

WHAT APPROACH TO THE INTERPRETATION
OF PRIVATE CONTRACTUAL OBLIGATIONS
SHOULD COURTS ADOPT?
COULD THE APPLICATION OF LAW AFFECT
THE SO CALLED WELFARE STATE?*

*¿Puede la interpretación y aplicación que del Derecho
privado haga el juez ser determinante en la subsistencia del
estado de bienestar?*

José Manuel de Torres Perea
Profesor Titular de Derecho Civil
Universidad de Málaga
jmdetorres@uma.es

doi: [http://dx.doi.org/10.18543/ed-66\(1\)-2018pp161-169](http://dx.doi.org/10.18543/ed-66(1)-2018pp161-169)

Recibido: 12.04.2018

Aceptado: 25.06.2018

Resumen

En el presente contexto global somos testigos de un enfrentamiento entre dos enfoques opuestos a la hora de interpretar y aplicar la ley. Uno, consagrado a lograr lo justo, considerando la justicia como esencia y fundamento del Derecho; y otro que hace prevalecer la seguridad jurídica y la interpretación literal de los contratos

* Cómo citar / Citation 'Chicago-Deusto' (Autor-fecha / Author-date / Lista de referencias / Reference list entries): De Torres Perea, José Manuel. 2018. "What Approach to the Interpretation of Private Contractual Obligations should Courts Adopt? Could the application of Law affect the so called Welfare State?". *Estudios de Deusto* 66, n.º 1: 161-169. doi: [http://dx.doi.org/10.18543/ed-66\(1\)-2018pp161-169](http://dx.doi.org/10.18543/ed-66(1)-2018pp161-169).

independientemente del resultado justo o injusto al que pueda llegarse. En este estudio, analizamos estos enfoques y sus consecuencias. Una de ellas podría ser, sin duda, la creciente desigualdad entre ciudadanos, en tanto que la carencia de recursos impediría a parte de ellos poder asesorarse correctamente al contratar y quedar de este modo ligados al sentido literal de lo escrito. Desde esta perspectiva el riesgo en realidad lo es del propio concepto del «estado de bienestar».

Palabras clave

Derecho privado; capitalismo; justicia; desigualdad; estado de bienestar.

Abstract

Is private law dominated by savage capitalism? Is justice something that can be bought? Currently we are witnessing a conflict between opposing approaches to the interpretation and application of the law. On one view, the concept of justice, should be taken into account when judges decide legal cases. The alternative view favours legal certainty and the literal interpretation of contracts whether the outcome is just or not. In this lecture we consider these conflicting approaches and analyse what could be the consequences. One consequence could be increasing inequality between citizens, and consequently the concept of “the welfare state” being put at risk.

Keywords

Private law; capitalism; justice; inequality; welfare state.

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I. WHAT TYPE OF PRIVATE LAW IS REQUIRED TO ACHIEVE AND MAINTAIN THE WELFARE STATE¹?

The “welfare state” in the context of this lecture means a statehood model in which the state seeks to protect and promote the well-being of its citizens. This model of statehood is based on the principles of equality of opportunity and equitable distribution of wealth, and it is based on democracy.²

Today there is an ideological conflict between two opposing views of the role of judges in the interpretation and application of the law. The area of international commercial law illustrates this point nicely. Several studies have reported that when the choice of law governing the substance of the contract is chosen, the most frequently chosen governing applicable law is English law (40%), followed by New York law (17%). The ‘other’ laws include a broad range of national laws.³

Therefore, at first glance, there is apparently a preference for parties in international trade choosing common law jurisdictions and laws to determine disputes. Why the preference for common law jurisdictions? There are different possible reasons, first the language, English is today the new international “lingua franca”, but also others like strict rules through case law, parties’ freedom to contract, and perhaps the most important one: the comparatively little judicial interference with the parties’ contracts. In other words, common law jurisdictions favour legal certainty when interpreting legal obligations with generally no place for “good faith” or “fairness” doctrines⁴ to be incorporated by the judges. This means that the role of judges in common law jurisdictions is generally not to police the fairness of every contract by reference to moral principles or an implied good faith doctrine. Rather their role is to follow established legal principles in the interpretation of contractual obligations. From this point of view, as far as

¹ We do not refer the very specific meaning of “welfare state” in English Law, meaning the social security system of a country, but a broader concept, the Nordic welfare model.

² See, SMITH and LIPSKY 1998; and RHOES and MÉNY 1998.

³ FRIEDLAND and MISTELIS 2010: 11.

⁴ There are exceptions to this general rule –employment being a prime example. In the context of employment law contracts, judges will expressly take into account the unequal bargaining powers of the parties and have implied contractual terms such as “good faith” into these types of contracts.

there is freedom to contract, the role of judges is simply to enforce contractual obligations.⁵

In contracts, the application of continental law to international contracts is less favoured, most likely because it is perceived to result in greater legal uncertainty for the contracting parties. In spite of the fact that this continental law exists in different laws and jurisdictions, it is possible to find common elements that are in contrast to the approach adopted by judge in common law jurisdictions.

In order to understand how the continental legal system understands and applies the law it is useful to remind the famous judgment of the Reichgericht, 28 November 1923, (RGZ, pp.107-78). In this case the German court realized that the performance of the contract as it was drafted would cause the economic ruin of defendant. It is a fact that the cost of living index had risen by about ten times. From a quotation of April 1920 the gold Reichmark was about 60 Reichmarks to the dollar, so the purchasing power of the paper Reichmark had fallen due to a considerable inflation of German money after I WW. Under these circumstances it was logic the claim for the revalorization of mortgages debts, when an enormous increased value of the land had taken place. Finally the decision ordered the revision of thousands of contracts, as far as a consequence of this hyperinflation the revision was "legally permissible".⁶

This is a clear example of how the general clauses can be applied by the judge, and how by this way is possible the judicial development of law. In this case the Reichgericht chose to prioritize the application of the good faith principle to the rules of private law.⁷ In fact, the German court stated that: "*The good-faith provision must take precedence over the provisions of the currency legislation because when the currency provisions were drafted, the possibility of a currency inflation that would make the consequences of applying the currency legislation conflict with the fundamental principle of good faith and with fairness was not taken into consideration*".⁸ Finally the court added that the idea of good faith must take precedence over any law, any positive legal provision... the lawmaker cannot frustrate by the power of his word a result that the good faith principle absolutely requires.⁹ This is a decisive decision that shows how the application of the good faith provision

⁵ HARVEY, Tony, Professor at John Moores University, Liverpool. "Choosing the Jurisdiction for International Commercial Contracts". Workshop taught at Malaga University School of Law on 13 of December of 2014.

⁶ GORDLEY and VON MEHREN 2006: 516.

⁷ WEBER 1992: 633 ff., citado por MIQUEL GONZÁLEZ 1997: 301.

⁸ RENNER 1999: 27.

⁹ WEBER 1992: 633.

of the BGB (paragraph 242) may allow the judge to interpret contractual obligations and adapt them to the case in order to balance the interests of justice.

This decision established a new legal principle, the use of so called “general clauses” such as the good faith clause, that can dis-apply the application of a legal disposition, or modify a clause in a contract, when the judge understands that there is not balance between the rights and obligations of the parties. This means that the continental judge, in spite of the fact that the parties have entered freely in the contract, in spite of the fact of there being a valid contract, can amend its content when its content is abusive, because the concept of justice must take precedence. This approach to applying the law has spread to other continental legal systems. Spanish law has developed different judicial doctrines in application of the good faith principle such as the principle that one cannot act against one’s own acts, or the one that prevent from disloyal delay. The two most important articles concerning good faith in the Spanish civil code are articles 7 in the preliminary title, and article 1258.¹⁰

Therefore, there is a conflict between two different ways to understand the purpose of the application of the Law. One is based broadly on the supremacy of legal certainty and this favours judges adopting a literal interpretation to the meaning of contracts. The other incorporates the concept of justice and this therefore allows judges to change the content of a contract if he considers that it is abusive. In this conceptual conflict it appears from the statistics that parties opt for laws and jurisdictions which favour legal certainty over the application of any concepts of justice. The difference between these approaches not only affects international commercial contracts, but also the whole of private law.

Now we pose a critical question: what are the consequences of adopting a common law choice of law and jurisdiction as opposed to a continental choice of law and jurisdiction? Could the choice made be fundamental to achieving and maintaining the so called, “welfare state”?

¹⁰ Article 7 Spanish Civil Code: *Rights must be exercised in accordance with the requirements of good faith. The law does not support abuse of rights or antisocial exercise thereof. Any act or omission which, as a result of the author’s intention its purpose or the circumstances in which it is performed manifestly exceeds the normal limits to exercise a right, with damage to a third party, shall give rise to the corresponding compensation, and the adoption of judicial or administrative measures preventing persistence in such case.*

Article 1258 Spanish Civil Code: *Contracts are concluded by mere consent, and from that moment the parties are bound not only to the fulfilment of what has been expressly stipulated but also to all the consequences which, according to their nature, may be in keeping with good faith, usage and law.*

The philosophy behind the common law approach is well illustrated in a famous anecdote between two American judges:

Ronald Dworkin relates a well-known meeting between Justice Oliver Wendell Holmes and Judges Learned Hand,¹¹ two of the greatest figures in American Law. It is said that after having lunch together, Holmes began to drive off in his carriage to return to work when Hand ran after him and cried: "Do justice, sir, do justice". Just in that moment, Holmes ordered the carriage to stop and chided Hand: "That is not my job. It is my job to apply the law". There are other notorious sentences of Justice Holmes: "Men should know the rules by which the game is played. Doubt as to the value of some of those rules is no sufficient reason why they should not be followed by the courts." "I am not at liberty to consider the justice of the Act." "I hope and believe that I am not influenced by my opinion that it is a foolish law. I have little doubt that the country likes it and I always say, as you know, that if my fellow citizens want to go to Hell I will help them. It's my job".¹²

These expressions illustrate the philosophy underpinning the work of the common law judge. However, this strict application of the law and the literal interpretation of contracts, may mean there is little room for achieving "justice". However, Dworkin warns us against this way of thinking. He considers that pragmatism is empty as a theory of law. He criticizes also the contemporary legal positivism as far as it is based on what he considers to be a mistaken semantic theory, that allow to venerate an erroneous account of the nature of authority.¹³

Arnold (Respondent) v Britton and others (Appellants) is a judgment of the Supreme Court of the UK of 10 June 2015¹⁴ in which the judges considered how they should approach the interpretation of a commercial contract. In this case different chalets were let on a lease which was for a term of 99 years from 25 December 1974 and reserved a rent of £10 per annum

¹¹ DWORKIN 2008: 10.

¹² SOWELL 2010: 338-339.

¹³ DWORKIN 2008: 10.

¹⁴ Arnold (Respondent) v Britton and others (Appellants) judgment of the Supreme Court of the UK of 10 June 2015. This decision involved a case of unambiguous drafting. If the drafting of a contract is ambiguous then judges can adopt a "purposive" approach to interpretation which may involve taking account of facts and circumstances beyond the strict wording of the contract. However, the purpose of the exercise is again to give true effect to the true meaning of the agreement between the parties which was the true meaning as at the date the contract was entered into.

<https://www.supremecourt.uk/cases/docs/uksc-2013-0193-judgment.pdf>

Another recent case on contractual interpretation:

<https://www.law.ox.ac.uk/business-law-blog/blog/2017/04/literal-or-contextual-what-correct-approach-contractual>

increasing by £5 for each subsequent period of 21 years. These leases were subject to a service charge provision in clause, which required the lessee to pay for the first year of the term a fixed sum of £90 per annum, and for each ensuing year a fixed sum representing a 10% increase on the previous year – ie an initial annual service charge of £90, which increases at a compound rate of 10% in each succeeding year.

The consequences of the annual sum of £90 being increased annually by 10% on a compound basis were significant to a lessee holding a chalet under one of the leases. If one assumes a lease granted in 1980, the service charge would be over £2,500 in 2015, and over £550,000 by 2072. This appears to be an alarming outcome for the lessees, at least judging by how things look in 2015 because of the last 15 years, interest rates- have hardly ever been above 4%. The service amount to be paid was disproportionate relative to the actual value of the services performed.

However, the majority of the supreme court judges decided in favour of the landlord despite the negative consequences for the lessees. This is because the judges considered that they could not depart from the natural meaning of the wording in clause 3 (2) in the lease relating to the compound interest rate, because it would involve inserting words which are not there. The problem was that the terms and effects of the clause appeared clear in each lease as a matter of language. The judges affirmed that whilst they would have expected most solicitors to have advised against such a clause, the parties had control over the language they used in the contract. They concluded that the mere fact that a contractual arrangement, if interpreted according to its natural language, had worked out disastrously, for one of the parties was not a reason for departing from the natural meaning of the unambiguous language. Finally, this decision can be summed up in a sentence: the judges saw their role and the purpose of interpretation to identify what the parties had agreed, and not what the court thinks that they should have agreed.

Therefore, the decision was for the landlord, because the clause had been introduced freely by the parties. It is a problem of the concerned party to choose the clauses to be introduced in the contract, and if he is negligent when introducing them, then potentially only his lawyer is liable. However, law is not always understandable to laymen. And, the lesson that this decision teaches is that is the responsibility of the citizen to hire a good lawyer to draft a contract, irrespective of whether the citizen is rich enough to pay him.

If this case had taken place in Spain, it would have resulted in a completely different outcome. Article 1258 CC states that contracts are concluded by mere consent, and from that moment the parties are bound not only to the fulfilment of what has been expressly stipulated but also to all the consequences which, according to their nature, must be in keeping with good faith. This means, that if the judge considers that there is not a balance between the undertakings of

the parties he may chance the content of the clause in order to avoid that unbalance that is against the principle of good faith. Professor Miquel González explains how the mechanism of the “general clauses” works in Spanish Law: The general clause is the outlet or escape value of the legal system. The lawmaker can neither foresee all the possible cases that the reality can offer, nor adapt automatically the law to the social reality that is always changing. Therefore, the judge cannot be rigidly linked to the strict interpretation of the law, but must apply it in a flexible way. This is what is called the corrective function of a general clause, as in the case of the good faith general clause set out in article 7 of the Spanish Civil Code.¹⁵ What is most important for our purpose is that this method of applying the good faith principle allows the judge to modify a contractual abusive clause to balance the interests of the parties. However, even in Spanish law we are observing a greater influence of common law principles, specially in commerce law.¹⁶

Having explained the general differences between the approach in common law and continental jurisdictions, it can be appreciated that there are very real consequences for the citizen depending on whether they live in common law or continental jurisdiction.

As mentioned at the outset, in continental countries the concept of welfare state refers a model in which the state seeks the protection and promotion of the well-being of the citizens that it is based on the principle of equality of opportunity and equitable distribution of wealth, and it is based on democracy.¹⁷ However today we are suffering of a growing capitalism potentially lacking in limits. In fact, the tendency is that everything can be bought. In fact, if you’re sentenced to a jail term in California, you may buy a prison cell upgrade when being in Santa Barbara. Even in Washington you can pay someone to stand in line in long overnight queues for Congressional hearings. The US army is full of private military contractors.¹⁸ As Michael Sand-

¹⁵ MIQUEL GONZÁLEZ 1997: 306-307. He states that a general clause, like the good faith one, elevates it to the position of the Law. This allows the judge to modify the positive norm in order to adapt it to a specific case to achieve a just result.

¹⁶ There are a number of matters where the concept of legal certainly is systematically imposed over the concept of justice. Only some examples, like the resistance of the division of companies to the exercise of the bankruptcy reinstatement actions (art. 47 Act 3/2007 *Ley sobre modificaciones estructurales de sociedades mercantiles*); or the admission of the one-person company.

¹⁷ See, SMITH and LIPSKY, Michael 1998; and RHOES and MÉNY 1998.

¹⁸ Examples provided by SANDERS, Michael, “Why we shouldn’t trust markets with our civic life”. Lecturer of Political Philosophy at Harvard University.

https://www.ted.com/talks/michael_sandel_why_we_shouldn_t_trust_markets_with_our_civic_life/transcript. Michael Sandel has got the award “Princesa de Asturias de Ciencias Sociales 2018”.

ers affirms we are heading to a society where everything is up for sale. A society where markets values begin to dominate every aspect of life. In other words, putting a price on everything means to discriminate, to guaranty wealthy and not wealthy people to live separate lives, to curtail equality, and this effect is completely harmful for the welfare state.

From this perspective, the predominance of common law in a word ruled by increasingly dominant capitalism principles can be understood. As the parties are the drafters of a contract, they are also responsible for its content. It is not the role of judges or the courts modify a comma of the clauses agreed by the parties. This is the position irrespective of the fact that one of the parties can be affluent and hire a well-known lawyer- and the other a poor man who cannot afford a lawyer at all. To conclude in common law systems, it seems that justice can be bought. There is not necessarily a general principle of good faith or concept of justice which allows judges to re-dress any imbalances between the contracting parties. To this extent, the price of legal certainty and the literal interpretation of contracts can, indeed, be justice.

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