

CONSTRUING CONTRACT CLAUSE: THE LITERAL RULE

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# CONSTRUING CONTRACT CLAUSE: THE LITERAL RULE

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## **ABSTRACT**

In drafting a contract, contracting parties will negotiate terms of their contract and subsequently translate them in writing. It is very important to ensure the words used effectively reflect their true intentions. This is because the law cases relating to ambiguous terms in contracts would allow the courts to construe the word base on their opinion. The disagreements and differing opinions by the parties as to the true construction of particular terms frequently happened in construction industry. There are many approaches that judge use to construing construction contract clauses, such as Literal Rule, Golden Rule, Mischief Rule, Purposive Rule, Contra Proferentem Rule and etc. The courts use those rules to the ambiguous express terms to resolve the ambiguity or inconsistency or discrepancy. Literal Rule is the oldest of the rules of construction and is still used today. As there is always the danger that a particular interpretation may be the equivalent of making law, some judges prefer to adhere to the law's literal wording. However, there some criticism against the use of Literal Rule which the rule rests on the erroneous assumption that words has a fixed meaning. In fact, words are imprecise, leading judges to impose their own prejudices to determine the meaning of a statute. The objective of this study is to identity suitability of using Literal Rule in interpretation approach in construction industry. The law cases that been analyzed was under “Pay When Paid”, “Performance Bond” and “Termination” clauses. The finding of this study stated that, not all the construction clauses are suitable to be construed using Literal Rule approach.

## ABSTRAK

Dalam merangkai kontrak, pihak berkontrak akan berunding terma kontrak mereka dan seterusnya menterjemahkan dalam bentuk tulisan. Ia adalah sangat penting untuk memastikan perkataan yang digunakan dalam kontrak dapat menunjukkan tujuan sebenar mereka. Ini adalah kerana kes undang-undang yang berhubungan dengan salah tafsiran dalam kontrak akan membenarkan mahkamah untuk mentafsirkan perkataan asas dengan pendapat mereka. Percanggahan pendapat dengan pendapat yang berbeza oleh pihak berkontrak sering berlaku dalam industri pembinaan. Terdapat banyak kaedah yang boleh digunakan oleh hakim dalam mentafsirkan fasal kontrak pembinaan, seperti “*Literal Rule*”, “*Golden Rule*”, “*Mischief Rule*”, “*Purposive Rule*”, “*Contra Proferentem Rule*” dan sebagainya. Mahkamah menggunakan kaedah tersebut untuk menyelesaikan masaah tafsiran and percanggahan. “*Literal Rule*” adalah kaedah yang paling lama digunakan dan masih digunakan hari ini. Oleh kerana sentiasa terdapat bahaya bahawa tafsiran tertentu mungkin dianggap sebagai merangka undang-undang, jadi hakim lebih suka berpegang kepada “*Literal Rule*”. Walau bagaimanapun, terdapat beberapa kritikan terhadap penggunaan “*Literal Rule*” bahawa peraturan tersebut bergantung kepada andaian salah di mana perkataan mempunyai makna yang tetap. Malah, sesuatu perkataan jika tidak mempunyai makna yang tepat, hakim akan mentafsirkan perkataan mengikut prasangka mereka sendiri untuk menentukan makna statut. Objektif kajian ini adalah untuk mengenal pasti kesesuaian menggunakan “*Literal Rule*” sebagai pendekatan tafsiran dalam industri pembinaan. Kes yang telah dianalisis adalah berkaitan dengan terma dalam fasal “*Pay When Paid*”, “*Performance Bond*” and “*Termination*”. Kajian ini mendapati bahawa, tidak semua fasal sesuai ditafsirkan dengan “*Literal Rule*”.

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*Teknik Cekap Sdn Bhd v Public Bank Bhd* [1995] 3 MLJ 449

*Thomas J Dyer Co v. Bishop International Engineering*[1962] Co 303 F2d 655

*Wallis v. Smith* [1882] 21 Ch D 243

*Ward v. Eltherington* [1982] Qd. R. 561 (SC, Qld)

## **CHAPTER 1**

### **INTRODUCTION**

#### **1.1 Background of the Study**

The contract's clarity is important; it could help contract drafters and professional to review and clarify the contract easily. The clear terms and conditions in the contract make it easy for the parties to understand the contract.<sup>1</sup>The contractual obligation of contracting parties in any contract or agreement will be questionable if the terms and condition of the contracts are not fully appreciated.<sup>2</sup> It is very important for contract to be drafted in clear and unambiguous term that clearly set out the intention of the parties. Unclear term will lead misunderstanding and disputes.

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<sup>1</sup>Chong, H.Y and RosliMohamadZin (2008).*A case study into the language structure of construction standard form in Malaysia*. International Journal of Project Management 28 (2010) 601-608

<sup>2</sup>Mohamad Ibrahim Mohamad1 And ZulkifliMadon, Understanding Contract Documentation, *Proceedings Of The 6th Asia-Pacific Structural Engineering And Construction Conference (APSEC 2006)*, 5 – 6 September 2006, Kuala Lumpur, Malaysia.



There are many disputes in construction industry. One of the reasons is poor understanding of contract terms. Poor understanding of contracts is caused by ambiguous term or unclear term. When terms are ambiguous, the courts use various methods of interpretation to construe the meaning of words. However when the term are clear and unambiguous, court will used literal meaning or plain English meaning.<sup>3</sup>

According to the Free Online dictionary, ambiguity defined as unclearness by virtue of having more than one meaning. If there is an ambiguity, and the original writer cannot effectively explain it, then the ambiguity will be decided in the light most favorable to the other party.<sup>4</sup> A contract is said to be *ambiguous* when it is uncertain what the intent of the drafter and the contract is capable of more than one reasonable interpretation. Courts will interpret against the ambiguous contract words. The court may also imply a term if it's necessary to give a contract a construction or meaning that is reasonable. However, a term will not be implied in a contract when the court concludes that the parties intended for the contract to be silent on a particular point.<sup>5</sup>

For the ambiguous clauses, the court will interpret the meaning of the term and provision. This construing exercise is particularly important when the meaning of a contractual term is ambiguous or uncertain or contradictory. When a judge construes a provision of a statute or a term in a contract, he will normally applies certain established "rules of construction". "Construction" can be define as the form of a building or combine together the parts of anything, structure and arrangement. In the other hand, "Construction" also refers to the arrangement and connections of words in a sentence,

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<sup>3</sup> Helen Scott. *Contract II Outline*. Spring 1995

<sup>4</sup> Farlex, "Ambiguity", The free Dictionary. Retrieved on 14 August 2012 and available at <http://legal-dictionary.thefreedictionary.com/ambiguity>

<sup>5</sup> US Legal. *Interpretation of Ambiguous contracts*, 2010. Retrieved on 14 August 2012 and available at <http://contracts.uslegal.com/interpretation-of-contracts/interpretation-of-ambiguous-contracts/>

syntactical arrangement in construing, interpreting, or explaining a declaration or facts, an attributed sense or meaning, understanding, explanation and etc.<sup>6</sup>

There are many type of interpretation method in construing statutory provision and contract document. For example literal rule which the words are to be taken prima facie in their ordinary, literal or grammatical meaning; golden rule, which the grammatical and ordinary sense of the words is to be adhered to and purposive rule, which give effect to the true purpose of legislation and are prepared to look at much extraneous material that bears on the background against which the legislation was enacted. There is also mischief rule which the courts may consider the pre-existing problem and the intention of the parliament as regards the remedy for it and by reading the contract as a whole.<sup>7</sup>

In the case of *Simpson v. Foxon*<sup>8</sup>, the court had held that the meaning of a document must be sought in the document itself. In the case of the *Lloyd v. Lloyd*<sup>9</sup>, the clauses in the sale and purchase agreement are complete and unambiguous in their terms that there can be no other construction possible then the one which was held by the learned judge. Lord Cottenham LC stated that “If the provisions are clearly expressed, and there is nothing to enable the court to put upon them a construction different from that which the words import, no doubt the words must prevail”. It was intention may prevail over the words used.

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<sup>6</sup> Accurate & Reliable Dictionary, “*Construction*”, A free English online dictionary. Retrieved on 14 August 2012, and available at <http://ardictionary.com/Construction/11089>

<sup>7</sup> Wikipedia, the free encyclopedia

<sup>8</sup> [1907] P 54

<sup>9</sup> [1837] 2 My & Cr 192

In construing the words, the words are to be taken in their literal meaning. It can be showed in the case of *Wallis v. Smith*,<sup>10</sup> in determining whether a clause can be considered as liquidated damages, the court held that a clause provided that a sum of money will be payable to contractor for any substantial breach committed by defendant, and the court of appeal construed it as being a liquidated damages clause.

When construing a contract, a contract is to be construed as a whole. It was shown at the case of *East Ham Corporation v. Sunley*<sup>11</sup>. It was a case which the plaintiff is seeking damages for the defective performance of a building contract which was a contract for labour and materials. The normal measure of his damages was the cost of carrying out remedial work. Reasonableness was a part of the primary assessment of damages as well as of mitigation of damage.

When the main issue related to the ambiguity of a term in a contract, the court will use a suitable method of interpretation in order to find out the exact intention of the parties. The courts have developed a range of rules of interpretation to assist them. One of the rule that commonly been used is Literal Rule, when the literal rule is applied the words in a statute are given their ordinary and natural meaning, in an effort to respect the will of Parliament.<sup>12</sup>

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<sup>10</sup> [1882] 21 Ch D 243

<sup>11</sup> [1965] 1 WLR 30

<sup>12</sup> Pearson, Catalogue, *Chapter 3 Statutory Interpretation*. Retrieved on 19 August 2012 and available at [http://catalogue.pearsoned.co.uk/assets/hip/gb/hip\\_gb\\_pearsonhighered/samplechapter/ELS\\_C%20and%20M\\_Chap%203.pdf](http://catalogue.pearsoned.co.uk/assets/hip/gb/hip_gb_pearsonhighered/samplechapter/ELS_C%20and%20M_Chap%203.pdf)

## 1.2 Problem Statement

Literal rule is one of the important methods of interpretation. Literal rule is not only being used in interpretation clause in contract, but also in interpretation statutory provision. Literal rule is mainly used when the words in clause are clear and unambiguous. For example in the case of *Teknik Cekap Sdn Bhd v Public Bank Bhd*<sup>13</sup>, the court held that the wording of the performance bond itself, it was clear and unequivocal. Therefore giving the words in the performance bond its literal plain meaning, it was a conditional bond.

The literal approach is dominant in the English legal system, although it is not without critics, and devices do exist for circumventing it when it is seen as too restrictive. This view of judicial interpretation holds that the judge should look primarily to the words of the legislation in order to construe its meaning and, except in the very limited circumstances considered below, should not look outside of, or behind, the legislation in an attempt to find its meaning.<sup>14</sup>

Under the literal rule the judge considers what the clause actually says, rather than what it might mean. In order to achieve this, the judge will give the words in the literal meaning. Sometimes, the effect of plain meaning is to produce what might be considered as an otherwise unjust or undesirable outcome. The literal rule says that the intention of contract parties is best found in the ordinary and natural meaning of the words used. If the judges are permitted to give an obvious or non-literal meaning to the words of contract law, then the meaning of contract can be contradict.<sup>15</sup>

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<sup>13</sup> [1995] 3 MLJ 449

<sup>14</sup> Fundamentals Level – Skills Module, *The literal Approach*. Paper F4 (ENG) Corporate and Business Law (English) December 2009 Answers.

<sup>15</sup> LabSpace, open educational resources. *Judge and the Law: Part E The rules of statutory interpretation The literal rule*. Retrieved on 19 August 2012 and available at <http://labspace.open.ac.uk/mod/resource/view.php?id=415849>

Literal meaning is a simple exercise. All that the judge does is to give the words in the clauses their literal or plain English meaning. For example in the case of *Brightside Mechanical & Electrical Services Group Ltd. & Anor v Hyundai Engineering & Construction Co. Ltd.*<sup>16</sup> The relevant payment provision reads as “Within five days of the receipt by the contractor by the sum included in any certificates of the architect, the contractor shall notify and pay to the sub contractor.....”. In construing the wordings of this provision, Judge Thean said the clauses were clear and unambiguous and effect must be given to them.

However, the literal meaning may not be in compliance with the intentions of the contract. For example “Pay When Paid” clause, it may not be correct to assume that the subcontractor will not be paid at all so long as the employer has not paid the main contractor for whatever the reasons is. If the reason for not payment to the main contractor is the default of the main contractor, thus it is cannot that the subcontractor will not be paid at all. For example in the case of *Durabella Ltd v. J Jarvis & Sons Ltd*<sup>17</sup>, the court held that a contractor cannot rely on a “Pay When Paid” clause if the reason for non-payment is its own breach of contract or default. It is trite law that one cannot take advantage from one’s breach of contract.

The literal rule may also not be suitable when the interpretation gives a different meaning. It was showed in the “Termination” clause for the ways of serving termination notice. In the case of *Goodwin & Sons v Fawcett*<sup>18</sup> which decided that the provisions for giving of the notice of determination by registered post was not mandatory and that such a notice given by recorded delivery was valid. However in the case of *Fajar Menyensing Sdn Bhd v Angsana Sdn Bhd*<sup>19</sup>, the court held that clause of the contract clearly required

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<sup>16</sup> [1988] 1 MLJ.500

<sup>17</sup> [2001] All ER (D) 102

<sup>18</sup> [1945] EG 186

<sup>19</sup> [1998] 6 MLJ 80 (HC)

the notices to be given by registered post or recorded delivery. The notices of determination delivered by hand were hence invalid.

The literal rule fails to recognize that the English language itself is ambiguous and that words may have different meanings in different contexts. The use of this rule can sometimes lead to absurdities and loopholes which can be exploited by an unmeritorious litigant. Judges have tended to over-emphasize the literal meaning of statutory provisions without giving due weight to their meaning in a wider context. Placing emphasis on the literal meaning of words assumes an unobtainable perfection in draftsmanship. Finally, it ignores the limitations of language.<sup>20</sup>

The use of literal rule also can lead to harsh outcomes. It was shown in the case of *London & North Eastern Railways Co. v Berriman*<sup>21</sup>, where a rail worker was killed when doing maintenance work. When his widow tried to claim compensation she was told she would not receive anything due to the work of maintaining the line. This was because the word maintaining was not “Relaying” or “Repairing” as said in the Fatal Accidents Act. It showed that there had been a minor technicality with the words maintaining and repairing as they had been seen as being completely different words when taking the meaning of them literally.<sup>22</sup> After the *Berriman* case, Professor Michael Zander decided that the literal rule was mechanical and divorced from the realities of the language which was in use.

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<sup>20</sup> Ibid, no.15

<sup>21</sup> [1946] AC 278

<sup>22</sup> Amy Cross. Using cases to illustrate, explain how and why the courts make use of the doctrine of judicial precedent and statutory interpretation to resolve points of law. November 2008

The literal rule has been widely used in interpretation of contract clauses; however it is not always suitable for construing of all contract clauses. Literal rule gives meaning to words without the consideration of different situations. It will lead to the unfair judgment and obscure outcomes.

### **1.3 Objective of the Research**

The objective of the study is to identify the suitability of using literal rule in construing contract clause.

### **1.4 Scope of the Research**

The approach adopted in this research is case law based. The cases specifically related to the issue of literal rule have been discussed in this study. The relevant court cases are taken from the Malayan Law Journal and other sources. Furthermore, this study has been conducted based on the relevant provisions in Standard Forms of Construction Contract used in Malaysia such as PAM contract 2006, PWD Form 203A 2010, CIDB 2000 and other provisions under Common Law.

## **1.5 Research Methodology**

The methodology of this study is by documentary analysis. To achieve the objective of this study, a systematic process has been planned. The process of the study divides into five stages as followings:

- a) Identify the issue of study
- b) Literature review
- c) Data collection
- d) Data analysis
- e) Conclusion and recommendation

### **1.5.1 Stage 1: Identify the Issue of Study**

Before identify an issue, it involved general reading on various type of material such as journals, articles, newspaper, magazine, online database, previous research report and cases in the Malayan Law Journal. After confirming an interesting topic or issue, it involved extensive reading and of the concept involved to collect more data to make sure the issue was strong enough.



### **1.5.2 Stage 2: Literature Review**

After identifying the issue, the next stage is literature review which explained and discussed about the research topic. The data and information are gathered from the journals, books, articles and magazines. Besides that, it also refers to the court cases from different sources such as Malayan Law Journal, Malaysian Bar and etc. This phase is to increase the understanding and support for the research before proceeding to another stage. Apart from that, the clause in various type of standard form will be referred such as PAM form of contract 2006, PWD Standard Form of Contract 2010 and CIDB 2000 standard form of contract.

### **1.5.3 Stage 3: Data Collection**

Data collection is a process of obtaining the data and information related to the study. In order to meet the goals and objectives, the cases that are relevant to plain English in the Malayan Law Journal (MLJ) cases will be focused. It carries out by using the online database via university library. Besides that, other source such as articles, journal and related website are also been studied and referred.

#### **1.5.4 Stage 4: Data Analysis**

Data analysis is done after the data collection stage. The relevant court cases that related to the research objective will be reviewed with the facts, issue and court held by each different cases. After the discussions have been made from the analysis, there will be the recommendation and conclusion chapter to accommodate those researches findings.

#### **1.5.5 Stage 5 Conclusion and Recommendation**

The final step of study is conclusion and suggestion of the study. The findings of the research are concluded and some suitable recommendations for further study are made.

Stage 1 - Identify the Issue of Study
General reading on various type of material to identify objective of study, issue and scope of study.
Stage 2 - Literature Review
Data and information gathered from the journals, books, articles, magazines and etc.
Stage 3 – Data Collection
Relevant Malayan Law Journal (MLJ) cases from online database via university library
Stage 4 – Data Analysis
Documentary analysis, Analysis of cases relevant to Literal Rule
Stage 5 conclusion and Recommendations
Conclude the findings from research

**Figure 1.1** Research Methodology

## 1.6 Organization of Chapter

Organization of chapter is a summary of the content for the Research Project Report. The report consists of four chapters:

a) Chapter 1 : Introduction

This chapter covers the background of the study, statement of problem, research objective and scope of study. This chapter also includes the research methodology for this study.

b) Chapter 2 : Method of Interpretation

This chapter is literature review for the study. It explains the data and information obtain from secondary resources. It's including the introduction of statutory provision interpretation and contract document interpretation.

c) Chapter 3: Literal Rule

This chapter also is literature review for the study. It was a further explains for the chapter 2 date information. It's more focused on the Literal rule interpretation approach and the criticism of the literal rule.

d) Chapter 4 : Case Analysis

This chapter presents the findings achieved from documentary analysis of the law cases. The law cases are analyzed and discussed.

e) Chapter 5 : Conclusion and Recommendation

This chapter concludes the findings of the study and some recommendations are suggested.

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