

The Meanings Behind the Words

This chapter looks at the problems of contract interpretation – how the lawyer works out what the words that have been used in the contract actually do mean – if and when there is a dispute. We all need to be able to second-guess the lawyers.

THE PROBLEM OF WORDS

This is the most difficult area for most people. It is difficult for three reasons:

- When we start talking words in contracts we find ourselves dealing, not just with law, but with lawyers. Lawyers are very good at words. Just as accountants are very good at sums, lawyers are good at writing things down. Because they are good at words, they can scare people.
- It is all too easy to get the words wrong. As Winston Churchill once said ‘words are tricky little b——s’. English is a very flexible language, with lots of words that have two or more different meanings.
- We are not very good at quality control when we deal with words.

THE BASIC PRINCIPLE

The commercial contract in writing is presumed to be a ‘complete’ and ‘precise’ statement of the terms agreed between the parties. This means two things. If it isn’t included in the written document (or referred to, ‘included by reference’, in the written document), it is not part of the contract. If it is in the written document, it is part of the contract.

The law then sees its job as providing a remedy for any party if the other party has failed to carry out its contract obligations properly.

HOW THE LAW SEES THE COMMERCIAL ORGANISATION

We have already said that the company is automatically expected to know what it is doing when it enters into a contract. Even more important, the law also presumes that the company knows what it is saying when it enters into a contract. The law automatically assumes that the company has agreed to the precise words that are written into the contract and is prepared to take the risks and liabilities that go with those words.

Therefore once a contract is made, the company must live with the words, whatever they may be, for the duration. Of course you may agree to change the words, or to have 'agreed interpretations' of some of the words. And in real life nobody is bothered by the thousands of minor mistakes in carrying out contracts that happen every day. Nevertheless the principle holds good. The law expects the company to have the necessary language skills to say what it intends, and therefore presumes that the commercial contract means what it says, when interpreted correctly, that is by a lawyer.

This is pretty well a universal principle, applicable to all commercial contracts everywhere. Common law and civil law are identical.

A REASONABLE PERSON

The words used in a contract mean what a 'reasonable' (and impartial) person, knowing the factual background to the contract, would think that they meant.

A reasonable person is one with the appropriate skills and knowledge to understand the contract. A contract made between two engineering companies will mean what a reasonable person with word skills and engineering knowledge would think that the words mean when he reads the contract. A contract between two insurance companies will mean what a reasonable person with knowledge of the insurance industry would think that they meant when he reads the contract – and so on.

WHO IS A REASONABLE PERSON?

The problem is that if your company is involved in a contract, you are not the reasonable person. Even though you know what the words are supposed to mean, you are not 'impartial' in legal terms. This is because you are employed by one of the parties to that contract. The people employed by the other company involved are in the same position. An impartial person has to be an outsider.

The choice is limited. You may ask an expert in the industry, or a mediator or conciliator, but if there is no other way of resolving the dispute you may have no choice

but to ask a judge, arbitrator or adjudicator. The problem is that the judge is not a reasonable industry expert with good technical word skills. He is a lawyer and lawyers are seldom expert in industry or technology. But they do have incredible legal word skills; they spend their entire working lives using words. And although an arbitrator or adjudicator may understand your world, he has an obligation to make his decision in 'a judicial manner', that is very broadly in the same way as a judge.

The way a judge will reach his decision is that he will listen to the arguments of the advocates, in the UK probably barristers, who present the case for both sides. He will then make his decision only on the basis of the legal arguments that they have put to him. An arbitrator or adjudicator has to take a similar approach.

Therefore if one of your contracts becomes the subject of a dispute, the words that you have written into the contract will be subject to the interpretation of professional lawyers. Lawyers might not interpret the words of the contract in the way that people in the industry would interpret them. They will interpret words in the way that lawyers interpret words and, in an imperfect world, you have to live with this.

THINGS TO LOOK OUT FOR

1. The terms of the contract can be of different kinds – conditions, warranties and innominate, or intermediate, terms. The law here is rather confusing.
2. Words and grammar – it is all too easy to say something different to what we wanted to say.
3. Organising the contract properly – to avoid unnecessary mistakes.

THE ROLE OF TERMS

CONDITION

The word 'condition' can be used in contracts in two ways. Firstly it can mean one of the terms of the contract, as opposed, for example, to the specification. Secondly, in lawyers' jargon, it can mean a particular type of contract term. This second meaning is what concerns us here.

The condition is a major promise, a significant term of the contract. If the party that has made that promise fails to carry it out, the other party is entitled either to claim damages for the failure to comply, or to terminate the contract and claim the damages as well. The damages claimable will be all of the losses that the injured party can prove that he has suffered as a direct result of the breach (see Chapter 8).

WARRANTY

The warranty (also lawyers' jargon) is a less important promise, a minor term of the contract. If the party that has made that promise fails to carry it out, the injured party is entitled to claim damages for the losses that he has suffered as a result, but will not be allowed to terminate the contract. He must live with the contract as performed.

INNOMINATE OR INTERMEDIATE TERM

An Innominate or Intermediate Term is neither a condition nor a warranty, but has elements of both. In such a case a serious breach of the term would entitle the injured party to terminate and/or claim damages, whereas a minor breach would permit only a claim for damages.

TERMS IN PRACTICE

As you can see already the only practical differences between the three types of term is in the rights the injured party will have against the other if there is breach of contract. All three give the injured party the right to claim damages. The problem is when a contract can be terminated.

Of course the usual commercial solution is to avoid argument by simply including a 'termination clause' in the contract conditions, allowing for termination of the contract in the case of any breach of the terms of the contract which is not remedied by the party at fault within a reasonable period.

HOW DID WE GET TO WHERE WE ARE NOW?

Traditionally English law recognised only conditions and warranties. This meant that whenever there was a dispute about whether a contract had been properly terminated for breach or not the judge always had to decide whether a contract clause was a condition or a warranty.

There was, and is, no hard and fast rule. Whether any particular term of the contract is a condition or a warranty will depend upon the words used in the contract. Some promises are almost automatically conditions, such as delivery date or that the goods should comply with the specification. Then the contract may make a particular clause a condition – 'it is a condition of this contract that ...' – and so on.

Although this applied to the majority of cases there are one or two cases in which judges held that terms of the contract stated to be conditions were not really conditions but merely warranties, with no right of termination for breach. All of these cases however concerned slightly unusual contracts. In the standard purchase/procurement situation it is reasonably safe to say that if a clause in the contract is stated to be a condition then it will be.

THE INNOMINATE TERM

There was a series of cases during the 1950s and '60s involving contracts for the purchase of second-hand cars. The typical situation was that a purchaser had bought a second-hand car and then was dissatisfied with the car because of defects in it. He had tried to return the car to the dealer and ask for his money back. The dealer would refuse to take the car back but would offer the purchaser a small amount of money off the contract price or would undertake to try and repair the defects.

The dispute would always turn on the proper interpretation of the terms of the contract under which the car was bought and in particular of the way that the dealer had described the car (that is the specification). The description of the car would be that the car was 'in perfect condition' or was 'very reliable', or something of that nature. There would be no doubt that the car was defective, and there would be no doubt that the defects in the car were in breach of the wording of the contract. The nub of the dispute would be whether or not the purchaser had the right to return the car to the dealer. If the term of the contract was a condition then the purchaser would have the right to terminate the contract (and return the car and get his money back). If the term in the contract was merely a warranty then the purchaser would not have the right to return the car to the dealer but would have to accept repair work or money off the price.

The cases led to a series of judgements in which judges produced convoluted arguments as to whether or not particular words in a particular contract were to be interpreted as a condition or a warranty. Of course what the judges really were doing was looking at the state of the car and asking themselves whether the purchaser should have the right to walk away from the contract. If they decided that the purchaser should have the right to walk away they would call the words a condition. If they felt that he should not have the right to walk away they would call the words a warranty. Not surprisingly, this led to a number of dubious decisions, and finally the courts did accept that 'reverse reasoning' was taking place.

The solution to this problem was created in a case involving Kawasaki Motorcycles – *Kawasaki KKK v Hong Kong Fir Shipping Ltd*. In this case the court held that it was possible for a term of the contract to be neither a condition nor a warranty, but somewhere between the two, what the court called an 'Innominate' or 'Intermediate Term'. In such a case a serious breach of the term would entitle the injured party to terminate and/or claim damages, whereas a minor breach would permit only a claim for damages. In theory this is a perfect solution to the problem of the rights of the injured party in any case of breach of the contract.

However, the Kawasaki dispute arose because Kawasaki had a contract to hire a ship to transport motorcycles from Japan to other countries. The contract, a charter

party, was for a period of 21 months. In the contract there were clauses that the ship was to be in good condition, and the crew efficient. A series of problems caused by bad seamanship and seriously defective steering gear and engines kept the ship out of action for almost all the first three months of the contract. Kawasaki terminated the contract. But when the case got to court, four years later, the court decided that the clauses were innominate terms and that the breach had not been serious enough to entitle Kawasaki to terminate. The result was that although the shipping company was in breach of contract and wholly at fault, it won heavy damages for wrongful termination from Kawasaki who was not in any way to blame.

The problem is obvious: because the innominate term does not create a clear-cut situation, it can simply create a lottery as to what the courts may decide in any instance several years after the event if one party terminates and the other disputes that decision. It is therefore perhaps best avoided by making the important terms clearly stated conditions and leaving everything else as a warranty – and then including a termination clause anyway.

CIVIL LAW

Civil law takes a radically different approach to common law. Common law says that the terms of the contract can be of different types, so that breach of different types of term will have different consequences. Civil law takes the opposite view. Under civil law all terms of the contract are equal in status. Their status is similar to that of a warranty under English law. Therefore the only basic right that either party has for breach of any term of a contract is to claim damages for the results of the breach. Damages will be assessed on, effectively, the same basis as under common law.

Therefore neither party to the contract has the power to terminate the contract for breach, unless there is a specific termination clause in the contract. If there is no such clause in the contract the only way to terminate the contract is by going to court and asking for a court order to terminate the contract, (effectively suing the other party for breach – which takes time and costs money). As a result it is normal practice for all commercial contracts in civil law countries to include a termination clause.

INTERPRETATION

The aim is to derive from the contract 'a common sense interpretation so as to give effect to the commercial purpose of the parties to the contract'. The difficulty is that once the parties are in dispute this may not always be possible.

A FOUR-STAGE PROCESS

1. Ascertain all the background knowledge reasonably available to both (or all) the parties at the time of the contract. This background includes

anything that would affect the way in which the contract should be understood. However it excludes previous negotiations between the parties and any statements they have made which have not become part of the contract. This has been called the 'factual matrix'.

2. Decide what the words of the contract mean. The words of the contract must be given their 'natural and ordinary meaning'. In other words the basic principle is that the parties are deemed to have intended to use the words they did actually use.
3. Decide what the parties would reasonably have understood the words of the contract to mean against the relevant background.
4. Apply this interpretation to the actual dispute that has arisen.

Remember that contracts can be very different. Some contracts contain very little information, and the only way to give them a commonsense interpretation is to look at the background. For instance a contract with a bank for an overdraft says nothing about why the borrower wanted the money or why the bank manager decided it was a good risk. Then it is essential to look at the background. However in the complex contract normal within engineering and technology most of the factual matrix is in fact already in the contract. Our contracts contain masses of factual information about what equipment and services are to be supplied, how they are to be supplied, what they are to be used for, details of the site, and so on. The more information there is in the contract the more important Stage 2 above becomes, and the less important Stages 1 and 3.

HOW DOES THE LAW INTERPRET A CONTRACT?

It does this by a process of careful interpretation of the exact words used in the contract (Stage 2 above), in order to determine *precisely* what the bargain is that the parties have actually made. It is therefore essential to be extremely careful how words are used when writing contracts.

This is going to be a very long answer to a simple question, but a lot of explanation is necessary.

(In theory civil law pays less attention to precise interpretation than common law, preferring to emphasise the need for the parties to carry out their commercial obligations in a proper manner. In practice the civil law approach to the wording of a complex contract is very similar to a strict interpretation – the common law approach.)

The problem is language, especially the English language

English is the most flexible language in the modern world. However with a contract the flexibility of English can become a problem. It is possible for the words used in a

contract to have a wide range of different meanings unless great care has been taken over how we do it.

Flexibility of language can create ambiguity: 'PERFECT POLISH' can mean four different things depending on how we pronounce it. Consider a notice in a local newspaper in spring. 'Put your clocks forward one hour before you go to bed on Saturday night'. Now compare that with 'Before you go to bed on Saturday night put your clocks forward one hour'. The second statement has one meaning but the first has two. Changing the order of the words can create or eliminate a problem. The reason for the ambiguity in this example is that the phrase 'one hour' can either be attached to 'put your clocks forward' (by how much) or 'before you go to bed' (when). Of course, one of these interpretations looks perverse as we all know what the newspaper meant to say. That is *precisely* the problem. Because we know what we mean to say, we can sometimes fail to see exactly what we have said.

Grammar is always a potential problem. Most of us, if we take care over our sentences, are reasonably competent in the language and can get the grammar correct. If, however, we get the grammar wrong then the words used may have a different meaning to the one that we intended.

In a high court case ten years ago the judge had to consider a contract provision: 'The Contractor shall do xxxxx and yyyyy in accordance with a specification.' The learned judge decided that this meant that the contractor was required to carry out yyyyy in accordance with the specification. He also had to carry out xxxxx, but xxxxx did not have to comply with the specification. However, said the judge, if the contract had said 'The Contractor shall do *both xxxxx and yyyyy* in accordance with the specification....', then his decision would have been different.

This decision might look totally perverse, but all that the judge has done is to read the words and then ask himself what those words in that grammatical framework actually meant. Of course the reason for the dispute was that the contractor had failed to comply with the specification and was looking for an excuse for not having done so; however in one sense the judge had little choice. The purchaser had written the words, and got the grammar wrong; so the purchaser had to stand the consequences. Where any party writes their own words into the contract they have to take the risk of getting the words wrong. A judge will always tend to interpret their mistakes in the other side's favour (what is called the 'contra proferentem' rule).

There can also be problems associated with the meanings of words. A word like 'hepatitis' has one meaning as it is a very specific technical term relating to a well-defined type of medical condition. However some words have several different meanings. 'Tack' for instance has 14. When a word that has several different meanings

is used in a contract, it might mean any one of those different things. The problem is therefore to manipulate the language of the contract to eliminate the unwanted meanings.

As an example consider the noun 'bit'. 'Bit' is related to the verb 'to bite'. It therefore means two basic things: first something that may bite into something else, and secondly things that might have been bitten off something else. In other words it has two basic categories of meaning: the first 'things that cut into other things or act upon other things', and secondly 'small amounts of things or bite-sized pieces'.

Then the word has different kinds of meaning. First it has a series of meanings that can be classified as ordinary, everyday meanings. These meanings will be such as 'piece', 'part', 'small coin' and so on. Then the word has jargon meanings. Jargon is immensely valuable in any area of technology or skill. It is the specialised use of words, giving those words very specific meanings within the context of the particular technology or skill in which they are being used. Every discipline uses jargon. Lawyers and accountants use jargon. Different professional engineering disciplines have different jargon. As a jargon word the word 'bit' means one thing to a drilling engineer, something totally different to a computer programmer, and something different again to a jockey or a locksmith.

Finally the word also has a series of colloquial meanings, centred round the idea of 'a small amount'. These meanings appear in such phrases as 'I'll be there in a bit', 'a bit of a laugh', 'a bit of a do' or 'a bit of a problem'.

In a dispute the judge can decide, if he feels that it is appropriate to do so on the basis of the evidence and legal argument, to give the words whatever meaning he thinks that those words ought to have, even if one or both of the parties disagree.

Get a good dictionary

The basic rule is that words in the contract will normally have their ordinary, everyday, meaning. If the contract, or the commercial context of the contract, makes it clear that words are to have a jargon meaning, then the words will be given a jargon meaning. They might also be given a colloquial meaning but that is very rare in commercial contracts.

The rule of interpretation of words in accordance with their ordinary everyday meaning is that the words will be given the precise meaning stated in an authoritative dictionary. Where a jargon meaning is to be applied then again it is the precise definition given in the dictionary that will apply. Only when a colloquial meaning is to be applied will the courts take into account what the parties actually *thought* the words should mean. In simple terms, the words in commercial contracts do not mean what

the draftsman thinks or hopes they mean: they mean what the dictionary says they mean. It is essential for anyone working with contracts to have a comprehensive dictionary.

THE PRINCIPLES IN PRACTICE

THE JUDGE'S DECISION

Often when a judge decides a case he will say something like 'Applying the well-known principle of interpretation that ... it is clear that the contract means ...' There are literally dozens of principles of interpretation applied by the courts when they interpret documents, and it is impossible to state or discuss them all here. Some apply particularly to special kinds of documents such as leases or legislation. Many however apply to contracts.

Principles of interpretation are important because they demonstrate how the judge/lawyer approaches a contract. The judge will pick whichever principle suits his purpose, and use it to justify his decision.

You will see that there is a common theme running through them, that the commercial company must live by the words that it uses. Therefore it is vitally important for the commercial company to get the words correct. In practice far too many disputes turn upon the interpretation of 'incorrect' words used in the contract. Some of the more important principles are given here.

- 'The construction of a contract is a matter of law. The meaning of words is a matter of fact.' In other words the judge has the right to impose his meaning on the contract words, using the factual meaning/definitions of those words in grammatical and dictionary terms.
- 'For the purpose of the construction of a contract the parties mean the words they have used.' If you say something that is different to what you intended to say you will have to live with the consequences, unless of course both parties are agreed that the words should be changed.
- 'The words of the contract shall have their precise but ordinary everyday meaning.' 'Bit' means a piece part or small quantity.
- 'The words of the contract must be read in a way that ensures the technical effectiveness of the contract.' 'Bit' means a drill bit and so on.
- 'The words must be interpreted in the way they were understood by the parties at the time they made the contract.' Colloquial meanings can apply.

- 'The intentions of the parties must be ascertained from the language they have used, considered in the light of the surrounding circumstances and the object of the contract, so far as that has been agreed or proved.' You have to live with what the contract actually says, not what you wanted to say, but failed or forgot to say.
- 'The court will generally adopt an objective approach. It will consider what would have been the intention of reasonable persons in the position of the parties to the contract.' This is because that is what the other party has a right to expect.
- 'Where the words of a contract have a clear meaning that meaning must apply.'
- 'Preliminary contract drafts and preparatory negotiations may not in general be used to interpret a contract. But a previous agreement may be relied upon to interpret a later contract made pursuant to it.' Because we may change our minds during negotiations.
- 'Where a contract is made wholly in writing no other terms can apply.'
- In any case where a contract is based upon a model form of contract the court is reluctant to disturb the established interpretation.' But the judge may interpret modifications to the model terms against the party that wrote them into the contract.
- 'The words of the contract should be construed in their grammatical and ordinary sense except to the extent that some modification is necessary to avoid inconsistency or absurdity.'
- 'Words will always be given the meaning that they had at the time that the contract was signed. If meanings change later on that will not affect the meaning of the contract.'
- 'It is permissible (and almost normal practice) to be prepared to imply terms into a consumer contract. The presumption however is against implying terms into written contracts. The more complete and detailed the written contract the harder it is to imply a term into that contract. If a term is to be implied into a commercial contract, it has to be one that is so obvious that neither party would have objected at the time.' Very few terms can be taken as read in commercial contracts.

Then two principles of major importance:

- 'The only term that is always implied into a written commercial contract is that neither party shall prevent the other party from performing its side of the

contract and that where performance of the contract cannot take place without the cooperation of both parties, then cooperation shall be forthcoming.’ Preventing the other side from carrying out its work is breach of contract.

- ‘Where a contract does not expressly or by necessary implication fix a time for the performance of any contractual obligation the law implies that it shall be performed within a reasonable time.’

THE CANONS OF CONSTRUCTION

These are the golden rules that judges apply when digging the correct meaning out of complex documents. They are no different to any other principles of interpretation:

- ‘In order to arrive at the true interpretation of any document a clause must not be considered in isolation but must be considered in the context of the whole of the document. In construing a contract all parts of it must be given effect where possible, and no part of it should be treated as inoperative or surplus.’ Don’t try to take words out of context.
- ‘Where the contract is a standard form of contract to which the parties have added special conditions, greater weight must be given to the special conditions, and in case of conflict between the general conditions and the special conditions, the latter will prevail.’
- ‘When the contract expressly mentions some things, it is often to be inferred that other things of the same general category which are not expressly mentioned were deliberately omitted.’ This rule is sometimes given a Latin tag *expressio unius exclusio alterius* – saying one thing excludes the others.
- ‘If a contract lists a number of things of the same general category, but then does allow other things to be included (for example, in a *force majeure* clause), then other things can only be considered to be included if they are of the same kind as those things already listed.’ Another Latin tag *eiusdem generis*.
- ‘A contract will be construed so far as possible in such a manner as not to permit one party to it to take advantage of his own wrong.’
- ‘A statement in a document will be ambiguous when it has two or more meanings each of which can apply without distorting the words. If the ambiguity is latent (in other words a hidden problem only shows up when you try to carry out the contract), then external evidence can be taken to try to resolve the ambiguity. If the ambiguity cannot be resolved the contract or clause is invalid.’ Because it is uncertain.

- 'Patent ambiguity exists when a document has two or more meanings right from the start. Where there is patent ambiguity in a document which forms part of a contract the court can refer to subsidiary, that is, lower-ranking, documents in the contract, if they will resolve the ambiguity.' 'Put your clocks forward one hour before you go to bed' is an example of patent ambiguity.
- 'A contract, or a clause in a contract, is uncertain if it is impossible to decide what it really means. If a clause or a contract is uncertain then that clause or contract is invalid.'