

Interpretation of Commercial Contracts in the Future European Civil Code – Objective or Subjective Method?

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1. Introduction

Interpretation of commercial agreements plays crucial role in the international trade. Since the creation of the European Community, the legislatures, courts, and the legal academies of different Member States presented significantly diverging views on the issue of the intent of the parties in the process of interpretation. The courts in the common law countries (the UK, Ireland) have voiced a preference for relying on objective manifestations of the parties' intentions (objective method of interpretation); while in the other Member States (Germany, Austria, France, Italy) the doctrine of the subjective interpretation takes precedence. Already in 1989 the European Parliament raised the question of harmonizing the substantive civil law within the area of the EC by the introduction of the European Code of Private Law.¹ For the purpose of the international commercial agreements, it is essential to determine, which of the two mentioned above doctrines (objective or subjective) should prevail in the future European Civil Code. Article 8 of the 1980 Convention on International Sale of Goods as well as the Principles of UNIDROIT and the Principles of European Contract Law may serve as the guidelines for the draft of the provisions in the future Code dealing with the interpretation of contracts.

2. The UK – Objective Method of Interpretation

In the common law system, courts usually apply objective test to determine intentions of the parties.² The standard by which their conduct is judged is not internal but external. In other words, the court will look at the outward appearance of agreement and will endorse what the parties objectively appear to have intended (a contract does not depend upon the state of the parties' minds). The meaning and the effect of the written agreement will be determined by the literal interpretation of the words. If the contract is unambiguous, the court will not even admit evidence of what the parties may have thought the meaning to be. On several occasions the UK jurisprudence affirmed the objective approach to the interpretation of the contract.³ The classic statement of the objective doctrine of interpretation is that of J. Blackburn in *Smith v. Hughes* made in 1871: "If, whatever, a man's real intention may be, he so conducts himself that a reasonable man would believe that he was assenting to the terms

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¹ "Resolution on action to bring into line the private law of the MS", [1989] O. J. C158/400; see also A. S. Hartkamp (ed.), *Towards a European Civil Code*, Dordrecht, Boston, London 1994.

² G. Treitel, *The Law of Contract*, London 2003, p. 172; see also M.H. Whincup, *Contract Law and Practice*, The Hague, Boston, London 2001, p. 15.

³ See, e.g., *AG Securities v. Vaughan* [1990] 1 AC 417 (not communicated belief does not have any effect on the agreement); *New Hampshire Insurance v. M.G.N.* [1997] L.R.L.R. 24 (in interpreting a written contract, evidence that both parties had had the same undisclosed intention was inadmissible); see also S. Wheeler, J. Shaw, *Contract Law*, Oxford 1994, p. 156.

proposed by the other party, and that the other party upon that belief enters into the contract with him, the man thus conducting himself would be equally bound as if he had intended to agree to the other party's terms."⁴ The latter is ensued by a number of other decisions, which follow the same pattern of reasoning. In *Summit Investment v. British Steel Corporation* Lord Donaldson made the point very clear – "[t]he parties actual intentions are irrelevant, since otherwise many, and perhaps most, disputes and question of interpretation of the parties' wishes would be resolved by holding that the parties were not *ad idem*."⁵ The UK courts tendency not to rely on the subjective intentions of the parties was also demonstrated in *Street v. Mountfort* – where an agreement was held as a matter of law to take effect as a lease even though the lessor subjectively intended it to take effect only as a license.⁶ The Scottish courts follow the objective method of interpretation adopted by the British jurisprudence. Already in 1905 Lord Dunedin noted: "commercial contracts cannot be arranged by what people think in their inmost minds. Commercial contracts are made by what people say."⁷ Concluding, the intention of the parties, which is not clearly expressed, has traditionally limited impact on the scope of the legal enforceability of agreements in the UK system.

One of the major consequences of disregarding the subjective intentions of the parties in the common law system is the presence of the Parole Evidence Rule. The latter states that if the parties have a final written agreement, no prior oral or written negotiations or contemporaneous oral negotiations are admissible to add to, vary or contradict the writing.⁸ Very often, during the negotiations, the parties express their subjective intentions. The Parole Evidence Rule was created to provide stability in commercial transactions and to ensure certainty of concluded business agreements.⁹ The UK courts applied the discussed rule on numerous occasions.¹⁰ In *LG Schuler AG v. Wickman Machine Tool Sales Ltd* the House of Lords concludes that extrinsic evidence is not admissible for the construction of a written contract.¹¹ The point is also made very clear in *B.R. Cantrell, E.P. Cantrell v. Wright & Fuller Limited* where it is said that a document has to stand on its own and not to be glossed by any extrinsic materials.¹² The Parole Evidence Rule exists also in Irish law. However, the courts in Ireland apply this rule in a less rigid way than the courts in the UK. According to the Irish jurisprudence the strict use of the Parole Evidence Rule would inevitably lead to injustice, and thus, extrinsic evidence may be admitted to assist the court in reaching a just conclusion (to explain the circumstances surrounding the creation of the contract).¹³ In *Revenue Commissioners v. Moroney* the Supreme Court admitted parole evidence, which demonstrated that what seemed to be an apparent sale (objective interpretation of an agreement), was a transfer by way of gift in subjective intentions of the parties.¹⁴

When interpreting the intention of the parties to create legally binding relations the UK courts apply different standard to business and commercial agreements and to all other

⁴ [1871] LR 6 QB 597.

⁵ [1987] 1 Lloyd's Rep. 230 CA.

⁶ [1985] AC 809.

⁷ *Muirhead & Turnbull v. Dickson* [1905] 13 SLT 151.

⁸ E. Mckendrick, *Contract Law – Text, Cases, and Materials*, Oxford 2003, p. 330.

⁹ M.H. Whincup, n. 2 above, p. 20.

¹⁰ See, e.g., *Anangel Atlas Compania Naviera S.A. and Others v. Ishikawajima – Harima Heavy Industries Co. Ltd.* [1990] 2 Lloyd's Rep. 526; *Elpis Maritime Co. Ltd. Appellants v. Marti Chartering Co. Inc.* [1992] 1 AC 21.

¹¹ [1974] AC 235.

¹² [2003] WL 21990428.

¹³ B. Doolan, *Principles of Irish Law*, Dublin 1993, p. 93.

¹⁴ [1972] IR 372; see also *Chambers v. Kelly* [1870] 7 IRCL 231; *Clayton Love v. B & I Steampacket Co.* [1970] 104 IRTR 157.

kinds of contracts (social, domestic, family arrangements). The courts rely on a presumption that the parties to the former agreements expect their contracts to be legally binding.¹⁵ That presumption can be rebutted only by clear words included in the agreement.¹⁶ Section 179 of the Trade Union and Labour Relations (Consolidation) Act 1992 is an important statutory exception to the above mentioned presumption (collective agreements between employers and trade unions are presumed not to be legally enforceable unless they are made in writing and expressly state that the agreement is to be legally enforceable).¹⁷

3. Germany - “wirkliche Wille”

English method of interpretation of commercial agreements was perfectly summarized by Lord Denning: “[i]n contracts you do not look into the actual intent of a man’s mind. You look at what he said and did. A contract is formed when there is, to all outward appearances, a contract.”¹⁸ This extremely objective approach was not adopted in the continental civil law systems. Most of the EU countries rely on a method of interpretation, which combines the elements of objective and subjective theories. However, some Member States particularly stress the importance of the subjective intent of the parties. The best example of the latter is § 133 of the German Bürgerliches Gesetzbuch. BGB § 133 indicates that while interpreting an agreement the “true intention” (true will - “wirkliche Wille”) should prevail over the declaration’s literal meaning (§ 133 - “Bei der Auslegung einer Willenserklärung ist der wirkliche Wille zu erforschen und nicht an dem buchstäblichen Sinne des Ausdrucks zu haften”). This provision has to be considered in connection with BGB § 157, which introduces objective elements to the interpretation of a contract.¹⁹ The latter states that an agreement should be interpreted according to the requirement of good faith, giving consideration to common usage (“Verträge sind so auszulegen, wie Treu und Glauben mit Rücksicht auf die Verkehrssitte es erfordern”).

In the German law literature, there is no *communis opinio* on what is meant by “wirkliche Wille”.²⁰ The creators of BGB opted for minimizing the role of objective interpretation, when examining the intent of the parties. However, the position of the German legal academy on the purpose of § 133 evolved over the last hundred years. Today, the special importance is given to the subjective (internal) intent only when it is communicated to the other party or, when the other party (acting in a reasonable way) can infer (deduce) that intent. New understanding of § 133 approximates German law to the common law standards. However, the major difference remains. When interpreting the commercial contract in Germany, the court will focus both on the subjective intent (“innere Wille”) and objective factors (“bekundete Wille”).²¹ In the UK only the latter will be taken into consideration. One of the consequences of interpretation of contracts, with the focus on the subjective intent of the parties is the presence of *falsa demonstratio non nocet* (an erroneous designation does not impair) rule in the German system.²² If the parties to the agreement objectively express

¹⁵ R. Card, J. James, *Law for Accountancy Students*, London 2002, p. 129.

¹⁶ See *Rose and Frank Co v. J.R. Crompton & Bros Ltd* [1925] AC 445, HL.

¹⁷ n. 5 above, p. 130.

¹⁸ *Storer v Manchester City Council* [1974] 3 All ER 824.

¹⁹ G. Krüger-Nieland, H. Zöller in *BGB-RGRK*, Berlin 1982, § 133.11.

²⁰ See, e.g., *BGB mit Einführungsgesetz und Nebengesetzen*, red. H. Schultze, Band I, Stuttgart 1967, p. 537.

²¹ T. Mayer-Maly, J. Busche in *Münchener Kommentar BGB - Allgemeiner Teil*, red. F.J. Sackler, Band I, München 2001, p. 1275.

²² H. Heinrichs in *Palandt BGB*, München 2004, s.116.

certain intention, but the subjective intentions of the parties differ (and are the same for both parties), the court will rule accordingly to the subjective intentions. The German courts elaborated on *falsa demonstratio non nocet* rule on several occasions.²³

Swiss law presents very similar approach to the interpretation of commercial contracts. Even though Switzerland is not a member of the EU, Article 18 of the Swiss Federal Code of Obligations 1911 may be used as one of the guidelines for the purpose of the future European Civil Code. According to the latter provision, when interpreting an agreement, the mutually agreed real intention (“*übereinstimmende wirkliche Wille*”) of the parties must be considered and not incorrect terms or expressions (“*unrichtige Bezeichnung oder Ausdrucksweise*”) used by the parties by mistake in order to conceal the true nature of the contract.²⁴ The Swiss courts usually try to establish the literal meaning of the wording of an agreement (“*Buchstabeninterpretation*”) as well as what the parties may have had in mind (the subjective intention of the parties - “*wirkliche Wille*”).²⁵ The latter has a special importance because the addressee of a particular declaration is deemed to be obliged to give all possible attention to the subjective intent of the other party (consider all aspects allowing the understanding of the declared intent).²⁶

4. France – Subjective Method of Interpretation

The main rules followed by the French courts when interpreting a contract, are stated in Articles 1156-1164 of the French Civil Code of 1804. Those rules, because of their brief character, are sometimes considered to be the mere guidelines.²⁷ Article 1156 declares a general principle that the meaning of a contract should be determined according to the common intention of the parties. When the intention is not clear, the courts will rather look to the true state of mind of the parties (French law will only hold a person bound in contract if it is his real intention to be bound) and not to the external appearance of the contract (the latter approach is typical for the common law courts).²⁸ Because of the adoption of subjective method of interpretation, the French civil law gives a special importance to the theory of “defects of consent” (in particular to mistake and *dol per réticence*).²⁹ To determine the real state of mind of the parties the courts will examine all available extrinsic evidences (absence of the Parole Evidence Rule). In the common law system, the whole area of mistaken agreements is very controversial and the case-law is highly confused (the number of cases in which “mistake” is invoked is relatively small). However, it is of less importance in modern English law than formerly because of improved remedies for misrepresentation. In the UK cases that deal with the issue of mistake the courts follow a purely objective approach (“there is no principle of English law that any contract may be ‘avoided’, *i.e.* not come into existence, by reason simply of a mistake, whether a mistake of one or both parties. The question is simply whether objective agreement has been reached and, if so, upon what terms. If objective agreement has been reached, in the sense we have described, then the parties will

²³ See, e.g., BGH NJW 1983, 1610; BGH NJW 2002, 1038; BGH III ZR 62/03; BGH V ZR 65/01.

²⁴ H. Altherr, E. Brem, H. Bühlmann, Schweizerisches Obligationenrecht, Bern 1994, p. 15.

²⁵ *Obligationenrecht – Allgemeine Bestimmungen*, red. H. Becker, Bern 1941, p. 71.

²⁶ *Introduction to Swiss Law*, ed. F. Dessemontet, T. Ansay, The Hague, Boston, London 1995, p.110.

²⁷ Cass. Req. 24 February 1868, DP 1868.1.308.

²⁸ B. Nicholas, *French Law of Contract*, London 1982, p. 46.

²⁹ *Ibid.*

be bound.”³⁰). In France courts apply Articles 1109 and 1110 of the Civil Code. The former states that “there can be no valid consent if such consent have been given through mistake”, the latter indicates that “mistake is not a cause for annulling the agreement except when it occurs in the very substance of the thing which is the object thereof.” Case law significantly widened the scope of the court power when it comes to the interpretation of the “substance of the thing” in Art. 1110. On several occasions³¹ (after establishing the real intentions of the parties) courts declared agreements null because of one or both parties’ mistake (the objective interpretation would not lead to the annulment of the contract).

Italian 1942 Civil Code includes rules on interpretation which closely resemble principles stated in Articles 1156-1164 of the French Civil Code. Article 1362 gives preference to the subjective method of interpretation (“That which was the common intent of the parties, not limited to the literal meaning of the words, shall be sought in interpreting the contract.”) and clearly accepts parole evidence in the process of interpretation (“In order to ascertain the common intent of the parties, the general course of their behavior, including the subsequent to the conclusion of the contract, shall be taken into account.”).

5. The Scandinavian Perspective

The legal systems of Scandinavian countries are not as code-oriented as the rest of the continental Europe law, and not as case-oriented as the common law. Years of cooperation between Sweden, Denmark, Norway, Finland and Iceland led to the adoption of very similar statues in the field of sale of goods and contract law.³² However, the courts in different Nordic states interpret commercial contract following not exactly the same pattern of interpretation. Danish and Swedish legal traditions demonstrate particularly interesting features of agreement interpretation.

When interpreting an agreement, the Danish courts will rarely directly address the question of subjective intentions of the parties. They will rather focus on the problem - what the parties might reasonably expect in the given social, economic or commercial situation. In other words, the courts in Denmark tend to apply objective (pragmatic) test. However, that pragmatic test is more flexible than the one used by the courts in the UK. One of the examples of that flexibility is the absence of the Parole Evidence Rule in the Danish system (information about negotiations preceding the conclusion of the contract, marketing materials, previous agreements between the parties, and other preceding and subsequent circumstances can be used establishing the contents of the contract).³³

In Sweden the courts traditionally try to interpret an agreement according to the common intentions of the parties. If it can be established that a written contract does not show “meeting of minds” of the parties, the written text is set aside (*falsa demonstratio non nocet* rule).³⁴ In most of the cases it is a difficult task to establish the common intention of the parties (very often it simply does not exist), and thus, the courts use a two-step test to

³⁰ *Whittaker and Whittaker v. Campbell* [1983] 77 Cr. App. R. 267; see also *Centrovincial Estates PLC v. Merchant Investors Assurance CO. Ltd.*, *The Times*, March 8, 1983.

³¹ See, e.g., Orleans 21.1.1931, DH 1931. 172; Tribunal de grande instance of Paris 13.12.1972, D 1973.410.

³² M.H. Whincup, n. 2 above, p. 30.

³³ P. Mogelvang-Hansen in *Danish Law in a European Perspective*, ed. B. Dahl, T. Melchior, D. Tamm, Copenhagen 2002, p. 254; see also case law – U 1984 p. 392 (Supreme Court); U 1977 p. 1031 (Court of Appeals).

³⁴ *Swedish Law in the New Millennium*, ed. M. Bogdan, Stockholm 2000, p. 283.

interpret an agreement. The first part of the process is called *tolkning* (interpretation), the second *utfyllnad* (supplementation).³⁵ *Tolkning* is based on a purely objective analysis, where the court carries the semantic interpretation of a wording. During *utfyllnad* all the extrinsic evidences are taken into account (Swedish system does not recognize the Parole Evidence Rule). Concluding, if the common intention of the parties cannot be found, the Swedish courts rely on the objective interpretation of an agreement. Alternatively, they establish which party is to be blamed for the lack of clarity in the contract (the intention of the other party should take precedence).³⁶

6. The Netherlands and Belgium – Principle of Confidence

The principle of confidence is recognized in German (“*Vertrauensprinzip*”) and French legal literature (“*principe de la confiance*”). According to that principle, the declaration of a party is understood in the sense that the addressee could in good faith attribute to it, and thus, the courts do not focus on the subjective intent of a party. They also do not interpret an agreement only in accordance to the literal meaning of the wording of a contract. The principle of confidence has a special importance in the Swiss legal system.³⁷

The New Dutch Civil Code (*Nieuw Burgerlijk Wetboek* – entered into force in January 1992) contains only very broad guidelines connected to the interpretation of contracts; all major principles and rules were developed by the Dutch courts.³⁸ In 1981, in a landmark decision, the Supreme Court stated that the intention of the parties must be examined, rather than the literal sense of the words of a contract.³⁹ The Court clearly indicated that: “the sense the contracting parties could mutually reasonably attach to the stipulations in the present circumstances and that which they could reasonably expect from each other to that matter” should be the decisive factors, which help to define the intentions of the parties. The judgment in *Ermes v. Haviltex* case became known as “*Haviltex formula*”. That formula introduces and underlines the importance of the principle of confidence in the Dutch legal system (the declaration of one party is understood in the sense that the other party, acting in a reasonable way, could attribute to it). The principle of confidence can be also inferred from the wording of Article 35 Book 3 of the New Civil Code (“The absence of intention in a declaration cannot be invoked against a person who has interpreted another’s declaration or conduct, in conformity with the sense which he could reasonably attribute to it in the circumstances, as a declaration of a particular tenor made to him by that other person”). To determine what one party could reasonably expect from the other, all means of evidence can be used (the Parole Evidence Rule is not adopted in the Dutch system).⁴⁰

The Belgian law of contracts is codified in the third Book of the *Code civil* (Civil code). The present Civil Code is still very close to the French original. All but 37 of Articles 1106-1369 of Belgian and French Civil Codes are identical.⁴¹ General rules on interpretation are stated in Art. 1156. According to that provision: “it is necessary to search into the mutual intention of

³⁵ *Swedish Law – a Survey*, ed. P. Cronhalt, Stockholm 1994, p.192.

³⁶ *Ibid.*; see also U. Bernitz, *Standardavtalsrätt*, Stockholm 1987, p. 36 and next.

³⁷ n. 26 above.

³⁸ M. H. Whincup, n. 2 above, p.32; see also A.S. Hartkamp, M.M. Tillema, *Contract Law in the Netherlands*, The Hague 1995, p. 97-98.

³⁹ *Ermes v. Haviltex*, NJ 1981, 635.

⁴⁰ A.S. Hartkamp, M.M. Tillema, n. 33 above, p. 66.

⁴¹ *Introduction to Belgian Law*, ed. H. Bocken, W. De Bondt, Brussels 2001, p.224.

the contracting parties, rather than to stop at the literal sense of terms." More precise principles of interpretation were developed by the Belgian courts. The principle of confidence was recognized by the *Cour de Cassation* in the judgment from 20 June 1988.⁴² However, there is no *communis opinio* as to the impact of that decision. It is not clear, whether this judgment applies to the law of contracts in general or is limited only to the contract of mandate.⁴³ In the view of the majority, the intention (will) of the parties (not the "reasonable expectation" as it is according to the principle of confidence) is still the starting point for the interpretation of a contract.⁴⁴ Concluding, the principle of confidence in the Belgian contract law may be used only as one of the supplementary means of interpretation.

In Belgium, the subjective intention of the parties has a crucial importance when determining the content of an agreement. However, the rule of evidential form of written instrument (Arts 1319, 1320, 1322, 1341 of the Civil Code) allows the court to give the precedence to the subjective intent (and not to the literal wording of an agreement) only when a contract is written in an ambiguous way.⁴⁵

7. CISG - Article 8

Article 8 of the *Convention on Contracts for the International Sale of Goods* (CISG) furnishes the rules to be followed in interpreting the meaning of any statement or other conduct of a party which falls within the scope of application of the Convention. This provision may serve as one of the most important guidelines for the purpose of the future European Civil Code. While drafting Art. 8 the UN Commission on International Trade Law had to face and reconcile conflicting theories about the fundamental nature of the process of contracting (subjective or objective method of interpretation).⁴⁶ UNCITRAL built Art. 8 relying on the subjective approach (Paragraph 1 - interpretation is to be based on a speaker's "intent", but only "where the other party knew or could not have been unaware" of that intent). Article 8 Paragraph 2 introduces objective method of interpretation ("statements made by and other conduct of a party are to be interpreted according to the understanding that a reasonable person of the same kind as the other party would have had in the same circumstances"). The latter provision is used only when Paragraph 1 is not applicable.⁴⁷

Article 8 Paragraph 1 applies to two different situations. First of all, it will determine the content of the agreement, when one party clearly expresses his intent and the other party is actually or supposedly aware of it (at the conclusion of the agreement the intention of the former becomes the common intention of both parties). Secondly, Art. 8(1) will apply, when the acting party does not express his intent in an unambiguous and clear way but the addressee is aware of the real intent.⁴⁸ Paragraph 1 has its roots in the approach taken by the creators of BGB - "wirkliche Wille" of a communicating party should be the main factor determining the meaning of the wording of the agreement.⁴⁹

⁴² Cass. 20 June 1988, RW, 1989-1990, 1425.

⁴³ See M.E. Storme, *De invloed van de goede trouw op de kontraktuele schuldvordering*, Brussels 1990.

⁴⁴ n. 36 above, p. 226.

⁴⁵ Cass. 13 September 1968, Arr. Cass., 1968-1969, 44.

⁴⁶ J. O. Honnold, *Uniform Law for the International Sales*, The Hague 1999, p. 117.

⁴⁷ See, e.g., W. A. Achilles, *Kommentar zum UN - Kaufrechtsübereinkommen (CISG)*, Berlin 2000, p. 32.

⁴⁸ F. Enderlein, D. Maskow, *International Sales Law*, New York, London, Rome 1992, p. 63.

⁴⁹ G. Reinhart, *UN - Kaufrecht*, Heidelberg 1991, p. 33.

The criterion of a “reasonable person” in Article 8(2) is taken over from the common law system. This provision protects the party who attributes a reasonable understanding to the other party’s condition. It also places an obligation on the parties to communicate in a clear way because the doubts are to be resolved against the one who prepares communication (the drafters of the CISG adopted the *contra proferentem* rule).⁵⁰ Even though, Paragraph 2 is created as the supplementary mean of interpretation (only when Paragraph 1 is not applicable), the meaning of the majority of contracts will be determined according to the objective standard of interpretation (almost always when parties are involved in controversy as to their common intent).⁵¹

The CISG does not specifically address the issue of extrinsic evidence and the Parole Evidence Rule. However, Article 8 Paragraph 3 states that all relevant circumstances of the case, including the negotiations, any practices the parties have established between themselves, usages and subsequent conduct of the parties can be taken into consideration when assessing the intent of the parties. The leading case on the Parole Evidence Rule in connection to Article 8 Paragraph 3 of the CISG was decided by the United States Court of Appeals (Eleventh Circuit).⁵² In *MCC-Marble v. Ceramica Nuova D’Agostino* the court underlined the major difference between the standard of interpretation applied in the common law system and the approach adopted in Art. 8 of the CISG (“Contrary to the result of the objective approach which is familiar practice in United States courts, the CISG appears to permit a substantial inquiry into the parties’ subjective intent, even if the parties did not engage in any objectively ascertainable means of registering this intent.”). The court concluded that under Art 8(3) parole evidence is admissible and may have a crucial importance for the determination of the common intention of the parties (“Moreover, article 8(3) of the CISG expressly directs courts to give due consideration (...) to all relevant circumstances of the case including the negotiations (...) to determine the intent of the parties. (...) article 8(3) is a clear instruction to admit and consider parole evidence regarding the negotiations to the extent they reveal the parties’ subjective intent.”).

Article 8 of the CISG combines the elements of subjective and objective methods of interpretation. The court is obliged to start the process of interpretation by establishing the intent of an individual party (Art. 8 does not refer to the common intention of the parties). If there is no indication as to the “real intention” of the party, the court has to use the objective criterion of an understanding that a reasonable person would attribute to the statements and conduct of the party to the contract, in the equivalent circumstances. Paragraph 3 lists the auxiliary means of interpretation and (not directly) allows the use of the extrinsic evidence while determining the meaning of a contract (parole evidence is admissible).

8. The Principles of European Contract Law and UNIDROIT Principles - Common Intention of the Parties

The Principles of European Contract Law (PECL) are the product of work of the Commission on European Contract Law (a body of lawyers from all the Member States). The Commission began its work in 1982 and thirteen years later Part I of the PECL was published. In 1999, the Second Commission on European Contract Law published Part II of the PECL which deals,

⁵⁰ n. 41 above, p. 118; see also H. Bernstein, J. Lookofsky, *Understanding the CISG in Europe*, Dodrecht 1997, p. 28.

⁵¹ n. 41 above.

⁵² *MCC-Marble Ceramic Center, Inc. v. Ceramica Nuova D’Agostino, S.P.A.*, 144 F.3d 1384 (1998).

inter alia, with the interpretation of commercial contracts. The Principles, designed primarily for the purpose of commercial contracts concluded between the parties from different Member States, are the first step in the long process of drafting the future European Civil Code.⁵³ The members of the Commission on ECL underline the difficulties connected with the unification of the civil law of the Continent and the common law of the British Isles⁵⁴ (especially, when it comes to different methods of interpretation). The most important source of inspiration for the Commission on European Contract Law have clearly been the UNIDROIT Principles of International Commercial Contracts (UP) which were published in 1994. The UNIDROIT Principles were prepared by the International Institute for the Unification of Private Law (UNIDROIT - an independent intergovernmental organization with its seat in the Villa Aldrobrandini in Rome).⁵⁵

The interpretation rules are stated in Articles 5:101 – 5:107 of the PECL and in Chapter 4 of the UNIDROIT Principles. In Paragraph 1 of Article 5:101 (Art. 4.1 of the UP contains almost identical provision) the subjective method of interpretation is adopted. The court is obliged to establish the common intention of the parties even if this differs from the literal meaning of the words. The interpretation given to the meaning of the contract may be different not only from the literal sense of the language used, but also from the meaning which a reasonable person would attach to it.⁵⁶ Paragraph 2 of Article 5:101 is the consequence of the rule that the intention of the parties prevails over the letter of the contract.⁵⁷ According to that provision, “[i]f it is established that one party intended the contract to have a particular meaning, and at the time of the conclusion of the contract the other party could not have been unaware of the first party's intention, the contract is to be interpreted in the way intended by the first party.”⁵⁸ Article 5:101(3)⁵⁹ introduces the objective method of interpretation, however, only as the supplementary way of determining the meaning of the contract. If the common intention of the parties cannot be found, “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.” When applying the objective method, the courts do not have the power to go against the unequivocal will of the parties.⁶⁰

Article 5:102 contains a non-exhaustive list of matters which the court should consider when seeking the common intention of the parties (preliminary negotiations, the conduct of the parties, the nature and purpose of the contract, the interpretation which has already been given to similar clauses by the parties, the practices the parties have established between themselves, the meaning commonly given to terms and expressions in the branch of activity concerned, usages, good faith and fair dealing). The relevant circumstances set out in Article 5:102 are almost identical to those enumerated in Art. 4.3 of the UP (the latter provision does not mention “good faith and fair dealing”; those two factors are included in General

⁵³ *Principles of European Contract Law – Part I and II*, ed. O. Lando, H. Beale, The Hague, London, Boston 2000, p. XXI.

⁵⁴ O. Lando in *The International Sale of Goods Revisited*, ed. P. Sarcevic, P. Volken, The Hague, London, New York 2001, p. 162.

⁵⁵ See <http://www.unidroit.org>.

⁵⁶ G.G. Letterman, *UNIDROIT's Rules in Practice – Standard International Contracts and Applicable Rules*, The Hague, London, Boston 2001, p.159.

⁵⁷ n. 48 above, p. 289.

⁵⁸ See also Article 4.2.1 of the UP.

⁵⁹ See also Articles 4.1.2 and 4.2.2 of the UP.

⁶⁰ n. 51 above.

Provisions of the UP⁶¹). Article 5:102 does not address directly the issue of the Parol Evidence Rule. It is generally understood that the Parol Evidence Rule under the PECL is precluded.⁶² This assumption is based on the comparison between Article 5:102 and Article 8(3) of the CISG (those provisions are almost identical). The jurisprudence (mainly from the United States) indicates that the parol evidence is admissible under the latter article.⁶³ However, the Commission on European Contract Law clearly states that: “[t]he search for common intention is compatible with rules which forbid the proof of matters in addition or contrary to a writing (...) as it refers to external elements only to clarify the meaning of a clause, not to contradict it.”⁶⁴

Articles 5:103 – 5:106 contain five specific rules of interpretation. Article 5:103⁶⁵ states the rule *contra proferentem*, under which any ambiguities are to be resolved against the party drafting the contract. The *contra proferentem* rule has been adopted on several occasions by the EU.⁶⁶ Articles 5:104 (“Terms which have been individually negotiated take preference over those which have not.”), 5:105⁶⁷ (“Terms are to be interpreted in the light of the whole contract in which they appear.”) and 5:106⁶⁸ (“An interpretation which renders the terms of the contract lawful, or effective, is to be preferred to one which would not”) express interpretation rules which are adopted in the majority of the EU Member States.⁶⁹

9. Conclusion

One of the primary factors motivating the adoption of the European Civil Code is to provide parties to international commercial agreements with some degree of certainty as to the principles of law that would govern the creation and interpretation of contracts. Some authors question the idea of a European codification. They claim that the notion of the European Civil Code, even only for contracts, “appears to be still only a utopia.”⁷⁰ In my opinion, the issue of interpretation (the choice between objective and subjective approach) may serve as the example which demonstrates that the European Code of Private Law is not only desirable but also feasible. Major differences between methods of interpretation applied by the courts in the common law and continental countries, and also minor differences between civil law system countries, are slowly diminishing. Most civil law systems seem to have moved towards a more objective method of interpretation⁷¹ (*normativ Auslegung* in Germany, *il significato normale* in Italy), whereas, the UK courts gradually start to follow the suggestions of Lord Wilberforce (“English law is not left behind in some island of literal interpretation (...) the time has long passed when agreements were isolated from the matrix of facts in which they were set and interpreted purely on internal linguistic

⁶¹ See Article 1.7.1 of the UP – “Each party must act in accordance with good faith and fair dealing in international trade.”

⁶² M. Stanivukovic, *Editorial remarks on the manner in which the PECL may be used to interpret or supplement CISG Article 8*, <http://www.cisg.law.pace.edu/cisg/text/peclcomp8.html>.

⁶³ See, e.g., *Claudia v. Olivieri Footwear Ltd.*, 1998 WL 164824 (S.D.N.Y. 1998); *Filanto, S.p.A. v. Chilewich Intern. Corp.*, 789 F.Supp. 1229 (S.D.N.Y. 1992); see also n. 47 above.

⁶⁴ n. 48 above, p. 288.

⁶⁵ See also Article 4.6 of the UP.

⁶⁶ See, e.g., Council Directive 93/13/EEC of 5 April 1993 on unfair terms in consumer contracts, art. 5.

⁶⁷ See also Article 4.4 of the UP.

⁶⁸ See also Article 4.5 of the UP.

⁶⁹ n. 48 above, p. 295-297.

⁷⁰ A. Chamboredon in *The Harmonization of European Private Law*, ed. M. Van Hoecke, F. Ost, Portland 2000, p. 97.

⁷¹ M.W. Hesselink, *The New European Private Law*, The Hague, London, New York 2002, p. 132.

considerations⁷²) and adopt more subjective approach, which is based not only on the literal meaning of the contract.⁷³

The creators of the provisions on interpretation of contracts in the future European Civil Code should adopt the “complex method of interpretation”⁷⁴ (compilation of subjective and objective method). The starting-point in the process of interpretation should always be the common intention of the parties (*falsa demonstratio non nocet* rule should be adopted). This flows from the will theory of contract and already is accepted in most of the Member States (explicitly in France, Belgium, Luxemburg - Art. 1156 CC, Italy - 1362 CC, Poland - Art 65(2) CC). The search for the common intention of the parties should not be limited to the document which contains the agreement (parole evidence should always be accepted). This rule is adopted by the CISG (Art. 8), the Principles of European Contract Law (Art. 5:102) and UNIDROIT Principles (Art 4.3). However, the issue of the Parole Evidence Rule in those documents is not addressed in a direct way and sometimes creates confusion⁷⁵ (relevant provision in the future European Civil Code should clearly state that all extrinsic evidences are acceptable). In order to find a balance between the Continental and common law system, when the parties did not clearly express their common intention, the contract should be interpreted according to the understanding that a reasonable person with full knowledge of the factual background of the contract would have had (objective approach).⁷⁶ All ambiguities should be resolved against the party which drafted those provisions (*contra proferentem* rule is adopted both in the common law⁷⁷ and civil law⁷⁸ systems).

⁷² *Prenn v. Simmonds* [1971] 1 W.L.R. 1381.

⁷³ *UMMA Bank SAL v. Colin Graham Bird, Anthony Victor Lomas* [2002] WL 31914787; *Greatdays Holiday Services Limited v. Bannister, Jacobs* [2002] WL 1654998; *Petromec Inc v. Petroleo Brasileiro SA Petrobras* [2004] EWHC 127; *Egan v. Static Control Components (Europe) Ltd* [2004] 148 S.J.L.B. 507.

⁷⁴ The “complex method of interpretation” in Polish law is described by Z. Radwański, *Prawo cywilne - część ogólna*, Warszawa 2002, p. 228; see also Polish Supreme Court - SN z 29.06.1995, OSN 1995, poz. 168.

⁷⁵ See the decision of the District Court for the Southern District of Florida in *MCC-Marble Ceramic Center, Inc. v. Ceramica Nuova D'Agostino, S.P.A.*, No. 92-2108-CIV-KEHOE and also *Beijing Metals & Minerals Import/Export Corp. v. American Bus. Ctr., Inc.*, 993 F.2d 1178 (5th Cir. 1993) where the judges applied the Parole Evidence Rule to Art. 8 of the CISG.

⁷⁶ See *Investors Compensation Scheme Ltd v. West Bromwich Building Society (No.1)* [1998] 1 W.L.R. 896.

⁷⁷ See, e.g., *Houghton v. Trafalgar Insurance Co* [1954] 1 QB 247.

⁷⁸ See, e.g. French CC - Art. 1162, Spanish CC - Art. 1288.