*The Macrotheme Review*
***A multidisciplinary journal of global macro trends***

# THE IMPORTANCE OF THE INTERPRETATION OF THE CONTRACT AND THE GOOD FAITH

Ergysa IKONOMI
*University "Ismail Qemali" Vlore, Albania*

**Abstract**

*The contract, whose content is freely determined by the parties, is one of the most common legal actions, which creates, changes or quenches a legal relationship. When the parties have disagreements over the terms of the contract or when there are ambiguities in the content of a contract, they are interested in finding the best solution for their problem, which is certainly related to contractual rights and obligations. In finding a solution it is necessary the interpretation of the contract, which helps the parties to understand how the law considers their agreement. This paper aims to highlights the need and the importance of the interpretation of the contracts and then to explain how the interpretation may be realized and which are the theories about interpretation. The last part of the paper will focus on good faith in interpretation, the European national laws that provide it in the contract's interpretation and to find out the advantages of good faith in interpretation. Besides theoretical explanations, provisions of the Albanian Civil Code will be mentioned throughout the paper.*

Keywords: contract, interpretation, good faith, subjective, objective

## 1. INTRODUCTION

As by legal definition *"Interpretation is the art or process of determining the intended meaning of a written document, such as a constitution, statute, contract, deed, or will."*[1]

In the context of legal interpretation should be distinguished the interpretation of the law from that of the contract, the two interpretations, in fact, although appear at first glance identical, differ considerably especially for the different relief which must be given to the two wills: the legal and the negotiation. (Diener M. C. 2011, p. 493) The interpretation of constitutions or laws and statutes is needed when are applied or during judicial cases, despite this, it is an easier process first because their texts have been prepared with utmost care and spent several discussions before adoption, and second because their interpretation is usually done taking into account other legal documents, such as conventions, ratified international agreements or other legal acts. The interpretation of written documents that generally regulate the private sphere of life seems difficult to realize, because they include goals, wills and interests of some parties. The selection

[1] http://legal-dictionary.thefreedictionary.com/Interpretation

of words that are placed in such texts, their diversity, negligence and acceleration in the implementation of contracts obviously brings the need for interpretation. Diener clarifies that although the function of interpretation is the same, the criteria and the technical means are different. The interpretation of the contract tends to verify the contents of an act of private autonomy, however the interpretation of the law seek to determine the meaning of a text and the will that you want to clarify is impersonal and must be hooked up to all the other rules.

There are some national laws that regulate interpretation in very detailed way, e.g. Italian, French, Spanish, Portuguese and there are national laws, which are more general in this extent, e.g. German, Austrian, Greek.

There are different meanings that can be attributed to the term "interpretation" in relation to the context in which it is used and the object to which it refers. According to the definition most commonly used, the interpretation means to understand the meaning (or meanings) of a language that a person uses to communicate something to others, where language means linguistic expressions that are made not only of signs, but also sounds and somatic manifestations, however, all that which allows the perception. If, then, there are more, and among them different possible meanings, all equally congruent to a given semiotic code, the task of interpretation can be further referred to the choice that takes place to identify and elect one among these different meanings. (Fava P. 2012, p. 1689)

This paper will show the need and the importance of the interpretation of the contracts and will explain the theories about contract interpretation, clarifying the provisions of some European legislation. The last part of the paper will focus on good faith in interpretation, the European national laws that provide it in the contract's interpretation and to find out the advantages of good faith in interpretation. Besides theoretical explanations, predictions of the Albanian Civil Code will be mentioned throughout the paper.

## 2. NEED FOR INTERPRETATION

The contract, whose content is freely determined by the parties, is one of the most common legal actions, which creates, changes or quenches a legal relationship. "*A regular contract has the force of law for parties."*[2] Widely known as *pacta sunt servanda*, the maxim was now taken to imply that contractual promises must under all circumstances be honored. (Zimmermann R. 1996, p. 566-567) The principles of freedom to contract and party autonomy are the key points of contractual law. Despite this, the content or what the parties have agreed must be within legal limits. *"The contract obliges the parties not only as provided in it, but also for all the consequences arising from the application of the law."*[3] This obviously means that the implementation of the contract is an obligation for the parties; otherwise there will be room to compensate the caused contractual damage.

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. (Grigoleit H. C., Canaris C. 2010)

[2] Civil Code of the Republic of Albania, article 690
[3] Civil Code of the Republic of Albania, article 693

When the parties have disagreements over the terms of the contract, they are interested in finding the best solution for their problem, which is certainly related to contractual rights and obligations. In finding a solution it is necessary the interpretation of the contract, which helps the parties to understand how the law considers their agreement. This may happen probably because legal texts are often uncertain even 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, it is not part of the contract. If it is in the written document, it is part of the contract. (Wright D. 2004) Uncertainties within the meaning of the contract may come from the language used, grammar or when are used words that take several different meanings. Contracting parties should be aware that they may have differing assumptions concerning the meaning of words and phrases drafted into a contract. Words mean different things to different people. What may be clear to one may be ambiguous to another. There is therefore a need to draft contracts accurately and succinctly to avoid differing interpretations. (Goodman A.) The need for the interpretation of the contract, as has been observed, derives from the fact that the signs (such as expressions, spoken or written words) used by the contractors to externalize the negotiating regulation of their interests have a margin, of a greater or lesser degree of semantic indeterminacy: behind an apparently clear and unambiguous meaning can be hidden, ie, a different sense of the contractual agreement. (Sangermano F. 2007, p. 11)

Although there is a unilateral mistake, or a mutual one and despite the uncertainty that causes the dispute, there is always need for contract interpretation to arrive at the point which mostly reflects the intentions of the parties.

The interpretation of the contract is very useful because the contractual interpretation is not just a process of unrelentingly grasping the plain meaning of the words of the contractual text and applying them to the text of the dispute, but involves a wider examination of the contractual circumstances, which might include almost any information relevant to understanding the agreement, with one or two notable exceptions. In short, contractual interpretation must now be understood as an inclusive rather than an exclusive process. (Mitchell C. 2007, p. 1-2)

## 3. INTERPRETATING A CONTRACT

Questions of how courts interpret, and should interpret, contract terms and when courts imply, and should imply, terms to which the contracting parties have not explicitly agreed, loom large in contract disputes and in the legal literature on contract law. (Cohen G. M. 1999)

First, an interpreter identifies the terms to be interpreted. To elaborate, identifying the terms to be interpreted is primarily the province of the *parol evidence rule*. When applied, the rule renders prior parol agreements legally inoperative. The writing then becomes the sole container of the contract's terms. Second, an interpreter determines whether the terms are ambiguous and encompass the rival interpretations favored by the parties. Determining whether the terms are ambiguous usually is the province of the plain meaning rule. Even if the governing term is ambiguous in the abstract, it may permit only one of the rival interpretations advanced by the parties. When this is the case, a judge should hold that the language is unambiguous and that the unambiguous meaning (the "plain meaning") is the legal meaning. (Burton S. J. 2008, p. 2-3) In determining whether the language in a contract is ambiguous, the words must be given their

'natural and ordinary meaning,' and the fact that the parties interpret a provision differently does not mean the language is *per se* ambiguous. (Solan L. et al. 2008, p. 1272) Third, if the terms are ambiguous in a contested respect, an interpreter resolves that ambiguity by choosing between the rival interpretations. (Burton S. J. 2008, p. 2-3)

According to Burton there are some theories of contract interpretation. The first will be called "literalism." In a strict form, it restricts the elements that interpreters may rely on to the governing words and the dictionary. Most practicing lawyers like to think that they can give reliable advice as to the true interpretation of contracts crossing their desks simply by pondering the words in question and, if need be, consulting their dictionaries. (Mclauchlan D. 2012, p. 14) In fact, in this case, there is necessary to clarify if the word/term has one or more meanings. If a judge is reasonably certain that a term can only have one meaning, or that the meaning that one party assigns to the term represents the intention of both parties at formation, then the judge is not likely to look outside the language of the contract. (Solan L. et al. 2008, p. 1282) Despite this, the reference point of the interpreter must be naturally negotiating the text of the negotiation declaration, but not to be limited to the literal meaning of the words: (Torrente A., Schlesinge P. 2009, p. 554) "When a contract is interpreted, it should be clarified what was the real and common purpose of the parties, *without stopping in the literal sense of the words,* as well as assessing their behavior as a whole, before and after the completion of the contract."[4]

The second will be called "objectivism." It would broaden the set of elements to include the document as a whole, the objective circumstances at formation (including trade usages), the document's evident purpose(s), and any practical construction. The third will be called "subjectivism," which further broadens the set of relevant elements to include all relevant evidence, including evidence of the parties' course of dealing and the course of negotiations, and testimony by a party about its own past intention.

According to an authoritative doctrinal address, the rules of interpretation are divided into two groups: a) rules of ***subjective interpretation*** which are directed to seek the views of those in the negotiation. (Torrente A., Schlesinge P. 2009, p. 553-554) "When a contract is interpreted, it should be clarified what was *the real and common purpose* of the parties, without stopping in the literal sense of the words*,* as well as assessing their behavior *as a whole*, before and after the completion of the contract."[5] *"*Contract terms are interpreted by each other*, giving each the sense that emerges from the whole of the act."*[6] In France, interpretation basically focuses on the will of the contracting parties, i.e. , on what they had in mind when concluding a contract…This clearly is a "subjective approach" to interpretation: precedence is given to the intention of the parties. (Collins H. 2008, p. 210)

b) rules of ***objective interpretation***, which are involved when is not possible to attribute a meaning to the negotiation, despite the use of standards of subjective interpretation. (Torrente A., Schlesinge P. 2009, p. 553-554) *"In case of doubt, the contract or its terms are interpreted in the sense in which they can have any effect, and not in that, according to which there would be no effect."*[7] In England, interpretation primarily focuses on the meaning as it appears from the text of the contract. What people exactly had in mind when drafting the contract is difficult if not impossible to find out afterwards. The "normal meaning" of the text here seems to offer, at least

[4] Civil Code of the Republic of Albania, article 681
[5] Civil Code of the Republic of Albania, article 681
[6] Civil Code of the Republic of Albania, article 682/1
[7] Civil Code of the Republic of Albania, article 683

apparently, the most reliable basis for judicial interpretation of contracts. This may be called the "objective approach" a view which gives precedence to the external appearance of the expression because social and commercial intercourse requires that reliance be protected. (Collins H. 2008, p. 211)

Thus, in an effort to ascertain the intent of the parties, it is up to judges to determine not only whether language is plain or ambiguous, but whether a particular use of a word falls within its ordinary meaning. When the language is plain, judges typically enforce the contractual provision as written and thus as most likely intended by the majority of people and, presumably, by the parties. When there is some doubt, further inquiry into the parties' intent is permitted, although the ordinary meaning is often used as a reasonable surrogate for such intent. If the parties genuinely have different but reasonable understandings, a court may hold that they never reached agreement and that, therefore, no contract was formed. (Solan L. et al. 2008, p. 1272) "Words and phrases that can have two meanings should be taken in the most appropriate meaning, to the nature of the contract."[8]

German lawyers take an intermediate position between the French subjective approach and the English objective approach. They do not focus primarily on the contracting parties' thoughts, nor on some "objective meaning" of the words of the contract, but on the meaning a reasonable outsider would assume to have been meant. (Collins H. 2008, p. 211)

## 4. GOOD FAITH IN INTERPRETATION

It is CICERO who left the most complete definition of good faith: "These words, good faith, have a very broad meaning. They express all the honest sentiments of a good conscience, without requiring scrupulousness which would turn selflessness into sacrifice; the law banishes from contracts ruses and clever manoeuvres, dishonest dealings, fraudulent calculations, dissimulations and perfidious simulations, and malice, which under the guise of prudence and skill, takes advantage of credulity, simplicity and ignorance."[9]

The expression "good faith" often appears in the context the interpretation of legislation. In this case it is not given any specific definition. It seems to be understood as conflicting with a narrow and strict interpretation of texts. It ensures a certain flexibility of interpretation and prevents any paralysis which could otherwise result from a text being silent on an issue or giving rise to some doubt. [10]

*"The contract must be interpreted in good faith by the parties."*[11]So, it must therefore take account not only of the meaning of the words used by the person who made the statement, but also what they can reasonably give to those who receive. (Torrente A., Schlesinge P. 2009, p. 554)

Provisions providing for the application of the principle of good faith in contractual relationships are also found in other countries of the EU. However, it has not permeated the laws of these

[8] Civil Code of the Republic of Albania, article 685
[9] European Contract Law. Materials for a Common Frame of Reference: Terminology, Guiding Principles, Model Rules, 2008, p. 152
[10] European Contract Law. Materials for a Common Frame of Reference: Terminology, Guiding Principles, Model Rules, 2008, p. 164
[11] Civil Code of the Republic of Albania, article 682/2

countries as it has in Germany and the Netherlands. (Lando O. 2001) In Germany the BGB says that contracts are to be interpreted according to the requirements of good faith, giving consideration to common usage. The German BGB places particular stress on good faith and usage in the interpretation of contracts. The Italian Civil Code also says that the contract is to be interpreted "in accordance with good faith." The Italian Civil Code, for example, provides that in order to ascertain the common intent of the parties "the general course of their behavior, including that subsequent to the conclusion of the contract", is to be taken into account. The Spanish Civil Code has a similar provision. (MacQueen H. , Zimmermann R. 2006, p. 178- 185)

In contrast, English common law does not recognize any general obligation to act in accordance with good faith and fair dealing. However, many of the results achieved in the Continental systems by requiring good faith have been reached in English law by more specific rules. For example, a strict moral code has been imposed in fiduciary relationships, and good faith is required in contracts characterized as *uberrimae fidei.*[12] The duty of good faith is also required when the court is asked to grant equitable remedies. There are a growing number of cases where the courts have interpreted the terms of a contract in such a way as to prevent a party from using a clause in circumstances in which it was not intended to be used. New examples of cases where good faith has been invoked are constantly being added to English case law. (Lando O. 2001)

The French Civil Code concentrates on the common intention of the contracting parties, rather than the literal meaning of the terms used. But the French courts have recognised and developed a doctrine of "clear and precise terms" which is to the effect that if the terms of a contract are unambiguous they must generally receive effect as written. Some books on contract begin their treatment of interpretation with the "clear and precise terms" rule rather than the code provision. The whole approach to interpretation under current French doctrine is rather more objective than the terms of the Civil Code would suggest. (MacQueen H. , Zimmermann R. 2006, p. 178-185)

A part of the doctrine and jurisprudence leads the provision in question of the subjective interpretation... other part of the doctrine and jurisprudence, instead, places the interpretation in the objective sphere. It seems preferable a third theory, which is grounded in relation to the Code, according to which the interpretation of good faith is a principle of a general nature, not subsidiary, that must always prevail for every term and for each contract. This conclusion, moreover, is confirmed in the whole discipline of the contract that refers to good faith, as well as in the interpretation, even in the formation and execution of contract. (Diener M. C. 2011, p. 497 -498)

Good faith is also used in UNIDROIT Principles, which provides *that "Where the parties to a contract have not agreed with respect to a term which is important for a determination of their rights and duties, a term which is appropriate in the circumstances shall be supplied."* [13] This Article addresses a different though related issue, namely that of the supplying of omitted terms. Omitted terms or gaps occur when after the conclusion of the contract, a question arises which the parties have not regulated in their contract at all, either because they preferred not to deal with it or simply because they did not foresee it. The terms supplied under this Article must be appropriate to the circumstances of the case.[14] *"In determining what is an appropriate term*

[12]Of the utmost good faith - A legal agreement requiring the highest standard good faith.
[13] UNIDROIT Principles of International Commercial Contracts, 2010, article 4.8/1
[14] UNIDROIT Principles of International Commercial Contracts, 2010, p. 146

*regard shall be had, among other factors, to (a) the intention of the parties; (b) the nature and purpose of the contract; (c) good faith and fair dealing; (d) reasonableness."*[15]

## 5. CONCLUSIONS

It would be widely accepted that, despite its relative neglect in law school curricula, the law of contract interpretation is one of the most practically important areas of commercial law. (Mclauchlan D. 2012, p. 6)

European civil domestic legislation, the Albanian Civil Code among them, have provisions about the interpretation of the contracts. These provisions, as well as even by a legal interpretation, are divided in two groups, which inspired two main theories on contract interpretation: the objective theory and the subjective theory. It is not put in question the need and the importance of the interpretation of the contracts and the courts give the decisions avoiding literal interpretation and oriented by the legislation they focus mainly to one of these theories.

The interpretation of contracts—their possible amplification, correction, and modification by adjudicators—is in the interests of contracting parties. The reasons are no doubt well-appreciated in at least a general sense: interpretation may improve on otherwise imperfect contracts; and the prospect of interpretation allows parties to write simpler contracts and thus to conserve on contracting effort. (Shavell S. 2006, p. 289)

Good Faith Principle is one of those principles on which rest not only the interpretation, but also the formation and the execution of it. The approach to Good Faith in interpreting of the contracts, is different, according to the European legislation, even though good faith is not specifically requested in Common Law Family countries.

The views on interpreting the contracts in Good Faith are too different:

At one extreme, advocates of a textualist approach to contract interpretation, concerned that such a general concept as good faith might inject uncertainty in legal relationships, support a restrictive view of the obligation. According to this view, it should be limited to a prohibition of intentional dishonesty and courts should not invoke good faith to modify explicit contractual terms or restrict powers attributed by contract. At the other extreme, supporters of a contextualist approach to contract interpretation argue that the obligation should be interpreted expansively to guarantee the substantive justice of contractual relations. Under this view, the requirement of good faith incorporates equitable standards of fairness and decency whose respect might justify departures from express contractual provisions. (Sepe S. M. 2010)

In my opinion, Good Faith in contract interpretation, considering the dimensions of the principle is, not only useful, but it is an added value in interpretation of the contract, because the contract is a legal negotiation of parties that must carry not only the rights and the obligations, but also the human values.

[15] UNIDROIT Principles of International Commercial Contracts, 2010, article 4.8/2

## 6. REFERENCES

Collins. H. (2008). *Standard Contract Terms in Europe: A Basis for and a Challenge to European Contract Law"* Retrieved from http://books.google.com
Diener M. C (2011). *Il contratto in generale* Retrieved from http://books.google.com
European Contract Law. Materials for a Common Frame of Reference: Terminology, Guiding Principles, Model Rules (2008) Retrieved from http://books.google.com
Fava P (2012). *Il contratto* Retrieved from http://books.google.com
MacQueen H. , Zimmermann R. (2006). European Contract Law: Scots and South African Perspectives, p. 178-185
Mitchell C. (2007). *Interpretation of contracts.* Retrieved from http://books.google.com
Sangermano F. (2011). *L'interpretazione del contratto: profili dottrinali e giurisprudenziali.* Retrieved from http://books.google.com
Torrente A. , Schlesinge P. (2009). Manuale di Diritto Privatto. Retrieved from http://books.google.com
UNIDROIT Principles of International Commercial Contracts, 2010
Zimmermann R. (1996). *The Law of Obligations: Roman Foundations of the Civilian Traditions* Retrieved from http://books.google.com
Wright D. (2004). *Contract Interpretation* Retrieved from http://books.google.com
Burton S. J. (2008). Elements of Contract Interpretation University of Iowa Legal Studies Research Paper, Number 08-45, p. 2-3 Retrieved from URL.
Canaris C., Grigoleit H. C (2010). Interpretation of Contracts. Retrived from http://papers.ssrn.com
Cohen G. M. (1999). Implied Terms and Interpretation in Contract Law**.** Retrived from http://encyclo.findlaw.com
Goodman A. H. The rules of Contract Interpretation – How to say what you mean and mean what you say. Retrived from http://www.ceu-hq.com
Mclauchlan D. (2012). Contract Interpretation: What Is It About?. Victoria University of Wellington Legal Research Papers, Volume 2 Issue No 1, p. 14 Retrieved from URL.
Lando O. (2001). Salient Features of the Principles of European Contract Law: A Comparison with the UCC 13 Pace International Law Review, Volume 13, Issue 2 Retrieved from URL.
Shavell S. (2006) On the Writing and the Interpretations of Contracts. The Journal of Law, Economics, & Organization, Vol. 22, No. 2, p. 289 Retrieved from URL.
Sepe S. M. Good Faith and Contract Interpretation: A Law and Economics Perspective". University of Arizona, Discussion Paper No. 10-28 Retrieved from URL.
Solan L., Rosenblatt T., Osherson D. (2008) False Consensus Bias in Contract Interpretation. Columbia Law Review, Vol. 108, No. 5, p. 1272 Retrieved from URL.
Civil Code of the Republic of Albania
http://legal-dictionary.thefreedictionary.com/Interpretation