SUBJECTIVE AND OBJECTIVE APPROACHES TO CONTRACTUAL INTERPRETATION IN CIVIL LAW AND COMMON LAW COUNTRIES: INDONESIA AND CANADA*

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Abstract
Traditionally, civil law adopts subjective approach, whereas common law adopts objective approach to contractual interpretation. This research aims to examine the difference in the application of contractual interpretation methods in Indonesia that adopts a civil law system and Canada that adopts common law system. The analysis defines the nature and content of common law and civil law, and the structures and methods of common law and civil law in contractual interpretation. The case study between Indonesia and Canada interestingly shows how their sources of law influence court’s approach to contractual interpretation. In their applications, Indonesia, as a civil law country, starts the interpretation exercise with subjective approach and Canada, as a common law country, starts it with objective approach. Nonetheless, in their processes of contractual interpretation, these two countries combine both subjective and objective approaches to achieve accuracy in contractual interpretation. On the other words, it is observed that subjective and objective approaches are completely intertwined and tangled with one another and cannot be separated. Therefore, practically, these two approaches are not mutually restricted of each other in all aspects.

Keywords: contract, interpretation, subjective intent, objective intent

Intisari

Keywords: kontrak, penafsiran, niat subjektif, niat objektif


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A. Introduction

Contract consists of words, which are sometimes or even often ambiguous. In principle, contract language is ambiguous if it is reasonably susceptible to more than one construction and meaning (Rosen, 2000, para. 17-14; Rowley, 1999, p. 90). For that notion, majority of contract disputes generally involve questions of interpretation. Often, such questions are at the heart of the dispute. Interpreting contracts is a highly practical activity, but judges’ approach to the interpretation has important implications for both the theory and the success of dispute settlement mechanism (Karton, 2015, p. 1) and is of paramount importance to achieve accuracy in interpretation. There is little point in giving effect to the intents of the parties if the court has not accurately discerned what those intents are (Hall, 2007, p.7).

Corbin (1951) defines interpretation as “the process whereby one person gives a meaning to symbols of expression used by other person” (p.2), while Chief Justice Menon (2013) describes it as “the process by which meaning is ascribed to the expressions found within a legal text” (p.2). Chief Justice Menon further applies two tests to establish such meaning. The first is to apply an objective test, which is a test theoretically adopted by the common law, to determine what a reasonable person would understand the contract terms to mean in the equivalent circumstances (p.3; McLauchlan, 2005, para. 49). On the contrary, the second is to apply subjective test, a test chiefly adopted by the civil law. It requires court to interpret the terms according to the mutual intents of the contracting parties (Lookofsky, 2000). Therefore, it is commonly acknowledged that common law and civil law jurisdictions have distinctive approaches to contractual interpretation (Fairgrieve, 2016, p. 125; Valcke, 2008, p. 77; Vey, 2011, p. 501).

In the following, this paper will examine two different approaches of contractual interpretation in two different legal systems. As few researchers have addressed this topic, this research aims to deepen the basic knowledge and understanding of contractual interpretation rules in common law and civil law systems and examine the stringency of the application of contractual interpretation rules in those legal systems. Before starting the analysis, it is necessary to firstly comprehend the meaning of “legal system.” David and Brierley (1978) define legal system as:

“Each law in fact constitutes a system: it has a vocabulary used to express concepts, its rules are arranged into categories, it has techniques for expressing rules and interpreting them, it is linked to a view of the social order itself which determines the way in which the law is applied and shapes the very function of the law in that society” (p.18).

In other words, Tetley elucidates that the term refers to “the nature and content of the law generally, and the structures and methods whereby it is legislated upon, adjudicated upon and administered, within a given jurisdiction.”

To conduct a comparative study, Valcke (2008) explains that it is imperative to firstly identify “an appropriate neutral common basis, or tertium comparationis, upon which to conduct the comparison” (p.79). She then asserts that “a common language, conceptual territory, and set of criteria must be established which are sufficiently abstract to apply to the two terms under comparison without distorting the identity of either, yet not so abstract as to be meaningless” (p. 79). Considering
Tetley’s idea of a legal system, to apply Valcke’s comparative approach, this paper will first define the nature and content of common law and civil law, and the structures and methods of common law and civil law in contractual interpretation.

It will then differentiate specifically Indonesia as a civil law country from Canada as a common law country in their approaches to contractual interpretation. As further inspired by Tetley’s comparative legal research plan, it will review “various specific points of comparison as between the two legal traditions of contractual interpretation together with a number of resulting differences in their respective substantive rules” (p.681).

B. Common Law and Civil Law Approaches to Contractual Interpretation

A major distinction between civil law and common law is the sources of law, critical materials that must be discovered before a court can interpret the applicable contract law (Karton, 2013, p. 2). Common law applies stare decisis rule, compelling lower courts to follow decisions rendered in higher courts (Kalt, 2004, p. 277). Unlike common law, court decisions are not binding in civil law as it is based on written codes where legal doctrines provide guidance in their interpretation, leaving to judges the task of applying law (Cao, 2007, p. 26).

According to the sources of law, as a common law country, precedents will regulate Canadian contractual interpretation. Whenever a judge makes a decision that is to be legally enforced, this decision becomes a precedent, a rule that will guide judges in making subsequent decisions in similar case (Oliphant and Wright, 2013, p.39). To the contrary, Indonesia, as a civil law country, will base its contractual interpretation on general principles, contained in Indonesian Civil Code (“ICC”), specifically in Articles 1341-1352.

From those sources of law, it can be perceived that Canadian approach to contractual interpretation is more flexible, practical, and open, as it will follow the development of legal facts in contractual disputes and is not limited to certain legal principles. Conversely, in Indonesia, there is a tendency that the judges and legal practitioners construe the law and regulation in contractual interpretation in a very strict and formal legalistic way (Hartono, et.al, 2001, p.viii). Consequently, Indonesia’s approach to contractual interpretation is more impractical and closed in the sense that every kind of contract dispute will be governed by a limited number of general principles, which has been particularly stipulated in the ICC.

Contractual interpretation is, for most part, an exercise in giving effect to the intentions of the parties (Hall, 2007, p. 7). It always begins with the words the parties use in the contract because they are the roots of all the various aspects of contractual interpretation (DiMatteo, 2014, p. 84). In practice, Estey J. also implies that the court should give effect to the intentions of the parties as expressed in their written document (Manulife Bank of Canada v. Conlin, 1996, para. 79).

As inferred in the Part I, contractual interpretation relates to either the objective or subjective theories of contract or both. Barnes (2008) elucidates that objective theory of contract accentuates the parties’ mutual consent by examining knowable evidence of external manifestations of assent rather than the subjective or internal intention of the contracting parties (p.5). To put it simply, contract is formed on the basis of shared understanding, not one-sided knowledge. In addition, he inserts that the subjective theory of contract more
focuses on what the parties subjectively intended to make the contract than the external perceptions. Practically, most of common law countries (the UK, Ireland) objectively commence the contractual interpretation, although they indicate the mutual assent of the parties (Burling and Lazarus, 2011, p. 97).

Pursuant to common law, Zeller (2002) further elaborates that establishing intent is not practical unless it is discovered in the contractual document and understood by a reasonable person [para. 45]. Afterward, the objectivist view prioritizes the external fact of the expression, chiefly because social and economic interaction requires reliance to be held primacy in order to provide security and predictability (Cserne, 2009, p.5). As the objectivist’s argument, Cserne states that, “reliance is placed on what others actually say not on what they meant to say” (p. 5). Yet, Lord Hoffmann later clarifies that common law does not fully negate subjective intent, for example, in the case of rectification, where the subjective intent is admissible (Ter Haar, 2017, p.6). It can be said that certain contracts will be ineffectual if they disregard the subjective intent. In civil law, the subjectivist view underlines party autonomy and the free will of the individual (Burling and Lazarus, 2011; Cserne, 2009). When intention and its expression conflict, the intention of the parties prevail (Zeller, 2002). In a nutshell, hypothetically, civil law perceives contract as an expression of the parties' intent, while common law perceives it through the perspective of a reasonable person in the same circumstances to ascertain the intent.

C. Subjective and Objective Theories of Contract

In contract law, Barnett (2010) describes “subjective” as “what is in one’s head” and “objective” as “what one manifests or communicates to another person” (p.68). Theoretically speaking, contract law embraces the objective theory of assent since it does not require the meeting of the minds of the parties. Objective theory of contract is interrelated by nature with reasonableness (Fridman, 2006, p. 15). To the contrary, subjective theory of contract does not require reasonableness, but the subjective discretion must be exerted honestly and in good faith. It means, to apply the subjective test, inexistence of bad motive and some other evidence showing dishonesty must be established (Partec Lavalin Inc. v Meyer, 2001, para. 19).

Endicott (2000) supports the use of objective test in interpreting the contract. In his opinion, the content of an agreement is showed by the parties' subsequent conduct, where its conduct is consistent with the given interpretation. Waddams (2005) also adds that the aim of objective test is to protect the reasonable expectations created by promises. Accordingly, the existence of a promise or an acceptance in a contract should be indicated by the way of a reasonable person would act in the position of the promise (p. 103).

The subjective theory, which represents the French legal system, is concerned with the literal intentions of the parties as inferred in the previous chapters. That is to say, in establishing a binding contract, both parties had to jointly consent to the contract and the external manifestation of consent is simply taken to verify the mutual intent (Barnes). Therefore, the parties are unnecessarily compelled to perform obligation beyond their consent (Tura, 2011, p. 4).

In France, the contractual interpretation rules are specifically stipulated in Articles 1156-1164 of the French Civil Code of 1804. Article 1156 of
the Civil Code instructs that the meaning of a contract should be determined according to the mutual intent of the parties. If the intention is imprecise, the courts will rather find the genuine state of mind of the parties instead of the external appearance of the contract (Nicholas, 1982, p. 46). To establish the parties’ actual intent, yet, other courts also examine all available extrinsic evidences (CISG-AC Opinion No.3). Due to the adoption of subjective approach of interpretation, the French civil law emphasizes the theory of “defects of consent”, i.e. mistake, “a false assessment of reality made by a contracting party”, as found in Article 1110 of the French Civil Code (Fabre-Magnan).

While, pursuant to Barnes, objective theory of contract scrutinizes “the external evidences of the parties’ intention as the only relevant consideration”, which means contract has nothing to do with the personal or individual intent of the parties (p. 5; Rowley, 1999, p. 84). It is rather perceived as an obligation attached by sheer force of law to certain acts of the parties, which ordinarily supplement and represent a mutual intent (p. 6). Due to its logical pragmatism and vindication of many policy-oriented concerns of contract law, this theory has been well established in the Anglo-American systems and in most of other major jurisdictions (p. 8). It preserves that vague and uncertain terms should be interpreted by examining what the parties said, wrote or did but not what they actually intended to say, write or do (Mckendrick, 1990, pp. 15-16). Correspondingly, in the case of vague language of a contract, the court is necessitated to apply the objective test as a matter of general rule.

D. The Subjective and Objective Tests: Indonesia and Canada

As a common law country, Canada applies precedent as the sources of law. In this matter, related to contract law, the Supreme Court of Canada (SCC) ruled in Sattva Capital Corp. v Creston Moly Corp. (Sattva), in which the ruling becomes a landmark decision in the law of contractual interpretation. The SCC unanimously departed from the historical approach to contractual interpretation and determined that it now involves issues of mixed fact and law. The SCC held so because it is an exercise in which the principles of contractual interpretation are applied to the words of the written contract. Justice Rothstein wrote that the goal of contractual interpretation is to ascertain the objective intent of the parties – a fact-specific goal – through the application of legal principles of interpretation (para. 55). Thus, it is a fundamental principle of the law of contractual interpretation that the exercise is objective rather than subjective (Hall, 2012, p.24).

The objective approach of contractual interpretation (assessed from the perspective of a reasonable person) can be illustrated in 642718 Alberta Ltd. (c.o.b. CNE Centre) v. Alberta (Minister of Public Works, Supply and Services). The issue was whether offer to purchase document (referred to as the “Third Offer”) forwarded to the plaintiffs by the defendant Province of Alberta constituted an acceptance of a purported oral agreement to purchase land. Interpretation of the Third Offer was approached on the following basis: “The question then becomes, what should the Plaintiffs reasonably have concluded was intended by the Province when they forwarded this document.” This formulation aptly demonstrates the objective perspective to contractual interpretation: the question was
not what the Defendant intended by the words it used but rather “what should the Plaintiffs reasonably have concluded was intended ...”.

Additionally, to objectively construe the contract, Sattva acknowledged “factual matrix” or the “surrounding circumstances” known to the parties at the time of the formation of the contract, particularly, the knowledge that was or reasonably ought to have been within the understanding of both parties at or before the date of contracting (para. 58). Even if the surrounding circumstances are considered in interpreting the terms of a contract, they must never be allowed to depart from the words of the contract (Hall, 2012, p. 30).

The goal of examining such evidence is to deepen decision-maker’s understanding of the mutual and objective intentions of the parties as expressed in the words of the contract (Sattva, 2014, para. 57). Nevertheless, it is said that the interpretation of a written contractual provision “must always be grounded in the text and read in light of the entire contract” (Hall, 2012, pp. 15, 30-32). While the surrounding circumstances are relied upon in the interpretive process, Sattva reaffirmed that “courts cannot use them to deviate from the text such that the court effectively creates a new agreement” (Glaswegian Enterprises Inc. v. B.C. Tel Mobility Cellular Inc., 1997). In other words, the fundamental principle of contractual interpretation is that a contract must be construed as a whole (McCamus, 2012, pp. 761-62).

Indonesian contract law adopts three approaches of contractual interpretation: subjective approach, objective approach, and combination of both objective and subjective approaches (Sutiyoso, 2013, p. 213). Subjective approach seeks to determine what the parties subjectively intended. This approach has been adopted in the ICC. Article 1343 of the ICC stipulates that “if the wording of an agreement is open to several interpretations, one shall ascertain the intent of the parties involved rather than be bound by the literal sense of the words.” While objective approach, according to Sutiyoso, put more emphasis on what is written in the contract rather than the subjective intention of the contracting parties, particularly if the words of a contract are obviously clear. This approach conforms to the plain meaning rule where the plain meaning of a contract is obvious; there is no room for interpretation. This approach can be found in Article 1342, regulating that “if the wording of an agreement is clear, one shall not deviate from it by way of interpretation.” In practice, Sutiyoso also explains that there is no priority in applying the interpretation method. It can be applied alone or combined with other methods of interpretation (p. 214).

Both Indonesian and Canadian contractual interpretations embrace both objectivist and subjectivist elements and have the same overriding aim when construing a commercial contract, which is to give effect to the expressed intention of the parties. Even if Canada favors objective approach in contractual interpretation, such approach generally does reflect subjective intentions of the contracting parties (Barnett, 2011, p. 6). Canadian court will not consider the surrounding circumstances when the language of the written contract is clear and unambiguous.

In relation to surrounding circumstances, if it is further analyzed, Indonesian contractual interpretation rule actually recognizes it in Article 1346 of the ICC. Article 1346 of the ICC stipulates that “if the wording is ambiguous, it shall be interpreted in a manner, which is customary
in the country or in the location where the agreement was entered into". As a civil law country, which is subject to codified legal rule, “surrounding circumstances" adopted by Indonesia are more rigid and specific thus they are limited to what is written in the ICC.

In the case of standard form contract interpretation, Canadian contractual interpretation rule precludes “surrounding circumstances" in interpreting contract. In Ledcor, Justice Cromwell admits that “for standard form contracts, there are usually no relevant surrounding circumstances, but, such as the purpose of the contract, the nature of the relationship it creates, and the market or industry in which it operates should be considered when interpreting a standard form contract” (para. 30).

In this matter, Indonesia differs from Canada in having no specific or detailed rule for standard form contract, as said in Article 1345 of the ICC that “wording which is open to two kinds of interpretation shall be interpreted in the sense which corresponds most with the nature of the agreement". This provision is not specifically designed for a standard form contract, but for a contract in general so that it can accommodate all types of contract.

Referring to the standard form contract issue, as Indonesia is subject to codified rule, it is reasonable that the contractual interpretation rules appear to be unclear or even broader as they are not fact-based analysis, that's why they should be able to accommodate all possible legal facts arising. If they are shape to govern more specific issues, it will increase difficulties for the judges to apply the law, where codified rule is the main source of law. Nevertheless, the positive point is that the law is more predictable as certain exact rules will be applied in all types of cases of contractual interpretation.

Contrarily, Canadian contractual interpretation rules appear to be more specific as they are fact-based analysis, in which its application cannot be predicted. However, the unpredictable application of Canadian rule can result in greater fairness than Indonesian rule as it follows the development of legal facts. Hence, every contractual interpretation dispute will not be treated equally if it contains different legal facts.

Again, it is theoretically said that Indonesia as a civil law country should be “more subjective” than Canada in interpreting contract (Adams and Bomhoff, 2012). But then, Article 1348 of the ICC stipulated that “all stipulations, contained in an agreement, shall be interpreted having regard to their relationship to one another; each shall be interpreted having regard to its relationship to the whole agreement." This provision subtly also reflects a fundamental principle of contractual interpretation, stated in Sattva that a contract must be construed as a whole. Therefore, basically, Indonesia and Canada adopt the combination of both approaches. However, due to their different sources of law and application of the rules, the rule of contractual interpretation is constructed differently

E. Conclusion

As previously explained, ideally, civil law upholds subjective approach to contractual interpretation, while common law upholds objective approach to contractual interpretation. Subjective approach seeks to determine what the contracting parties subjectively intended (the true intention of the parties), but the subjective discretion must be exercised honestly and in good faith. On the other hand, objective approach seeks to determine the parties’ intention by
examining the understanding of a reasonable person in the equivalent circumstances, which means that it relates to the notion of reasonableness.

In the following, the case study between Indonesia and Canada interestingly shows how their sources of law influence court’s approach to contractual interpretation. From the sources of law, it can be concluded that Canadian approach to contractual interpretation is more flexible, practical, and open, as it will follow the development of legal facts in contractual disputes and is not limited to certain legal principles. Conversely, Indonesia’s approach to contractual interpretation is more impractical and closed in the sense that every kind of contract dispute will be governed by a limited number of general principles, which has been particularly postulated in the ICC.

In their applications, Indonesia, as a civil law country, starts the interpretation exercise with subjective approach and Canada, as a common law country, starts it with objective approach. Nonetheless, in their processes of contractual interpretation, these two countries combine both subjective and objective approaches to achieve accuracy in contractual interpretation. Simply put, it is observed that subjective and objective approaches to contractual interpretation are completely intertwined and tangled with one another. Therefore, in practice, these two approaches are inseparable; they not mutually exclusive of each other in all aspects.
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