good faith and fair dealing" was also stipulated in Art. 1:102 (1) PECL which was the model for Art. II.–1:102 DCFR and in the "interim outline edition" of the DCFR, where it has been eliminated in the final revision. For a critique see H. Eidenmüller, F. Faust, H.C. Grigoleit, N. Jansen, G. Wagner, R. Zimmermann, JZ 2008, 529, 537 seq. = OJLS 2008, 659, 678 = RTD eur., 695, 781.

[3] Cf. ECJ Judgment of 05/10/1999 (Spain/Commission), C- 240/97, ECR 1999 p. I-6571, 6634 (no. 99); S. Grundmann, JZ 1996, 274, 278; 591.

[4] Cf. H. Kelsen, *Reine Rechtslehre*, 2nd ed. 1960, p. 285.

[5] See F. Bydlinski, *Privatrecht und umfassende Gewaltenteilung*, in: 2. Festschrift für Wilburg, 1975, 53, 67.

[6] Cf. in more detail e.g. R.A. Posner, *Economic Analysis of Law*, 7th ed. 2007, § 1.2. = p. 23 seqq.; H. Eidenmüller, *Effizienz als Rechtsprinzip*, 3th ed. 2005, p. 41 seqq.

1.2.2 The Function of Interpretation: Ascertaining the Intention of the Parties

If the basic function of the contract is to allow the parties to determine their legal relations as they see fit, the function of interpretation is to ascertain the intentions of the parties. The right of self-determination, taken seriously, necessarily includes the freedom to pursue and to agree to something unreasonable – just as the vote in a democratic decision is not subject to any control of reasonableness. Not reason but the intentions of the parties, therefore, form the basis of the contract according to the maxim: "*Stat pro ratione voluntas*".[7] This implies that the legal system only has to make sure that the decision of the parties is as free as possible not only in its legal but also in practical circumstances.

This assumption is in accordance with the fact that the economic goal of efficiency is to achieve at the greatest possible compliance with the individual preferences. Thus, the assessment of personal utility is left to the sole discretion of the individual. It is no contradiction that this utility is also measured by its monetary value because money, in economic theory, merely has an instrumental character in relation to the individual evaluation of the utility. The individual determines the monetary value of his utility in the context of the transaction. However, this again does not preclude discussion on the issue of just distribution.

Accordingly, it is not legitimate to impose "reasonable" solutions upon the parties by means of interpretation. Rather, the goal of interpretation is to determine the intention of the parties – primarily the actual, alternatively the hypothetical intention. Only if this fails may one resort to the "reasonable" intention; because then it has to be assumed that the parties are rational actors and thus intended something reasonable in case of doubt. The prevalence of the actual over the reasonable intention is generally acknowledged in all European legal systems[8] and also forms the basis of the rule of Art. II. – 8:101 DCFR (~Art. 5:101 PECL) and of the similarly phrased rule of Art. 8 CISG (for more detail see 2.1. and 2.2.). Under Italian law, for instance, it is widely held that the rule of Art. 1366 CC "*Il contratto deve essere interpretato secondo buona fede*" is subordinate to Art. 1362 CC "*Nell'interpretare il contratto si deve indagare quale sia stata la commune intenzione delle parti…*".[9] By contrast, it is questionable that Art. 39.4. CEC rules: "*En tout état de cause, l'interprétation du contrat ne doit aboutir à un résultat qui soit contraire à la bonne foi ou au bon sens*". If the parties intended such a result in an agreement it is not the task of interpretation to correct it. If a correction should prove to be necessary at all, it should be based on the rules questioning the *validity* of contracts as a matter of law. The external nature of the correction and the policy reasons that justify this correction should be openly addressed as, for example, in cases of mistake, misrepresentation, fraud, unfair exploitation or unfair standard terms etc.

1.3 Legal Certainty, Protection of Reliance and Individual Responsibility as Correlatives of Self-determination

1.3.1 The Problem of a Diverging Understanding by the Parties

There are (at least) two parties involved in a contract. Therefore the intention of only one party cannot form by itself the authoritative criterion for the interpretation of the contract because it constitutes a purely psychological internal state and, as such, is generally not discernible by the other party. Thus, one cannot simply resort to the internal intention of the declaring party if the addressee understood the declaration differently. Conversely, the understanding of the addressee cannot be authoritative by itself if it differs from that of the declaring party. These statements result directly from the principle of freedom of contract and from the idea of self-determination. If contract terms which one of the parties neither intended nor could discern were regarded as authoritative, his freedom of contract would be disregarded and his self-determination would virtually be turned into heteronomy.

On the other hand it would go too far to consider a contract invalid whenever the parties understood its terms differently. This would largely deprive the contract of its suitability as an effective instrument for regulating the relations between the parties. It is therefore a compelling

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[7] Cf. W. Flume, *Allgemeiner Teil des Bürgerlichen Rechts II*, 4th ed. 1992, § 1, 5.

[8] See the overview given in PECL, 2000, p. 290 seq.; H. Kötz, 1996, p. 166.

[9] Cf. G. Cian, A. Trabucchi, 2008, Art. 1366, sub II. Some authors, however, attribute priority to the interpretazione secondo buona fede; see e.g. C.M. Bianca, 2000, p. 420, 424.

imperative of legal certainty to hold a party to a contract under certain circumstances even if he was mistaken about its terms. Similarly, a party has to be protected in his reliance on the effectiveness and the terms of the contract if he understood it "correctly". It is generally fair and reasonable to hold the erring party to the "correct" terms because of, and insofar as he is responsible for, his "incorrect" understanding. Like every freedom, the freedom of contract and, accordingly, contractual self-determination correspond with responsibility which restricts self-determination as far as it is necessary to protect individual reliance and the functioning of the markets.

1.3.2 The Standard of Reasonableness and Good Faith as the Resolution of Diverging Understandings

What is the measure to determine the "correct" understanding of the contract if both parties have a different perception of it? One could take the perspective of a non-involved third party, but this would be in conflict with the fact that the declarations are generally – i.e. apart from special situations such as declarations in commercial papers or in corporate contracts (see below 2.5.3) – not made to be received and understood by an "outsider" but by the addressee. Therefore, it is consequent to take the addressee's perspective as the relevant point of view because the contract is an act of communication with this party only and it concerns only his or her interests. To define this perspective more precisely, one has to assume that the addressee seeks to grasp the understanding of the declaring party in a reasonable way and in good faith. Under the postulate of individual responsibility, on the one hand, it is not expecting too much of the declaring party to be bound by a reasonable and fair understanding and, on the other hand, only reliance in such an understanding deserves protection by the law.

Therefore, this view has two sides. The declaring party *as well as* the addressee is held to an understanding which the latter party was able to have and ought to have had when a standard of reasonableness and good faith is applied. The test works *equally* for and against *both* parties: As little as the declaring party can allege his understanding if it is unreasonable or contrary to the requirements of good faith, he cannot be held to an unreasonable or unfaithful understanding the addressee might have had. In this manner, the conflict described under 1.3.1 is resolved in a fair balance. It is useful – while not crucial – to accentuate the notion of good faith in this balancing approach besides the criterion of reasonableness. The latter concerns mainly the aspect of rationality whereas the former has a connection to the principle of fairness. This is to say that a self-centred understanding of the contract may still seem reasonable from the perspective of one of the parties, but it is not an understanding in good faith and therefore the legal order cannot take it as a standard for the interpretation of a contract.

This view is generally shared in all European legal systems.[10] Art. 5:101 (3) PECL, which is modelled after Art. 8 (2) CISG, consequently refers to the perspectives of the parties by stating that "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". The corresponding rule of Art. II.–8:101 (3) (a) of the DCFR adopts the reasonableness test but lacks the reference to the individual parties and circumstances. This variance is due to imprecise drafting rather than to a conceptual divergence. Obviously, the main challenge of interpretation is to find out what a reasonable and fair understanding of a contract is. To give an answer to this question all circumstances of the individual case may be relevant (see in more detail below sub 2.1).

A different matter is whether a party may avoid the contract by reasons of mistake if he has misunderstood the content of the contract. Some legal systems, such as the German, the Swiss and de facto the Italian as well, have special rules for such a mistake ("*Inhaltsirrtum*"), whereas most legal systems and Arts. II.–7:201, II.–7:202 DCFR (~Arts. 4:103, 4:104 PECL), Art. 151 CEC treat such a mistake like other mistakes.[11] This issue belongs to the doctrine of mistake which is the subject of another chapter of this book.[12] It should be emphasised in this context, however, that the rules of interpretation are to be applied with priority, i.e. a remedy on the grounds of mistake may only be

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[10] Under Portuguese law, for instance, the rule of Art. 236 CC almost literally corresponds to Art. 5:101 (3) PECL. Furthermore see the overview in PECL, 2000, p. 291 and the citations in note 19.

[11] See E.A. Kramer, *Der Irrtum beim Vertragsschluß – eine weltweit rechtsvergleichende Bestandsaufnahme*, 1998, p. 87 seqq.

[12] See chapter # in this book by M. Fabre-Magnan and R. Sefton Green.

taken into consideration if the contract cannot be interpreted in accordance with the assumptions of the mistaken party.[13]

1.3.3 "Subjective" and "Objective" Interpretation: The Will Theory and the Theory of Declaration

A theory of interpretation which is based on the actual intention of the parties is often called "subjective" whereas a theory which emphasises the external signs of the communicative act, such as the literal meaning of declaration in particular, is characterised as "objective". This antagonism pervades the entire history of interpretation while the prevalence of one position over the other sometimes changed.[14] It is characteristic that Roman Law knew two different maxims of interpretation as the proposition of *Papinian* "*In conventionibus contrahentium voluntatem potius quam verba spectari placuit*"[15] and the word of *Paulus* "*Cum in verbis nulla ambiguitas est, non debet admitti voluntatis quaestio*"[16].

Historically, the objective approach with its focus on the literal meaning of the words has been the starting point. This is related to the fact that in legal systems whose development has not yet reached an advanced level there is obviously a strong leaning to formalism and therefore an over-emphasis of the role of the literal meaning of contract terms. In the course of legal and judicial development, however, the modes of interpretation have become more refined and more flexible. Correspondingly, the idea of freedom of contract – which is the underlying principle of "subjective" interpretation – had to gain acceptance bit by bit against the original notion that only certain types of contracts are admissible.

Systematically, there are different issues underlying the conflict between "subjective" and "objective" interpretation. The first problem is the formalism caused by overemphasising the literal meaning of the contract. The result of such formalism can be that the parties are bound to the terms of the contract even if they have mistakenly phrased them or made them cover a situation which neither of the parties could have reasonably meant. Modern laws in principle reject such formalism. The French Code Civil, for instance, rules in Art. 1156: "*On doit dans les conventions rechercher qu'elle a été la commune intention des parties contractantes, plutôt que de s'arrêter au sens littéral des termes*". This formula is matched by the Italian rule of Art. 1362 CC almost literally and, likewise, the German BGB demands in § 133 BGB "*nicht an dem buchstäblichen Sinne des Ausdrucks zu haften*".[17] Nevertheless the historical approach of formalism still has a certain influence today, albeit in modified forms (see 2.5.1 and 2.5.2 below).

The term "objective" interpretation serves a different function when it is used to describe the perspective of a reasonable party as the basis of interpretation. This perception is not about overemphasising the literal meaning of a declaration, but about its divergence from the intention of the declaring party. In this respect the "objective" approach takes into account that the declaring party has not appropriately expressed his intention and therefore the addressee cannot reasonably consider the actual intention as relevant for the interpretation of the contract. In modern contract law, this aspect of "objective" interpretation has prevailed for good reason, as we just have described above under 1.3.2. Yet, this "objective" approach does not proceed "formalistically" in the sense of being strictly bound to the literal meaning, but it allows an unlimited variety of other criteria to be considered in addition and besides the meaning of the words (see in more detail under 2.1).

With respect to this function of "objective" interpretation, one can draw a certain parallel to the dispute between the will theory and the theory of declaration, which played a major role in the 19th century legal discourse especially in Germany. This dispute has, however, no practical consequences for the theory of interpretation. This is to say that even the advocates of a strict will theory cannot argue that the intention of the declaring party determines the terms of the contract even if it could not have been recognised by the addressee. Doing so would mean to disregard the intention of the latter

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[13] See e.g. PECL, p. 230 seq.

[14] A comprehensive historical analysis is provided by R. Zimmermann, p. 621 seqq.

[15] Pap. D. 50, 16, 219.

[16] Paul. D. 32, 25, 1.

[17] With the same wording under Austrian law § 914 ABGB.

and would therefore be contradictory to its own premise. Even on the basis of a strict will theory, therefore, differences between the intention of a party and the "objective" meaning of his declaration can only have a practical impact on the question whether the contract is invalid or subject to rescission, which is answered to the affirmative under German law in § 119 Abs. 1 BGB (*Inhaltsirrtum*). The dispute between the will theory and the theory of declaration therefore becomes only relevant for the doctrine of unilateral mistake and does not prejudice the issue of interpretation.[18]

1.4 The Scope of Interpretation

Interpretation is not only about the content of an agreement, but also about the logically prior question whether or not a contract has been formed at all. In some cases it may be doubtful whether a declaration is to be understood as an offer or just as an invitation to the other party to make an offer of his own (*invitatio ad offerendum*), in other cases it has to be determined whether a declaration is an offer to enter into a contract or just a declaratory message to confirm that an alleged contract has been formed before etc. To answer such questions, no other rules are to be applied than those which govern the process of specifying the contract terms.

The rules of interpretation can also be applied without modification to declarations that are not expressed in words, but merely through a certain conduct. It is common currency in contract law that a conclusive form of conduct - for example a certain motion of the head or raising a hand in a public auction - may be sufficient to imply a binding contract. This is, for example, expressly emphasised in Art. II.–4:102 DCFR (~Art. 2:102 PECL) and in § 863 (1) of the Austrian ABGB. There may often be doubts about whether the conduct shown is in fact conclusive. This, too, is a problem of interpretation and therefore one has to ask how the other party reasonably had to understand the conduct in question.

2 Rules of Interpretation

The rules of interpretation in the different European legal systems largely overlap, as all national approaches are based on the described fundamental principles and their implications.

2.1 General Principle: The Intention as Seen from the Perspective of the Addressee

According to the principles discussed above (see 1.3.), most European legal systems and the DCFR attempt to strike a balance between subjective and objective considerations.[19] The content of a contract is primarily determined by the actual intentions of the parties (Arts. II.–8:101 DCFR ~ 5:101 (1) PECL). The fundamental goal of interpretation, therefore, is to establish what the intention of each party was at the time of contracting. As far as their intentions correspond, they form the content of the contract. The objective aspect of interpretation concerns the perspective that is adopted in order to determine the intention of each party. In this context, the content of each declaration has to be determined separately and the perspective of the addressee has to be adopted (cf. above 1.3.2). It is crucial how the addressee could reasonably understand the declaration in view of the individual circumstances of the case (Arts. II.–4:102, II.–8:101 (3), II.–9:102 (1) DCFR ~ Arts. 2:102, 5:101 (3), 6:101 (1) PECL).

In ascertaining the perspective of a reasonable addressee, it is generally irrelevant whether the declaring party knew or could have known that perspective. The declaring party is sufficiently protected by the rule that his reasonable perspective is relevant for the interpretation of the corresponding declaration of the other party. If the two declarations do not correspond, the parties do not consent and no valid contract is formed.[20]

When establishing the meaning of a contract, the judge must consider all circumstances which allow him to draw conclusions with regard to the intentions of the parties at the time of contracting.

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[18] To the same effect H. Kötz, 1996, p. 171 with note 22; J. Ghestin, 2001, no 386.

[19] See e.g. J. Beatson, 2002, p. 31; G.H. Treitel, E. Peel, 2007, para 6-01; J. Ghestin, 1993, no. 390; J. Ghestin et al., 2001, no. 9 seqq., H. Mazeaud et al., 1998, no. 123; G. Cian, A. Trabucchi, 2008, Art. 1362, sub X. Moreover Artt. 4.1, 4.2 Unidroit Principles.

[20] Such a dissent, however, is rare because usually the reasonableness test defines identical perspectives for either party; for examples see below sub 3.1.

Special consideration has to be given to the circumstances of the negotiations. In certain cases, circumstances which occurred before the state of negotiations – e.g. particular practices which the parties have established between themselves – or after conclusion of the contract – e.g. the specific handling of a certain aspect of performance mutually agreed upon – may also be taken into account.[21] It should, however, be emphasised that, from a theoretical perspective, those circumstances, regardless of when they occurred, are only circumstantial evidence as to the *parties' intentions at the time of contracting*.

The content of a declaration is to be determined objectively only to the extent that the addressee can reasonably rely on the "normal" use of language, "the regular" meaning of a certain conduct etc. It is therefore not justifiable to use an "absolutely objective" standard, i.e. a standard which is entirely independent from the individual situation and purely based on the declaration itself or its wording. Moreover, it is almost impossible to obtain such an "absolutely objective" perspective. In evaluating an act of communication, it is generally unavoidable to respond to the individual circumstances of the case, e.g. the branch of trade involved, the objectives of the parties etc. Otherwise, one can hardly identify the meaning of words and of other means of expression used. This approach is consistent with the general rules of hermeneutics under which an act of communication is to be understood only with reference to its context. It is therefore rather inaccurate and oversimplifying to contrast a subjective approach to interpretation with an objective doctrine as it is commonly done. At a closer look, it is the subjective perspective of the addressee that matters and this viewpoint is objectified only to a certain extent, i.e. by the standard of reasonable and faithful understanding.

2.2 The Significance of the Wording and the Need for its Meticulous Analysis

The wording, however, is necessarily the starting point of interpretation. It is the outward manifestation of the parties' intention. Being balanced against other criteria, the language used has a particularly significant weight. The wording may not impetuously be disregarded by arguing the reasonableness of a solution which is far from or even not at all in accordance with the text. This point may be demonstrated by using an example drawn from the Comments to Art. 5:101 (3) PECL, given there as an illustration of the objective method:[22]

A clause in an insurance contract provides that the policy covers the theft of jewellery only in cases of "clandestine entry" into the place where the jewellery was. An individual, A, pretends to be a telephone repairman and presents himself at Madame B's home to repair her telephone. A distracts B under some pretext and takes the opportunity to steal her jewellery. The insurance company refuses to pay arguing that there has been no "clandestine entry". *On a reasonable interpretation,* the commentary to the PECL argues, *entry gained by fraud is a form of "clandestine entry*".

This example shows the risk of not taking the wording of the contract seriously enough and of allowing the interpreter to realise his own evaluation of what amounts to a reasonable understanding. By its literal meaning, the term "clandestine entry" hardly encompasses "entry gained by fraud". One would use the term "clandestine" if the victim did not notice the entry of the thief, but not if she voluntarily admitted him into her home not realising his identity and intentions. "Entry gained by fraud" can surely not be considered to be within the core meaning of the expression "clandestine entry", but at its periphery at most. Therefore, the parties' interests and the purpose of the contract clause must be analysed thoroughly. In this respect, significant differences between the two situations become evident. If B did not suspect that an unknown person had entered her home, she had no reason to take special care to protect her jewels from theft. On the other hand, if she deliberately admits a telephone repairman into her home, the need to lock the jewels away or keep an eye on them is apparent. The crucial factor in interpreting the *ratio* of the expression is the aspect of control: It is immaterial whether the thief really is or just pretends to be a telephone repairman. The decisive issue is that B, despite being aware of an unknown person's presence, left the jewels unguarded and let

[21] This is substantially laid down under Spanish law in Art. 1282 CC.

[22] Cf. PECL, 2000, p. 289.

herself be distracted. This could have happened with a real telephone repairman as well. With respect to the purpose of the insurance, B's legitimate interest to be protected against theft by a pretender is almost as low as against theft by a real telephone repairman and not nearly as high as against theft by unknown intruders. Thus, the case is much closer to a situation which is clearly not covered by the insurance than to one which falls into the core meaning of the clause. That is why with respect to the purpose of the insurance contract and the clause in question its wording is to be construed narrowly. Hence, theft after "entry gained by fraud" is not covered by the insurance. This example shows how the criteria of reasonableness may be applied in a rational and methodical manner: The usual meaning of the words and the purpose of the clause to be interpreted must be combined with a twofold comparison of the situation in question with situations that are clearly inside and those clearly outside the scope of the clause. Moreover, in the example, B cannot successfully invoke the *contra proferentem* rule (cf. below 2.5.4). In spite of the fact that the contract was phrased by the insurer, there are no remaining doubts which could justify the application of the *contra proferentem* rule after careful analysis of its wording and its purpose and after taking into account the interests of the parties.

2.3 The Prevalence of the Recognised Intention over the Objective Meaning

On the other hand, if the intentions of the parties correspond, but deviate from the regular understanding of their declarations, neither party can reasonably rely on the objective meaning of the contract. In such a situation, the corresponding intentions of the parties have priority over the "regular" or "correct" meaning of the declaration (*falsa demonstratio non nocet*). This priority is based on the above mentioned assumption that there is no "absolutely objective" perspective underlying interpretation. What matters is the individual perspective of the addressee. This perspective is not purely shaped by the "bare" declarations, but also by all those circumstances that allow conclusions concerning the actual intention of the other party.

The priority of the corresponding intentions over the objective meaning is common ground in all European legal systems.[23] One formula, which is often used (e.g. in Arts. II.–8:101 (1) DCFR, 5:101 (1) PECL and in Art. 39 II CEC), states that the corresponding intentions of the parties have priority over the literal meaning of the words.[24] If, for instance, the object of a sale is denominated as "*Haakjöringsköd*" and both parties take it for granted that this refers to *whalemeat*, even though "*Haakjöringsköd*" – according to the general use of language – means *sharksmeat*, then the contractual agreement is about whalemeat.[25] The same applies if the parties knowingly use the term sharksmeat in the wrong sense in the written contract (e.g. if they fear that trading openly with whalemeat might damage their reputation). This is in line with the generally recognised rule that contractual simulations are disregarded and the true intentions of the parties prevail (Art. II.–9:201 (1) DCFR ~ Art. 6:103 PECL).[26]

The objective meaning of the statement is also disregarded, if one of the parties realises or if it is obvious to him that there are certain intentions underlying the other party's declaration that contradict the normal understanding (Art. II.–8:101 (2) DCFR ~ Art. 5: 101 (2) PECL).[27] Even though in such a case there is *no common* intention, the addressee's reliance on the regular use of language is not worthy of protection. Rather, the addressee can reasonably be expected to reveal the discrepancy if he prefers not to be bound to the intention of the other party. In a modified version of the example given above, this means that the seller owes whalemeat if the buyer knows that the seller has mistakenly used the term "Haakjöringsköd" for whalemeat, notwithstanding that the buyer intends to enter into a contract about sharksmeat (which might be the case because sharksmeat is more valuable).

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[23] For an overview see PECL, 2000, p. 290. For limitations see below 2.5.1. Under English law the principle of *falsa demonstratio non nocet* is implemented with respect to written contracts by the equitable relief of rectification; see J. Beatson, 2002, p. 339 seq.

[24] Cf. e.g. under French law Art. 1156 CC. Under Swiss law Art. 18 (1) OR.

[25] Cf. RG 8.6. 1920, RGZ 99, 147.

[26] For an overview see PECL, 2000, p. 307.

[27] BGH 26.10.1984, NJW 1984, 721. Under English law, again, the rules on rectification concerning unilateral mistakes lead to similar results; see J. Beatson, 2002, p. 340 seq. For an overview see PECL, 2000, p. 291.

2.4 General Remarks Concerning the Definition of Further Rules

Before we turn to the evaluation of further and more specific rules, some general characteristics of defining rules of interpretation need to be considered.

2.4.1 The Problem of Defining Rules of Interpretation

Although the principles discussed under 2.1 and 2.2 appear to be widely accepted and quite well founded, it is difficult to phrase them in more definite terms and to complement them by further rules. The reason for this difficulty lies in the nature of communication and its fundamental dependence upon the circumstances of the individual case.[28] It is possible to establish general rules, for instance by establishing pragmatic guidelines based on the experience of normal communication. However, the number of potential rules is practically unlimited. Moreover, any rule is prone to mistakes due to peculiarities of the case and must allow for a wide range of exceptions that cannot be formulated in advance for all circumstances.

It is therefore not surprising that, even in continental systems, interpretation is largely governed by general principles and judge-made law.[29] The recent comprehensive codification, the Dutch *Burgerlijk Wetboek*, for instance, deals very briefly with the topic of interpretation.[30] The draftsmen of the German Civil Code (BGB) deliberately abstained from stating detailed rules of interpretation since they wanted to avoid instructing the judiciary in "practical logic".[31] Nevertheless, detailed rules can be found in Arts. 1156 et seq. of the French CC, in Arts. 1362 et seq. of the Italian CC and in Arts. 1281 et seq. of the Spanish CC. The DCFR also provides rules related to interpretation in Arts. II.–4:102, II.–8:101-107, as do the PECL in Arts. 2:102, 5:101-107 and the CEC in Arts. 39-41. It is noteworthy that only limited binding force is attributed to the French rules of interpretation.[32] The *Cour de Cassation* holds that a judgment does not have to be reversed purely on the ground that rules of interpretation have not been observed.[33] The rules in the PECL are – in parts – consciously drafted in a way that courts may abstain from applying them in exceptional cases.[34]

One should draw a clear line between definite rules and the mere enumeration of aspects that ought to be taken into consideration in the process of interpretation. In Art. II.–8:102 DCFR (~ Art. 5:102 PECL) some factors are named that must be taken into account when interpreting a contract.[35] This kind of list is supposed to outline circumstances that are of particular importance in determining the perspective of the reasonable addressee. The perspective of the addressee is, however, characterised by an indefinite number of individual factors. Moreover, the choice of possible factors will always be the self-explanatory expression of common sense. Thus, there is little use in enumerating the factors relevant to interpretation in a code: where such an enumeration is specific, it will always be incomplete; where it is general, it will only be stating the obvious, as demonstrated by Art. II.–8:102 DCFR (~ Art. 5:102 PECL). By listing the relevant factors of interpretation in a code, the law is merely pretending to offer guidance that it cannot give.

2.4.2 Interpretation as a Balancing Approach

Generally speaking, there is no strict concept of priority between the different aspects which play a role in the process of interpretation such as the meaning of the words, the purpose, the context or the origins of a contractual clause. These aspects are more or less loosely combined with one another and weighed by their persuasiveness in the individual case. There may be cases where a "weak" argument drawn from the wording of the clause has to step back behind a "strong" argument

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[28] Cf. R. Zimmermann, 1990, p. 638 seq.

[29] For an overview PECL, 2000, p. 290 sub 1.

[30] Art. 3:35 BW refers to the perspective of a reasonable addressee.

[31] Cf. Motive I, p. 155.

[32] Cf. J. Ghestin et al., 2001, no. 35 seqq.

[33] See Cass. civ., 19.12.1995, Bull. civ., I, no. 466, p. 324.

[34] Cf. PECL, 2000, p. 294.

[35] Similarly with regard to the question whether or not a statement constitutes a contract see Art. II.–9:102 (1) DCFR (~ Art. 6:101 (1) PECL). See also Art. 4.3 Unidroit Principles.

derived from the purpose or the contractual context. In other cases, a narrow understanding of the words may prevail, because the purpose of the clause does not speak clearly enough for an opposite understanding or is even vague or indistinct. Hence, interpretation is a process of balancing.[36]

Even though there is no strict priority between the different aspects of interpretation, some of them carry particular weight *from an abstract point of view* without regard to the individual circumstances of the case. First of all, this applies to the meaning of the words of the agreement. The words used are usually the manifestation of parties' intention as well as the object of their reliance (see 2.2 above). In addition, the meaning of the wording marks the borderline with regard to "constructive" interpretation, which may only be passed under certain conditions (see below 3.3.2). Thus, to overcome the presumption in favour of the literal meaning, very strong arguments are needed. The same is true with respect to arguments that are drawn from the purpose of a contractual clause or the purpose of the entire contract since the parties use the contract as a means to pursue their specific goals. Moreover, the focus on the purpose of legal arrangements generally prevails in modern jurisprudence. In many cases, however, the purpose remains unclear or can only be determined on the basis of other aspects such as the literal meaning of the words, the context or the origin. It should be emphasised that in spite of these abstract dimensional differences the relevant criteria should be treated as elements within the process of balancing. Even the aspects that are most important in general may have to step back behind other arguments if those turn out to be stronger in the particular case. Therefore the coordination of the relevant factors resembles what is described in legal theory as balancing diverging principles as opposed to applying a definite rule.[37]

A balancing approach inevitably bears uncertainties. But this does not mean that interpretation of contracts evades rational inspection or is even an arbitrary procedure. Rather, balancing works as reasoning does in general: one gathers as many arguments as are worth considering, weighs them by their persuasiveness and strikes a balance between them if they are in conflict. Yet, the uncertainties of the balancing approach explain why it is so difficult to develop abstract and definite rules for interpretation.

2.4.3 Interpretation as a Matter of Law and Restrictions of Judicial Review

The difficulty in setting up a scheme of definite rules also affects the question whether interpretation is a matter of fact or a matter of law. This distinction is relevant especially with regard to the scope of review of the trial court's decision on appeal. Interpretation is always based on facts, namely the subjective intentions of the parties and other individual circumstances of the case. Yet, the core question of interpretation – whether a binding contract has been formed on the established facts and what its content is – necessarily requires an additional legal judgment.[38] This follows directly from the assumption that the perspective of the reasonable addressee determines the outcome of interpretation. Because of the numerous particular circumstances that potentially need to be taken into consideration, it is difficult to distinguish fact-finding from the application of law. As a consequence, findings of trial courts concerning interpretation should be reviewed with restraint, in a similar way as with findings of fact. In order to secure the priority of the trial judge's verdict, some legal systems deal with interpretation as a matter of fact, but nevertheless allow some limited review on appeal.[39] It is more accurate and therefore preferable to regard the process of interpretation as a matter of law while limiting revision of the trial court's findings to cases in which the result of interpretation is *evidently* inconsistent with legal requirements.[40]

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[36] With more detail concerning the burden of proof and persuasion and on the scope of judicial review in issues of interpretation, cf. T. Riehm, *Abwägungsentscheidungen in der praktischen Rechtsanwendung*, 2006, p. 119 seqq., 237 seqq.

[37] Cf. R. Dworkin, *Taking Rights Seriously*, 1977, p. 22 seqq.; R. Alexy, *Recht, Vernunft, Diskurs*, 1995, p. 182 seqq.

[38] Similarly C.M. Bianca, 2000, p. 413.

[39] E.g. under French law; cf. J. Ghestin et al., 2001, nos. 14 seqq.

[40] Cf. K. Larenz, M. Wolf , 2004, § 28 no. 132 = p. 547 seq. For an overview see PECL, 2000, p. 290 sub 1.

2.5 Rules of Interpretation with Reference to Specific Circumstances

While the balancing approach is characteristic for the law of interpretation, many rules have been developed to give the interpretation of contracts a more definite structure. All these more or less precisely defined rules do not govern the process of interpretation in general but they derive certain conclusions from special circumstances of the contract. A choice of the most prominent of these rules shall be put under scrutiny.

2.5.1 Clauses Claires et Précises

The Roman Law principle "*cum in verbis nulla ambiguitas est, non debet admitti voluntatis quaestio*"[41] is still effective, for instance in the French doctrine of *clauses claires et précises*. If a contractual clause *in a written contract* is phrased unambiguously, the *Cour de Cassation* holds there is no room for interpretation and only the objective meaning is relevant. Thus, there is an *irrebuttable* presumption that the unambiguous clause is the correct and complete expression of the parties' intentions.[42]

Prima facie, the French doctrine appears to be an exception to the rule that the corresponding intentions of the parties have priority over the objective meaning of the declarations. This would be irreconcilable with the principles governing interpretation: If one party can prove that both parties had corresponding intentions which deviate from the unambiguous meaning of the written declarations, none of the parties has reasonably relied on the objective meaning. However, if one takes a closer look at the doctrine of *clauses claires et précises*, it is permissible under this rule to consider external circumstances to determine whether or not the term in question is ambiguous.[43] This is unavoidable also from a practical point of view, as there is no purely objective standard which allows a determination of the plain meaning of the words used. This leads to the second objection: The doctrine of clauses *claires et précises* is inconsistent because it presupposes a "regular" interpretation for determining the plain meaning or, respectively, an ambiguity while claiming that interpretation is not allowed.[44] This contradiction becomes apparent in a *Cour de Cassation* case concerning a shipment of sugar that was damaged on transport. There was a precise term in the contract providing for an allocation of transport risks. Contrary to the wording of the contract, however, the buyer was willing to accept delivery and to pay in full despite the damage the shipment had suffered because the price of sugar had risen and therefore acceptance of the damaged shipment was preferable to rescission of the contract. The court ruled that, on the one hand, the clause concerning transport damages was *clear* but, on the other hand, that the clause, being inconsistent with the apparent intentions of the parties in the situation given, was subject to interpretation.[45]

The obvious question is why the doctrine of *clauses claires et précises* has nevertheless not yet been abandoned. An important aspect might be that interpretation under French law is a matter of fact and thus there is, as a general rule, no review on appeal.[46] The conclusion that a declaration is unambiguous in a certain sense is a means to reverse the decision of the trial court on appeal. Thereby, interpretation becomes – not openly but practically – subject to a review of evident mistakes on appeal (see above 2.4.2).

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[41] Paul. Dig. 32, 25, 1.

[42] Cf. in detail J. Ghestin et al., 2001, no. 25, 28. With regard to a similar practice under Italian law see C.M. Bianca, 2000, p. 420; G. Cian, A. Trabucchi, 2008, Art. 1362, sub X 1.See also Art. 39 (1) CEC.

[43] Cf. J. Ghestin et al., 2001, no. 27; H. Mazeaud et al., 1998, no. 345.

[44] Cf. with more detail J. Ghestin et al., 2001, no. 25.

[45] Cf. Req., 15.4.1926, S. 1926, I, p. 151 seq.

[46] Cf. J. Ghestin et al., 2001, no. 15.

2.5.2 Interpretation of Written Documents: Parol Evidence Rule, Merger Clauses and Formal Requirements by Law

Related, but not identical to the doctrine of *clauses claires et précises* is the parol evidence rule which has played an important role particularly in the English legal tradition. Under this concept, the terms of a written contractual document may, as a general rule, not be amended, varied or contradicted based on extrinsic (parol) evidence.[47] The objection mentioned above is equally valid concerning this rule. It must therefore not be applied if none of the parties reasonably relied on the objective meaning or if the parties agreed on further terms of contract not embodied in the written document. Moreover, an interpretation which claims to leave aside circumstances that are not embodied in the written document is virtually impossible. It is therefore not surprising that the rigid ban on external circumstances was loosened in English law by recognising many exceptions. In 1986, the Law Commission even started doubting whether the parol evidence rule has any actual binding effect at all.[48] Admittedly, however, the parties usually consider the written document the complete and final expression of their legal relationship. Yet, this assumption can be appropriately accounted for by regarding it a rebuttable presumption:[49] Whoever claims circumstances not embodied in the written document to be valid bears the burden of proof for this claim.

This state of the law generally remains unchanged if the parties agree on a written form clause or a merger clause. Such a clause only implies a higher probability that the parties intend to restrict the content of their agreement to what is stated in the written document, thereby cancelling or excluding other (deviating) agreements. Such an intention, however, is subject to modifications: There is always the possibility that the parties – contrary to the clause – intend to leave certain other agreements intact or to provide new terms on certain issues after conclusion of the contract. The written form clause and the merger clause can be justified – like any other term of contract – on the basis of mutual consent and, therefore, they can be altered by mutual consent at any time.

It follows that a written form clause and the merger clause only strengthen the presumption that the written agreement is complete. This is in line with tendencies in most European legal systems[50] and with Art. II.–4:105 DCFR (~Art. 2:106 PECL) concerning clauses that aim to exclude non-written amendments to (written) contracts. The regulation of Art. II.–4:104 (1) DCFR (~Art. 2:105 (1) PECL) which attributes *unconditional* validity to *individually negotiated* merger clauses is, however, not fully convincing. This rule as well as the underlying legislative purpose demonstrates, again, that a rigid rule intending to limit interpretation to the written document is inadequate and inconsistent with other generally accepted requirements of interpretation. The first indication for this can be found in Art. II.–4:104 (3) DCFR (~Art. 2:105 (3) PECL) stating that declarations made at an earlier stage can be used for the interpretation of the contract. Furthermore, the merger clause is set aside according to Art. II.–4:104 (4) (~Art. 2:105 (4) PECL) if reasonable reliance of one party is infringed. Finally, there is a reference in the comments on the PECL that a merger clause is also ineffective with respect to stipulations made separately from the contract.[51] Again, these restrictions practically qualify the merger clause as merely giving rise to a rebuttable presumption. Thus it is less complicated and more accurate to clearly allocate this qualification to all merger clauses as it is provided in Art. II.–4:104 (2) DCFR (~ Art. 2:105 (2) PECL) concerning only not individually negotiated clauses.

An additional problem arises if written form is required by law. Here, the relationship between interpretation and the legal requirement of form needs to be specified. In addressing this problem, two

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[47] E.g. *Jacobs* v. *Batavia and General Plantations Trust* [1924] 1 Ch. 287, 295. Under French law a similar rule is stated in Art. 1341 CC. This provision, however, does not apply if there is an ambiguity in the contract; cf. Req., 31.3. 1886, S. 1886, I, p. 260; J. Ghestin et al., 2001, no. 28.

[48] Cf. J. Beatson, 2002, p. 132-134, 160-163; G.H. Treitel, E. Peel, 2007, para 6-013 fn. 61.

[49] This is substantially realized under Spanish law in Art. 1281 CC, stating the prevalence of the "*intención evidente de los contratantes*" over the literal meaning; cf. Paz-Ares Rodriguez et al., 1993, Art. 1282, sub II. To the same effect J. Beatson, 2002, p. 132.

[50] Cf. PECL, 2000, p. 153 seq.

[51] Cf. PECL, 2000, p. 152.

sub-questions should be distinguished – a distinction that is often neglected: In a first step, the content of the contract must be established before it can be determined whether the contract is valid with *that* specific content in a second step.

With regard to the first sub-question, the content of the contract is determined on the basis of the general rules on interpretation of written documents. At this level, the requirement of form does not pose any restriction on interpretation. The starting point is therefore the presumption that the written document is correct and complete. This presumption can be rebutted if one of the parties proves by way of external evidence that the actual intentions of the parties deviate from, or go beyond, the objective content of the written document. At the level of interpretation, there is no need to disregard extrinsic evidence due to the form requirement[52] as form requirements are generally not aimed at holding the parties to an agreement that contradicts their corresponding intentions.

Having established the content of the contract, one may turn to the second sub-question, i.e. whether the contract, with the terms given, is valid or invalid due to a breach of the form requirement. Generally, there can be no breach of the form requirement only on the ground that circumstances not embodied in the written document are relevant in order to determine the content of the contract. For it is practically impossible to phrase a written clause that is not in any need of interpretation on the basis of external circumstances. Thus, the requirement of form must, at least, be limited to ensuring that the actual intention is somehow indicated in the written document.[53] Yet, even if there is no such indication in the document with regard to a certain point, the contract is not necessarily invalid.

The question of whether or not the contract is valid, should depend on the specific objective of the form requirement in question.[54] This objective may frequently render the contract invalid. But this is not necessarily always the case. For example, under German law a sales contract concerning real estate remains valid even though the actual piece of land has been designated incorrectly in the written document if it can be established what piece of land the parties actually wanted to refer to.[55] The requirement of form governing real estate sales aims to alert the parties about the general risks of such contracts and makes them seek legal advice by a notary public; his purpose is fulfilled even if the technical designation of the piece of land is wrong.

2.5.3 Involvement of Third Parties and Commercial Contracts

As opposed to the issues discussed above under 2.5.1, it can be justified to apply a special standard of interpretation with regard to contracts that are specifically designated to evoke involvement and reliance of third parties'(i.e. parties who did not originally participate in the conclusion of the contract). Such contracts may require a more objective standard of interpretation which focuses on the wording of the contract and its objective meaning while extrinsic circumstances and the individual intentions of the contracting parties are generally disregarded. This standard of interpretation relates most prominently (but not exclusively) to negotiable instruments and corporate contracts. With regard to negotiable instruments, for instance, extrinsic circumstances can only be considered in the process of interpretation if they are known to anyone.[56] A similar rule applies to corporate contracts if legitimate interests of third parties, e.g. future shareholders or creditors, require such a restriction.[57] In such transactions, third parties typically rely exclusively on the wording of the agreement because they have no access to the individual circumstances accompanying the conclusion

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[52] Cf. e.g. G. Cian, A. Trabucchi, 2008, Art. 1362 CC, sub IX 5.

[53] See BGH 9.4.1981, BGHZ 80, 242, 245.

[54] Cf. in detail A. Lüderitz, 1966, p. 192 seqq.; K. Larenz, M. Wolf, 2004, § 28 no. 85 seqq. = p. 532 seqq.

[55] Cf. BGH 25.3.1983, BGHZ 87, 150, 152 seqq.

[56] Cf. e.g. BGH 30.11.1993, BGHZ 124, 263; OGH 1.12.1977, OGH SZ 50/157 (1977); M. Casper, in: A. Baumbach, W. Hefermehl et al. (eds.), *Wechselgesetz, Scheckgesetz, Recht der kartengestützten Zahlungen*, 23th ed. 2008, Introd to WG, no. 56; G.H. Roth, *Grundriß des österreichischen Wertpapierrechts*, 2nd ed., 1999, p. 27.

[57] Cf. e.g. OGH 25.11. 1997 AG 1998, 199; J. Farrar, B. Hannigan, *Company Law*, 4th ed. 1998, p. 117; G. Resta, Gli atti costitutivi e gli statuti, in G. Alpa, G. Fonsi, G. Resta, *L'interpretazione del contratto*, 2nd ed. 2001, Milan, p. 450. In detail see K. Schmidt, *Gesellschaftsrecht*, 4th ed. 2002, § 5 I 4 = p. 87 seqq.

of the contract. Therefore, the perspective of third parties will differ from the point of view of the original parties to the contract. Accordingly, the contract will be interpreted objectively and the original intentions of the parties do not deserve the regular safeguard of subjective interpretation if (and because) they exchanged offer and acceptance with a specific initial concern that third parties shall rely on their declarations.

In the DCFR, Artt. II.–8:101 (3) (b) and II.–8:102 (2) are designed to protect third parties' reliance in the contract by accounting for their perspective in its interpretation. Under these provisions, the contract must be interpreted objectively, i.e. from the perspective of a reasonable third person. The individual understanding of the contracting parties does not have priority if the third party has "reasonably relied on its apparent meaning". The only condition required for referring to the third party's perspective under the DCFR rules is that its reliance must be "reasonable and in good faith". Yet, there is no criterion that makes the protection of third parties dependent upon the specific character of the contract. The lack of this requirement marks an elementary[58] deficiency of the DCFR rules on interpretation. Unless the contracting parties clearly and deliberately designate their contract as directed at third parties there is no basis for giving the third party's reliance priority over the contracting parties' individual autonomy. The mere potential of a third party's reliance, e.g. by assignment or by creditors' dispositions, does not justify the prevalence of this party's perspective because, as a general rule of party autonomy, any assignee or creditor has to take the contractual rights as they have been defined by the contracting parties. Based on this understanding, one could admittedly argue that under the said provisions of the DCFR, a third party's reliance is only "reasonable" if the contract is specifically directed at third parties (as in the case of negotiable instruments or corporate contracts). However, Artt. II.–8:101 (3) (b), II.–8:102 (2) DCFR give no clear indication for such a construction and they may therefore turn out to be misleading in this very important context.

Even in the field of commercial contracts, where legal certainty is of particular importance, an individual understanding shared by the parties will prevail, as a general rule, over the objective meaning of a contract term. Special regard must be given, however, to contract terms which are specified in a certain sense by a commercial custom, like *fob*, *cif* etc. It is widely recognised across the European jurisdictions that there is a presumption that the parties intended to give the clause such meaning as is customary in commercial trade.[59] This presumption of conformity with commercial customs is in line with the general rules of hermeneutics and with the general standard of interpretation (see above 2.1) as commercial customs are elements of the objective framework of the declarations.[60] Yet, again in accordance with the general rules, the presumption of conformity with commercial customs is rebuttable due to the principle of party autonomy (see above 2.3): If both parties understood a term in a way that is different from commercial custom, their intention and understanding will prevail over the customary meaning even if legitimate interests of third parties are affected by the contract.[61] This prevalence of individual autonomy is not sufficiently respected by Art.

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[58] Minor flaws result from incoherences in the wording of Artt. II.–8:101 (3) (b), II.–8:102 (2) DCFR: The distinction between "a person, not being a party to the contract or a person who by law has no better rights than such a party" is not quite conclusive. Furthermore, only Art. II.–8:102 (2) DCFR states an example for the second category of third parties ("such as an assignee") while there is no reason that this example should not apply to Art. II.–8:101 (3) (b) DCFR, too. The example does also not fully give sense to the dichotomous definition of the third party.

[59] See C.-W. Canaris, *Handelsrecht*, 24th ed. 2006, § 22 no. 13; H.J. Sonnenberger, R. Dammann, *Französisches Handels- und Wirtschaftsrecht*, 3rd ed. 2008, p. 14, p. 45; K. Lewison, *The Interpretation of Contracts*, 4th ed. 2007, p. 172; R. Goode, *Commercial Law*, 3rd ed. 2004, p. 88.

[60] See C.-W. Canaris, *Handelsrecht*, 24th ed. 2006, § 22 no. 2; J. Neuner, ZHR 157 (1993), 243, 271.

[61] See BGH 22.1.1957, BGHZ 23, 131, 136 f.; C.-W. Canaris, *Handelsrecht*, 24th ed. 2006, § 22 no. 14 (with reference to the rule of „falsa demonstratio non nocet"); Großkomm, I. Koller, HGB, 28th ed. 1984, Vor § 373 no. 168. Third parties' interests can be served to a quite limited extent by granting commercial customs priority over constructive interpretation (see below under 3.3.2) as in the relevant cases the custom does not conflict with

II.-1:104 (2) DCFR (~Art. 1:105 (2) PECL) as this provision implements "common usage" as a binding objective standard ("the parties are bound by") rather than a supplemental tool and it therefore suggests that "common usage" has priority over the private agreements of autonomous parties.[62]

As a result, third parties who are affected by the contents of a contract, such as assignees or creditors, are only protected by the rules of interpretation if the contract is specifically designated to third party involvement, like negotiable instruments and corporate contracts. Therefore, third parties should and do secure their position by examining the "true" content of the contract and by holding the transferring party liable for certain contents of the contract. If one or both of the contracting parties have specifically evoked a third party's reliance in a certain term, they may also be subjected to (non-contractual) liability on the basis of the principle of estoppel.[63] An objective standard of interpretation should not be used to protect third parties with regard to "regular" contracts. In doing so, one would fail to draw a clear distinction between the actual intention of the *contracting* parties (which is the general standard for interpretation) and the protection of the reliance of *third* parties, which is based on different policy considerations and should accordingly be expressed by different legal doctrines.

2.5.4 Interpretation Contra Proferentem

Another widely accepted rule states that an ambiguous term is to be construed against the party on whose initiative it was inserted into the contract. This rule has its foundation in the Roman law principle "*Cum quaeritur in stipulatione, quid acti sit, ambiguitas contra stipulatorem est*".[64]

This so-called *contra proferentem* rule is laid down in Art. II.–8:103 (1) DCFR (~ Art. 5:103 PECL, Art. 6:203 (1) ACQP) and Art. 40 (3) CEC with regard to terms not individually negotiated (interpretation against the supplier). Moreover, this rule is an integral part of the already existing Community law in Art. 5 of the Directive 93/13 on Unfair Terms in Consumer Contracts. In the European national jurisdictions, the *contra proferentem* rule can be found not only in regulations that implement Directive 93/13, but also in other contexts.[65]

The rationale of the *contra proferentem* rule is to provide an incentive to avoid the negative effects of ambiguous terms. The party who introduces a clause into the contract can and should ensure its transparency and, respectively, avoid the uncertainty associated with ambiguous terms. This uncertainty is detrimental, since the other party is not sufficiently aware of the scope of his rights and duties when concluding the contract. Also, it is more difficult for the other party to evaluate the outcome of a dispute. The *contra proferentem* rule, moreover, preserves the legal status quo which would exist without the clause in question. If one party introduces a clause, he usually worsens the other party's existing legal position by establishing duties or limiting rights. The *contra proferentem* rule aims to achieve that the other party's legitimate legal position is only restricted to an extent that is made perfectly clear in the contract. This idea is sometimes also expressed by demanding that clauses which exclude essential duties or rights of one party have to be interpreted narrowly.[66] Accordingly,

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an actual intention of the parties but only with a hypothetical intention that in any case requires a more object approach; for an example and more detail from the German perspective see BGH 15.6.1954, BGHZ 14, 61, 62; C.-W. Canaris, *Handelsrecht*, 2[4th] ed. 2006, § 22 no. 13; Großkomm, I. Koller, HGB, 4[th] 1984, Vor § 373 no. 168.

[62] With more detail H. Eidenmüller, F. Faust, H.C. Grigoleit, N. Jansen, G. Wagner, R. Zimmermann, JZ 2008, 529, 538 = OJLS 2008, 659, 678 seq. = RTD eur., 695, 781 seq.

[63] Cf. C.-W. Canaris, *Handelsrecht*, 24[th] ed. 2006, § 22 no. 14 and in extenso *idem*, *Die Vertrauenshaftung im deutschen Privatrecht*, 1971, p. 94 seqq. u. p. 130 seq.

[64] Cels. D. 34, 5, 26. With regard hereto R. Zimmermann, 1990, p. 639 seq.

[65] Cf. under English law *Tan Wing Chuen* v. *Bank of Credit and Commerce Hong Kong Ltd.* [1996] 2 B.C.L.C. 69. Under French law Art. L. 133-2 C. consom.; with more details J. Ghestin et al., 2001, no. 40. Under Italian law see Art. 1370 CC. Under Spanish law Art. 1288 CC. Under Austrian law § 915 ABGB. Furthermore Art. 4.6 Unidroit Principles.

[66] Cf. H. Heinrichs, in: O. Palandt et al. (eds.), *BGB*, 69[th] ed. 2009, § 133 no. 23.

disclaimer clauses are often construed very restrictively.[67] Of course, this reasoning always bears the risk that the restrictive interpretation de facto serves to implement a mandatory rule prohibiting the disclaimer clause.

In Art. II.–8:103 (2) DCFR the *contra proferentem* rule has explicitly been extended to terms which have been individually negotiated. This leads to the question whether one can still consider one party to be *proferens* in the sense of the *contra proferentem* rule if the term has been individually negotiated. According to Art. 6:102 (2) ACQP the criterion "individually negotiated term" is defined by the ability of the other party to influence its content. Another, arguably more persuasive, definition qualifies such terms as individually negotiated that the other party can appropriately take into account in its own decision making process.[68] Either way, in many cases of individually negotiated terms it will be difficult to determine the unilateral responsibility for an unclear formulation which is characteristic for the *contra proferentem*-rule. Individual negotiation furthermore reduces the need of protecting the legal position affected by the term in question. This applies in particular if the other party has received some benefit in exchange of the term in question in the negotiation process. The conflict between unilateral responsibility and individual negotiation is supposedly to be solved under Art. II.–8:103 (2) DCFR by ascertaining the "dominant influence" of one party with regard to establishing the term in question. This criterion, however, is not at all suited to solve the issue as it is quite vague and virtually paradoxical. For it is the most elementary principle of private law that individual negotiation renders mere "dominance" of one party irrelevant if there is neither a dysfunction in the bargaining process nor in the market. Thus the extension of the *contra proferentem* rule to individually negotiated terms is highly questionable.[69]

Some rules combine the "interpretation against" one of the parties with the role this party plays in a specific contract. For example, there are rules in French Law which, in case of doubt, provide for an interpretation against the creditor (Art. 1162 CC) or against the seller (Art. 1602 CC). The idea of the *contra proferentem* rule might provide a certain justification for these rules which originate in Roman Law. In many cases, however, the contract is negotiated in detail or the debtor or the buyer is responsible for the drafting of the contract. If this is the case, there is – possibly with the exception of promises without recompense[70] – no plausible reason to put the creditor or the seller at a disadvantage. In a liberal contract system, interpretation cannot depend on social aspects, namely on the (presumed) relative economic strength of the parties. After all, a creditor or a seller are not necessarily economically more powerful than the debtor and the buyer. Consequently, the rule on uncertainty contained in Arts. 1162, 1602 (2) CC can, if at all, only be justified as an inaccurate expression of the *contra proferentem* rule.[71]

2.5.5 Prevalence of Individually Negotiated Terms and of the Reasonable and Effective Meaning

Another important and widely recognised rule states that an individual agreement prevails over terms which were not developed in individual negotiations (cf. Art. II.–8:104 DCFR ~ Art. 5:104 PECL).[72] This doctrine is well founded as the individual negotiations of the parties allow a more precise conclusion with regard to the intention of *both* parties than an abstract reference. According to another, equally convincing rule, an interpretation which avoids rendering the agreement void or meaningless is generally preferential (Art. II.–8:106 DCFR ~ Art. 5:106 PECL; Art. 40 II CEC).[73]

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[67] See *Hollier* v. *Rambler Motors* (A.M.C.) Ltd. [1972] 2 Q.B. 71; J. Beatson, 2002, p. 170-174; G.H. Treitel, E. Peel, 2007, para 7-015.

[68] See T. Miethaner, *AGB-Kontrolle versus Individualvereinbarung*, 2009 (upcoming).

[69] Similarly J. Neuner, in: Festschrift für Canaris, 2007, p. 901, 909.

[70] There are provisions specifically demanding an interpretation in favour of such promisor e.g. in Art. 41 s. 1 CEC, under Italian law (Art. 1371 CC), under Portuguese law (Art. 237 CC) and under Austrian law (§ 915 ABGB).

[71] See with the same result H. Kötz, 1996, p. 174 seq.

[72] For an overview over the jurisdictions see PECL, 2000, p. 295.

[73] To the same effect under English law *Lord Napier and Ettrick v. R.F. Kershaw Ltd.* [1999] 1 W.L.R. 756, 763. Under French law Art. 1157 CC. Under Spanish law Art. 1284 CC.

This notion is based on the (generally justified) assumption that the parties want to achieve the goals of the contract by reasonable and legal means.[74]

2.5.6 Examples of Questionable Rules in the DCFR

In spite of some essential directions resulting from the rules discussed, one should always bear in mind that the potential for defining the interpretation process is quite limited (see. 2.4). Therefore, lawmakers should be cautious when formulating such rules in a general and binding form. An example of too much specificity can be found in Art. II.–8:107 DCFR (~ Art. 5:107 PECL and Art. 4.7 Unidroit Principles). As far as contracts in various languages are concerned, the original version is generally authoritative under this provision. The underlying assumption is that the original version reflects the intention of the parties most clearly and reliably. This hypothesis is speculative and not convincing, not even as a general (rebuttable) presumption. In particular, it fails to consider that the parties have usually drafted the contract in different languages *in order to have a better understanding*.

As another example, the provision of Art. II.–8:105 DCFR (~ 5:105 PECL[75]), stating that the interpretation has to show consideration for the contract as a whole, appears to be superfluous since it is not a genuine rule but only one obvious aspect – the systematic approach – which has to be taken into account for interpretation (see 2.3.1). Aspects like these, which are only potentially relevant to interpretation, can be compiled into catalogues such as Art. II.–8:102 DCFR (~ Art. 5:102 PECL). From the point of view put forward here, however, it is preferable to abstain from this kind of regulation for reason of the self-evidence and almost unlimited number of such potentially relevant criteria.

3 Dealing with *Lacunae* in the Contract

It is not always possible to solve the problems of interpretation by reverting to the wording of the contract or to the clear and concurring intention of the parties. In practice, contracts often contain *lacunae*.

3.1 Lack of Agreement despite Interpretation

A gap in the contract may arise if the intentions of the parties' diverge and if this divergence cannot be resolved by means of interpretation. In such a case, there is no agreement with regard to one element of the contract. As a general consequence, the contract is void.[76]

Such a dissent is extremely rare. Normally, a dissent is ruled out either because the parties notice their disagreement or because the rules of interpretation demand that both declarations be understood in the same sense. In general, the corresponding interpretation of both declarations is ensured by the rule that each declaration has to be interpreted from the perspective of a reasonable recipient. In most cases, it follows that the same circumstances of the case are decisive for both parties. The perspectives of the reasonable recipient and, accordingly, the meanings of the declarations are the same for both parties.

Under German law, for instance, a dissent has been found in a case where both parties wanted to conclude a contract for the sale of tartaric acid by telegram. Both parties wanted to sell but due to the shortened language they failed to notice the equal intention of the other party.[77] This case underlines how seldom such a dissent occurs: Before the telegraphic declarations were exchanged one party had sent a price list to the other. Thus, one of the parties had made it clear that he wanted to sell and not to buy. Taking this into account, it would have been more appropriate to treat both declarations as congruent with the other party as buyer on the basis of the perspective of an objective recipient.[78] By comparison, the English case *Raffles v. Wichelhaus* seems to be a more justifiable

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[74] Cf. e.g. J. Ghestin et al., 2001, no. 33.

[75] Similarly in French law Art. 1161 CC and in Spanish law Art. 1285 CC.

[76] Under English Law see *Cundy* v. *Lindsay* (1878) 3 App Cas 459; J. Beatson, 2002, pp. 321-323. Under French law J. Ghestin, 1993, no. 495. Under Spanish law Art. 1284 CC.

[77] Cf. RG 5. 4. 1922, RGZ 104, 265.

[78] Cf. D. Medicus, 2006, no. 438.

example for a dissent in contractual declarations. Here the parties entered into a contract on the sale of a cargo of cotton 'to arrive ex Peerless from Bombay'. Unknown to both parties, there were two ships called 'Peerless' which arrived at the agreed port of Liverpool at different times. If both parties really had different ships in mind and if there were no indications which would have allowed the parties to unequivocally identify the ship that was referred to, the contract would be void.[79] Finally, in France, a dissent occurred in a case where the parties' intentions did not correspond with respect to the currency in which the price was to be paid. Due to a currency reform, the agreement could have referred either to old or to new Francs.[80]

3.2 The Applicability of Suppletive Law in Case of Lacunae

The case of differing declarations has to be strictly distinguished from the situation that the parties have not made any provisions at all with respect to certain questions. This may be the case either because they did not consider the question at all or because they deliberately abstained from dealing with it. As long as this gap does not affect fundamental elements of the contract such as, in particular, the parties, the subject matter of the contract, and the price, the contract is enforceable (cf. Art. II.–4:103 DCFR ~ Art. 2:103 PECL). In that case, the questions for which no provisions were made have to be solved under the rules provided by law.[81]

All European legal systems contain supplemental rules to complete contractual arrangements. In France, e.g., they are called *règles supplétives*, in England terms implied in law[82], and in Germany *dispositives Gesetzesrecht*. The necessity of these rules becomes obvious if one takes into account that the parties can never provide for all eventualities. Thus, the existence of suppletive law prevents contractual incompleteness (or voidness respectively) and thereby reduces the cost of negotiations and drafting. Supplementary law can, however, only achieve its goals if it responds to the typical interests which can be attributed to the parties of the particular type of contract. Therefore, its content has to reflect the kind of arrangement which reasonable parties would have made if they had considered the issue in question. Moreover, supplementary law serves to guarantee the fairness of contracts. While the *parties* generally do not have to justify the content of their contracts in terms of substantive justice in a legal system governed by freedom of contract, the opposite obviously applies to the *legislator* (respectively to objective law).[83] If one specifies the applicable form of justice, contract law is primarily governed by the rules of *commutative* justice whereas the appeal to principles of *distributive* justice is restricted to rare exceptions.[84]

In continental Europe, supplementary law can be found mainly in the codifications of private and commercial law. As far as these rules are concerned, it is virtually impossible, however, to achieve a comprehensive codification because the parties can construct the contract freely according to their own interests. Moreover, even a detailed elaboration of all known types of contracts would go far beyond the scope of a concise codification. Therefore, the body of supplementary law in a code will necessarily be subject to further specification by judicial case law which will grow in importance with increasing age of the codification. The common law shows that the supplementation of contractual gaps on the basis of objective law is possible and necessary even in the case where the pertinent rules are not codified at all.[85]

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[79] Cf. 2 H & C. 906, 159 Eng. Rep 375 (1864).

[80] Cf. Cass. com., 14 janvier 1969, Bull. civ. IV, no. 13, p. 13.

[81] In order to justify the rules of supplementary law, it is inaccurate and not necessary to refer to the actual intentions of the parties; for a more detailed discussion see J. Ghestin et al., 2001, no. 42.

[82] Cf. G.H. Treitel, E. Peel, 2007, para 6-037 et seq.

[83] Cf. with more detail on the theoretical background and limitations of lawmaking in private law H.C. Grigoleit, in: Jestaedt, Lepsius (ed.), *Rechtswissenschaftstheorie*, 2008, p. 51, 54 seqq.

[84] Cf. C.-W. Canaris, *Die Bedeutung der iustitia distributiva im deutschen Vertragsrecht*, 1997, p. 45 seqq., 75 seqq., 125 seqq.

[85] In more detail on supplementary law see H. Kötz, 1996, p. 176 seqq.

3.3 Ascertaining the Non-explicit Content of a Contract

The rules of supplementary law do not always offer legal results that meet the particular requirements of the case at hand. Therefore, courts often attempt to derive particular solutions from the actual contract itself, i.e. from the common intention of the parties, even if the parties did not express their ideas explicitly.

3.3.1 Completion of the Contract on the Basis of Implied Intent

As stated above (cf. 1.4), the content of a contract can be derived not only from the explicit declarations but also from the conduct of the parties. This kind of implied intention does not necessarily have to concern the conclusion of the contract as a whole. Rather, it is possible to derive implied provisions from the agreement which – in addition to its express terms – have to be acknowledged as a binding element of the contract because they reflect the *actual intention* of the parties (cf. Art. 6:102 (a) PECL; less clearly Art. II.–9:101 (1) DCFR). In particular, this is the case when a certain term is a necessary precondition for the meaningful performance of the explicit agreement. Such a conclusion justifies the assumption that the parties actually intended the provision in question. The more obviously the explicit agreement depends on a term not explicitly agreed upon, the more likely it is that the conclusion is justified that, according to the actual intention of the parties, the condition is an unexpressed element of the contract as well.[86] An obvious example is the case of a car rental contract which obliges the lessor to hand over the ignition key to the lessee even in absence of an explicit term to do so. This kind of recourse to implied elements of a contract is an essential tool of contractual interpretation. If it were not possible to consider these supplements, the parties would be forced into using an excessive amount of wording which would make the drafting process unnecessarily complicated and expensive.

Another important source of determining non-explicit intentions are the usual customs of a particular field of commerce. Provided that a solution to a specific question is established by custom, it is generally justified to assume that the parties were implicitly referring to the customary solution (Art. II.–1:104 (2) DCFR ~ Art.1:105 (2) PECL; Art. 32 (1) lit. c CEC).[87]

3.3.2 Reference to the Hypothetical Intention by Means of Constructive Interpretation

Yet, often the connection between the express terms of the contract and a certain problem is not compelling enough to justify a solution on the basis of the parties' actual intention. Some jurisdictions, however, nevertheless provide for contractual complementation by way of interpretation in such cases.[88] For instance, when filling gaps by constructive interpretation, the German *BGH* reverts to the rule which the parties themselves would have agreed upon with regard to the contract and the maxims of good faith and common usage.[89] On this basis, the court ruled, for example, that two doctors who had swapped their practices were barred from opening a new practice in the immediate vicinity of the old one for a period of two to three years.[90] The French *Cour de Cassation* allows considerable freedom in the interpretation of contracts as well. For instance, in a case where a radio station had contracted with an author to compose a radio play and had accepted the play without

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[86] Cf. Art. 32 (1) lit.d CEC. Furthermore, see the definition of the term implied in fact in *Shirlaw* v. *Southern Foundries (1926) Ltd.* [1939] K.B. 206, 227: "Prima facie that which in any contract is left to be implied and need not be expressed is something so obvious that it goes without saying; so that, if while the parties were making their bargain, an officious bystander were to suggest some express provision for it in the agreement, they would testily suppress him with a common 'Oh, of course!'."

[87] Cf. under English law ("term implied by custom") G.H. Treitel, E. Peel, 2007, para 6-047. Under Spanish law see Art. 1287 CC. To the same effect under French law Art.1160 CC; Art. 1159 CC additionally refers specifically to the custom "…dans le pays où le contrat est passé".

[88] See for an overview PECL, 2000, p. 305.

[89] Cf. BGH 18.12.1954, BGHZ 16, 71, 76.

[90] Cf. BGH 18.12.1954, BGHZ 16, 71, 76.

objections and paid for it, the court used the idea of contractual interpretation to find that the radio station actually had to broadcast the play even though there was no explicit agreement on that issue.[91]

In such cases, the only basis of interpretation can be the parties' *hypothetical* intention. However, in many cases, the distinction between the (implied) actual and the hypothetical intention of the parties is merely a gradual one. Therefore, a clear line cannot always be drawn.[92] It is a characteristic feature of constructive interpretation that the supplementary rule cannot be deduced exclusively from the contractual provisions. Instead, it requires an additional normative judgment with respect to the content of the agreement which goes beyond the reasonable recipient's perspective. The *BGH* reverts to the principle of good faith and common usage in this context. The provision of Art. II.–9:101 (2) DCFR (~ Art. 6:102 PECL) points in the same direction stating that a court may imply an additional term "where it is necessary to provide for a matter which the parties have not foreseen or provided for" on the basis of (among other factors[93]) the principle of good faith and fair dealing.

It is, however, not only difficult to distinguish constructive interpretation from the case of implied intent, but also from the provisions of supplementary law. The reason is the additional normative assessment which is necessary in both cases. In some cases, it can even be doubtful whether a distinction is fruitful at all or whether the method of constructive interpretation in fact uses the contract and its interpretation to covertly formulate rules of objective law. This objection is not to be taken lightly.[94] The reference to the parties' intention conceals that constructive interpretation profoundly interferes with the contract in two ways: on the one hand, the omission of a contractual term is, generally speaking, just as meaningful as a positive agreement. Thus, the court has to disregard this *negative exclusiveness*[95] of the agreement if it incorporates terms into the contract by constructive interpretation. On the other hand, even if one generally acknowledges the need for a complementing clause, there is always a certain discretion with respect to the particular legal result. Here again, constructive interpretation takes the solution of the pertinent issue away from the parties' autonomy and negotiation.[96] It follows that constructive interpretation is only permissible under restrictive conditions. Constructive interpretation is, in particular, *inadequate* if it can be *solely based upon objective normative considerations*. Rather, the parties' particular declarations or conduct have

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[91] Vgl. Cass. civ., 1re, 2 April 1974, Bull. civ., I, no. 109.

[92] Critically in general on the distinction, C.M. Bianca, 2000, p. 412 seq.

[93] In Art. II.–9:102 (2) (a) DCFR (~ Art.6:102 (b) PECL) "the nature and purpose of the contract" is treated as consideration independent and separate from the principle of good faith and fair dealing. This is unnecessarily complicated. Either the implied term results self-evidently from "the nature and purpose of the contract"; then it follows from the actual intention of the parties (see (a)). If this is not the case, the implied term needs an additional normative justification, which means that it has to be justified by objective principles such as good faith and fair dealing. The same objection can be raised against mentioning "the circumstances in which the contract was concluded" in the context of Art. II.–9:101 (2) (b) DCFR.

[94] See in particular the fundamental critique on constructive interpretation by J. Neuner, in: Festschrift für Canaris, 2007, p. 901, 918 seqq. J. Neuner basically argues that the reference to constructive interpretation disregards the strict dichotomy between autonomous and heteronomous obligations.

[95] The aspect of negative exclusiveness is laid down in Art. 1283 of the Spanish CC. See also J. Neuner, in: Festschrift für Canaris, 2007, p. 901, 909, 914.

[96] Recently, it has been suggested to solve the problem of judicial interference by establishing certain duties of the parties to adapt or amend the contract by negotiation. Cf. e.g. Art. 157 CEC; in detail Nelle, *Neuverhandlungspflichten*, 1994. Generally, solutions by negotiation are always desirable. However, there is no evidence that it is possible to establish legal duties which, on the one hand, are judicially workable and, on the other hand, can efficiently facilitate the process of working towards a voluntary agreement. Moreover, one has to keep in mind that duties to negotiate can never guarantee the successful conclusion of a voluntary compromise and, thus, will never fully replace judicial interference.

to indicate clearly and specifically that the constructive interpretation would have complied with the hypothetical intention of both parties at the time the contract was concluded.[97]

The distinction between constructive interpretation and supplementary law becomes particularly important in legal systems where mechanisms for the adjustment of contracts in the case of unforeseen circumstances are recognised in supplementary law, i.e. apart from interpretation. Those mechanisms of adjustment, such as the German rules of *Wegfall der Geschäftsgrundlage* (cf. § 313 BGB), are governed by very restrictive requirements, which should not be circumvented by constructive interpretation. If, however, a specific mechanism for the adjustment of contracts to exceptional circumstances is not recognised, as, for instance, still appears to be the case in France, constructive interpretation can function as a "safety valve" with respect to an overly strict reading of the principle of *pacta sunt servanda*. By contrast the open acknowledgement of a legal rule for contractual adjustment is preferable because, in many cases, the recourse to the parties' intention is merely fictitious.

3.3.3 The Source of Collateral Duties

All European legal systems acknowledge that the contract is not only the source of principal, but also of collateral duties which need not be described explicitly. To a certain extent, collateral duties can be directly derived from the parties (implicit) intentions and declarations. This is the case if the contract can only be performed if the collateral duties are carried out. The obvious example is, again, the duty to hand over the keys in a car rental transaction. Such collateral duties, however, have to be distinguished from duties which cannot be derived directly from the principal duty and which aim at a more general protection of the other party's rights and legally protected interests while the contract is being performed. An example of a collateral duty that has no direct link to the principal duty is the duty of a painter not to damage the principal's furniture by drops of paint.[98]

This second group of collateral duties is also well established in the European legal systems. With respect to the issue of interpretation, the most important question is whether it is possible to imply from the parties' intentions a general contractual duty to take reasonable care. This would correspond to the French doctrine that derives a general *obligation de sécurité* from the contract.[99] Moreover, a famous English example for the contractual construction of such a duty is the *Moorcock* case. In this case, the defendant was contractually obliged to unload the plaintiff's ship at his jetty. When the tide went out the ship stranded and was damaged. The court established liability of the defendant on the ground of breach of his implied duty to take reasonable care.[100]

Yet, there are two important arguments against relying on *the contractual agreement* to derive such general duties of care. First, there is generally no clear indication to this end in the parties' declarations. In other words: establishing such a duty based on the contract is purely fictitious. In terms of the parties' intentions, there is a clear difference between a general duty of care and other collateral duties directly aimed at achieving the contractually defined goal of performance. Accordingly, it is sufficient to have the parties bound to the contractual goal of performance in order to establish duties adhering directly to the principal duty whereas establishing a general duty of care is dependent upon an objective balancing decision taking into account the parties' conflicting interests.[101] Second, such a duty of care should not depend on whether or not a contract was concluded. In the *Moorcock* case, for example, there is no compelling reason to deny liability if the ship had been damaged at a time when the negotiating parties had not concluded a contract yet. Even

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[97] More detailed on the necessary limitations to constructive interpretation see H. Heinrichs, in: O. Palandt et al. (eds.), *BGB*, 69th ed. 2009, § 157 no. 8-10.

[98] With more detail on the distinction between primary and collateral duties see H.C. Grigoleit, in: Festschrift für Canaris, 2007, p. 275 seqq.

[99] Cf. J. Ghestin, 2001, no. 48.

[100] Cf. (1889) 14 PD 64.

[101] Cf. the criticism on the *Moorcock* decision by G.H. Treitel, E. Peel, 2007, para 6-045. Under French law, there is a dispute on the contractual character of l`obligation de sécurité as well; see J. Ghestin, 2001, no. 48 and footnote 310.

if the contract was invalid, e.g. if the parties, without noticing, had actually reached no agreement on the price, the question of liability should not be dealt with differently.

The reason for the frequent assumption of a general contractual duty of reasonable care is that liability in contract can be established more easily than liability in tort. In some European legal systems, liability in tort is restricted, as compared to contractual liability, with respect to the principal‘s responsibility for his agent, the compensation of pure economic losses and/or the burden of proof.[102] On the basis of the reasons given above, however, the question whether collateral duties are contractual in their origin does not address the right issue. Rather, one should ask whether the rules of contractual liability – if they in fact provide a more accessible remedy – apply even though the duties in question are not derived from the contractual agreement, but imputed by law. This position has gained more and more support in recent times and was recognised by the German legislator on the occasion of the reform of contract law in 2001 (see §§ 241 II, 311 II, III BGB). The reason for this legally imputed liability under the rules of contract law is that the parties necessarily grant each other special access allowing them to interfere with the legal goods and interests of the other that goes beyond the actual contractual performance and that cannot reasonably be provided for in advance. The duty of care is correlated with this special potential of interference. It protects the parties' reliance on the beneficial effects of mutual cooperation and helps create such reliance. The recognition of a duty of reasonable care and the resulting liability under the rules of contract law thus support and facilitate the conclusion of contracts. This concept allows to establish a duty of care even in cases where no contract has been concluded yet or where the contract is invalid. It is sufficient that the parties – while negotiating or performing a contract - grant each other the opportunity to interfere with the legally protected interests of the other. The details of this issue, however, are beyond the scope of our topic in this article.[103]

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[102] See for a comparative analysis C. v. Bar, *Gemeineuropäisches Deliktsrecht*, vol. I, 1996, p. 405 seqq, 459 seqq. With regard to the aspect of interpretation H. Kötz, 1996, p. 184 seqq.

[103] With regard to the position asserted here see C.-W. Canaris, JZ 1965, p. 475 seqq.; C.-W. Canaris, 2. Festschrift für Larenz, 1983, p. 27, 85 seqq. For a recent and detailed analysis see e.g. P. Krebs, *Sonderverbindung und außerdeliktische Schutzpflichten*, 2000.