CA 4628/93

State of Israel

v.

Apropim Housing and Promotions (1991) Ltd

The Supreme Court sitting as the Court of Civil Appeals

[6 April 1995]

Before Vice-President A. Barak and Justices D. Levin, E. Mazza

Appeal on the judgment of the Jerusalem District Court (Justice Ts. E. Tal) dated 22 June 1993 in OM 46/93.

Facts: Because of large-scale immigration from the countries of the former Soviet Union, the appellant wished to encourage the speedy building of residential apartments. This was done within the framework of a 'Programme Contract', which gave incentives to builders in the form of a State guarantee to buy apartments that were not sold on the open market, and it provided for sanctions in the event of delays. The incentives were particularly significant in development areas, where the State undertook to buy *all* the apartments that were not sold on the open market. However, the contract was drafted carelessly, and it left room for the respondent to argue that although it provided sanctions for building delays in desirable areas, there was no such sanction for building delays in development areas.

The District Court accepted the respondent's argument, holding that the Contracts (General Part) Law, 5733-1973, mandated a two-stage approach to contractual interpretation, whereby only if the language of the contract was unclear, could the court consider the surrounding circumstances. The District Court held that the language of the contract *was* clear, and therefore it could not take account of the circumstances, and particularly the underlying purpose of the contract.

Held: Whereas Justice Mazza (in the minority opinion) upheld the ruling of the District Court, the majority rejected the District Court's interpretation of the programme contract; the outcome that there was no sanction for building delays in development areas was inconsistent with the underlying purpose of the progamme agreement. Vice-President Barak rejected the two-stage doctrine of interpretation.

Appeal allowed.

Statutes cited:

Contracts (General Part) Law, 5733-1973, ss. 13, 16, 25(a), 25(b), 26, 39, 41, 44, 45, 46.

Foundations of Justice Law, 5740-1980, s. 1.

Government and Justice Arrangements Ordinance, 5708-1948, s. 10A.

Inheritance Law, 5725-1965, ss. 30(b), 54.

Palestine Order in Council, 1922, s. 46.

Israeli Supreme Court cases cited:

[1] CA 554/83 *Atta Textile Company Ltd v. Estate of Yitzhak Zolotolov* [1987] IsrSC 41(1) 282.

[2] CA 450/82 *State of Israel v. Hiram Landau Earth Works, Roads and Development Ltd* [1986] IsrSC 40(1) 658.

[3] CA 191/85 *State of Israel v. Neveh Schuster Co. Ltd* [1988] IsrSC 42(1) 573.

[4] CA 5795/90 *Sakali v. Tzoran Ltd* [1992] IsrSC 46(5) 811.

[5] CA 492/62 *Shahaf Port Shipping Co. Ltd v. Alliance Insurance Co. Ltd* [1963] IsrSC 17 1898.

[6] CA 464/75 *Promotfin Ltd v. Calderon* [1976] IsrSC 30(2) 191.

[7] CA 406/82 *Nahmani v. Galor* [1987] IsrSC 41(1) 494.

[8] CA 479/89 *Coptic Mutran v. Halamish — Government-Municipal Corporation for Housing Renovation in Tel-Aviv-Jaffa Ltd* [1992] IsrSC 46(3) 837.

[9] CA 453/80 *Ben-Natan v. Negbi* [1981] IsrSC 35(2) 141.

[10] CA 46/74 *Mordov v. Schectman* [1975] IsrSC 29(1) 477.

[11] CA 627/84 *Nudel v. Estate of Tzvi Pinto* [1986] IsrSC 40(4) 477.

[12] CA 327/85 *Kugler v. Israel Lands Administration* [1988] IsrSC 42(1) 97.

[13] CA 552/85 *Agasi v. I.D.P.C. Israeli Data Processing Company Ltd* [1987] IsrSC 41(1) 241.

[14] CA 345/89 *Neot Dovrat v. Israelift Elevators Y.M.S. Ilan Management and Investments Ltd* [1992] IsrSC 46(3) 350.

[15] CA 631/83 *HaMagen Insurance Co. Ltd v. Medinat HaYeladim Ltd* [1985] IsrSC 39(4) 561.

[16] CA 3804/90 *Delta Investments and Commerce (Keren Shomron) Ltd v. Supergas Israeli Gas Supply Co. Ltd* [1992] IsrSC 46(5) 209.

[17] CA 702/84 *Yuval Gad Ltd v. Land Appreciation Tax Director* [1986] IsrSC 40(4) 802.

[18] CA 650/84 *Stern v. Ziuntz* [1987] IsrSC 41(1) 380.

[19] CA 170/85 *Zaken Bros. Contracting Company v. Mizrahi* [1989] IsrSC 43(2) 635.

[20] HCJ 47/83 *Air Tour (Israel) Ltd v. General Director of Antitrust Authority* [1985] IsrSC 39(1) 169.

[21] CA 603/79 *Avargil v. Peleg & Shitrit Building and Development Co. Ltd* [1984] IsrSC 38(1) 633.

[22] CA 703/88 *Morgan Industries Ltd v. Batei Gan Leasing Ltd* [1990] IsrSC 44(1) 288.

[23] CA 1395/91 *Winograd v. Yedid* [1993] IsrSC 47(3) 793.

[24] CA 5597/90 *Cohen v. C.B.S. Records Ltd* [1993] IsrSC 47(3) 212.

[25] CA 765/82 *Alter v. Alani* [1984] IsrSC 38(2) 701.

[26] CA 1932/90 *Peretz Bonei Hanegev — Peretz Bros. Ltd v. Buchbut* [1993] IsrSC 47(1) 357.

[27] CA 536/89 *Paz Oil Co. Ltd v. Levitin* [1992] IsrSC 46(3) 617.

[28] CA 154/80 *Borchard Lines Ltd, London v. Hydrobaton Ltd* [1984] IsrSC 38(2) 213.

[29] CA 832/81 *Ralpo (Israel) Ltd v. Norwich Union Fair Insurance Society Ltd* [1985] IsrSC 39(1) 38.

[30] CA 685/88 *Kotterman v. Torah VaAvodah Fund* [1993] IsrSC 47(2) 598.

[31] CA 708/88 *Shelomo Schepps & Sons Ltd v. Ben-Yakar Gat Engineering and Building Co. Ltd* [1992] IsrSC 46(2) 743.

[32] HCJ 1683/93 *Yavin Plast Ltd v. National Labour Court* [1993] IsrSC 47(4) 702.

[33] CA 5559/91 *K.Z. Gas and Energy Enterprises (1982) Ltd v. Maxima Air Separation Centre Ltd* [1993] IsrSC 47(2) 642.

[34] CA 5187/91 *Maximov v. Maximov* [1993] IsrSC 47(3) 177.

[35] CA 324/63 *HaLevy Segal v. Georgiani Maggi Co. Ltd* [1962] IsrSC 18(4) 371.

[36] CA 655/82 *Grover v. Farbstein* [1986] IsrSC 40(1) 738.

[37] HCJ 15/56 *Sofer v. Minister of Interior* [1956] IsrSC 10 1213.

[38] CA 161/59 *Balan v. Executor of Litwinski's Will* [1960] IsrSC 14 1905.

[39] HCJ 163/57 *Lubin v. Tel-Aviv Municipality* [1958] IsrSC 12 1041.

[40] FH 32/84 *Estate of Walter Nathan Williams v. Israel British Bank (London) (in liquidation)* [1990] IsrSC 44(2) 265.

[41] HCJ 306/86 *State of Israel v. National Labour Court* [1987] IsrSC 41(2) 639.

[42] CA 783/86 *Reuven Gross Ltd v. Tel-Aviv Municipality* [1989] IsrSC 43(4) 595.

[43] CA 719/89 *Haifa Quarries v. Han-Ron Ltd* [1992] IsrSC 46(3) 305.

[44] CA 819/87 *Development of part of Parcel 9 Block 9671 Co. Ltd v. HaAretz Newspaper Publishing Ltd* [1989] IsrSC 43(2) 340.
[45] CA 196/87 *Shweiger v. Levy* [1992] IsrSC 46(3) 2.
[46] CA 779/89 *Shalev v. Selah Insurance Co. Ltd* [1994] IsrSC 48(1) 221.
[47] CA 226/80 *Kahan v. State of Israel* [1981] IsrSC 35(3) 463.
[48] CA 702/80 *Galfenstein v. Avraham* [1983] IsrSC 37(4) 113.
[49] CA 757/82 *Israel Electricity Co. Ltd v. Davidovitz* [1985] IsrSC 39(3) 220.
[50] CA 565/85 *Gad v. Nevi'i* [1988] IsrSC 42(4) 422.
[51] CA 449/89 *Flock v. Wright* [1992] IsrSC 46(2) 92.
[52] CA 2738/90 *Yahav v. Ben-Tovim* [1993] IsrSC 47(1) 695.
[53] CA 530/89 *Bank Discount v. Nofi* [1993] IsrSC 47(4) 116.
[54] CA 424/89 *Farkash v. Israel Housing and Development Ltd* [1990] IsrSC 44(4) 31.
[55] CA 403/72 *HaMeretz Automobile Chassis and Metalworks Ltd v. Grayev* [1973] IsrSC 27(1) 423.
[56] BAA 4/72 *Sofran v. Bar Association Tel-Aviv District Committee* [1973] IsrSC 27(2) 125.
[57] HCJ 188/63 *Batzul v. Minister of Interior* [1965] IsrSC 19(1) 337.
[58] CA 126/79 *Fried v. Appeals Committee under Nazi Persecution Victims Law, 5717-1957* [1980] IsrSC 34(2) 24.
[59] HCJ 932/91 *Central Pension Fund of Federation Employees Ltd v. National Labour Court* [1992] IsrSC 46(2) 430.
[60] CA 72/78 *Israel Land Administration v. Raab* [1978] IsrSC 32(3) 785.
[61] HCJ 305/82 *Mor v. District Planning and Building Committee, Central District* [1984] IsrSC 38(1) 141.
[62] BAA 663/90 *A v. Bar Association Tel-Aviv District Committee* [1993] IsrSC 47(3) 397.
[63] HCJ 4267/93 *Amitai — Citizens for Good Government and Integrity v. Prime Minister* [1993] IsrSC 47(3) 441.
[64] CA 528/86 *Polgat Industries Ltd v. Estate of Yaakov Blechner* [1993] IsrSC 47(3) 821.
[65] CA 39/47 *Asher v. Birnbaum* [1948] IsrSC 2 533.
[66] HCJ 59/80 *Beer-Sheba Public Transport Ltd v. Jerusalem National Labour Court* [1981] IsrSC 35(1) 828.
[67] CA 627/78 *Weizman v. Abramson* [1979] IsrSC 33(3) 295.

English cases cited:

[68] *Raffles v. Wichelhaus* (1864) 159 All ER 375 (Ex.).

[69] *Heydon's Case* (1584) 76 All ER 637 (K.B.).
[70] *Prenn v. Simmonds* [1971] 1 W.L.R. 1381 (H.L.).
[71] *Reardon Smith Line Ltd v. Hansen-Tangen* [1976] 1 W.L.R. 989 (H.L.).
[72] *Antaios Compania S.A. v. Salen A.B.* [1985] A.C. 191.
[73] *Glynn v. Margetson & Co.* [1893] A.C. 351.
[74] *Grey v. Pearson* (1857) 10 All E.R. 1216 (H.L.).

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For the respondent — P. Gladstein.

JUDGMENT

Justice E. Mazza

This is an appeal on a judgment of the Jerusalem District Court (the honourable Judge Ts. E. Tal), in which the court accepted the position of the respondent and rejected the position of the State, regarding the correct interpretation of clause 6(h)(3) of the '1990 Programme Contract'.

The programme contract

2. At the end of 1990, the Government decided to encourage the building of apartments for new immigrants and other persons entitled to housing. To advance this policy, the Ministry of Building and Housing prepared an incentive programme, which was based on the allocation of land for building by the Israel Lands Administration, and its undertaking to purchase from the contractors the apartments that would be built, wholly or in part. Within the framework of the steps taken to realize the incentive programme, a standard form of a programme contract was prepared. The form of this contract (which is the 'programme contract') constituted, from this point onward, a binding basis for contractual relationships (for which 'specific contracts' were also prepared) between the State (the Building and Housing Ministry), the contractors and the various building promoters. The programme contract imposed on the State a liability to buy from the contractor, at his request, a fixed quota of the apartments that would be built, at a price to be calculated in accordance with the provisions of clause 6(f) of the programme contract (hereinafter — the calculated price).

With regard to the obligation of the State to buy from the contractor, at his request, the apartments that would be built, the programme contract distinguished between two types of project: the first type included agreements to build apartments in sought-after areas, whereas the second type included agreements to build in development areas. One distinction between the types was in the quota of apartments that the State was liable to buy from the contractor: with regard to apartments of the first type, the State was liable to buy up to half (50%) of the apartments, whereas with regard to the second type, the purchase obligation applies to all (100%) of the apartments to be built. A further difference between the types concerns the date when the contractor's right to demand that the State carry out its purchase undertaking could be invoked; from clause 6(b)(1) of the programme contract it transpires that with regard to apartments of the first type, the contractor's right to demand purchase arises, at the earliest, when the building of the structure is complete (in the language of the contract: 'stage 40'); with regard to apartments of the second type, the contractor may (under clause 6(b)(2) of the contract) present his demand to the State earlier, as soon as the building frame and the partitions are finished ('stage 18'). We should point out that the programme contract did not limit the period during which the contractor might present to the State his demand to carry out the purchase undertaking, but (as will be clarified below) a delay in presenting his demand beyond defined periods affects the extent of the contractor's entitlement to receive from the State, in return for the apartments, the full calculated price.

3. Clauses 6(g) and 6(h) of the programme contract defined several cases where the contractor would lose his right to receive from the State the full calculated price, and in each of these cases, the programme contract established the amount of the reduction that the State would deduct from the calculated price. It was the nature of one of these cases, the one stipulated in clause 6(h)(3) of the programme contract, that was the focus of the dispute of interpretation on which the District Court gave judgment and which is the subject of the appeal before us.

Before I deal with the disputed interpretation of clause 6(h)(3), I will first quote in full clauses 6(g) and 6(h) of the programme contract:

> '(g) With regard to apartments purchased under clause 6(b)(1) above that are completed after the end of the performance period in the specific contract, notwithstanding what is stated in the contract with the contractor that will be signed or that was signed between the company and the Ministry, an amount equal to 2% of

the apartment price shall be deducted from the purchase price calculated under sub-clause (f) for each month of delay in performance.

(h) Notwithstanding what is stated in this clause above —

(1) Should the purchase undertaking be invoked after the end of the performance period, the interest shall be calculated as stated above only until the end of the performance period;

(2) Should the purchase undertaking be invoked more than 18 months after the end of the performance period, an amount of 2% shall be deducted from the apartment price, that will be determined as stated in sub-clause (f) above, for each month after the end of the period of 18 months as stated;

(3) Should the purchase undertaking be invoked with regard to projects for which a purchase undertaking was given for an amount of 100% after the end of the performance period, an amount of 5% shall be deducted from the apartment price, that will be determined as stated in sub-clause (f) above, for each month after the performance period.'

Factual background and scope of the dispute

4. The respondent company is a building contractor. On 27 March 1991, in consequence of an agreement reached between it and the Ministry of Building and Housing, the respondent signed the programme contract. When the contract was signed by the State (on 31 July 1991), pursuant to what was stipulated therein, the parties proceeded to enter into two specific building contracts, whereunder the respondent undertook to build 748 residential units in a development area in the south of the country. We are therefore concerned with agreements for the building of apartments, which for the purpose of the distinction set out in the framework contract, are projects of the second type.

On 27 February 1992, when the building of some of the apartments reached the end of 'stage 18', the respondent presented a demand to the Ministry of Building and Housing to invoke the State's undertaking to purchase these units from it. The State approved the demand for the purchase of the apartments, but the respondent failed to comply with the date agreed (in the specific contracts) as the date for completing the building. With the State's consent, the contractual period was extended to 29 November 1992, but in practice the respondent only completed the building of the apartments on 3 January 1993.

Against this background, a dispute arose as to whether the respondent was entitled to receive from the State, in return for the apartments (at this stage this referred to 165 apartments that were completely built), the full calculated price. In a calculation made by the Ministry of Building and Housing, 6% of the calculated price was deducted (in other words, the respondent was offered a payment equal to only 94% of the calculated price). The State argued that under clause 6(h)(3) of the programme contract, it was entitled to make a deduction from the calculated price at a rate of five percent for each month of delay in carrying out the building, in relation to the agreed performance period, and in this instance the delay amounted to a month and five days. The respondent disputed the State's contention and insisted that it was entitled to the full calculated price. According to the respondent, clause 6(h)(3) referred to a delay of the contractor in presenting his demand to the State to fulfil its undertaking to purchase the apartments. It follows that this clause and the delay in completing the performance of the building are unrelated.

The District Court judgment

5. The respondent applied to the District Court, by way of an originating motion, and put before it the question in dispute. It should be noted that, *ab initio*, its application also raised a factual dispute. This dispute mainly revolved around the question whether a document entitled 'Supplement to the Agreement', which was prepared by the State but signed only by the respondent, applied to the relationship between the parties. The respondent argued that this document constituted a part of the programme contract, and it also sought to rely on its contents to support its position with regard to the construction of clause 6(h)(3). Although the State did not deny that the document was prepared by the Ministry of Building and Housing, it argued that it did not apply to its relationship with the respondent. But when the action came to trial, the parties agreed to limit the dispute merely to the question of the construction of clause 6(h)(3), and to ignore their disagreement as to the facts, including the question of the application of the 'Supplement to the Agreement' on the relationship between the parties. In view of this agreement, the learned judge considered the question of the construction of clause 6(h)(3) within the framework of the programme contract only, without reference to the questions of fact. When he reached the conclusion that the respondent's construction was correct, the trial judge did not need to do more than merely allude to the respondent's claim that what was stated in the 'Supplement to the Agreement' also supported its position.

6. By accepting the respondent's position, the District Court held that clause 6(h)(3) referred to a case of a delay in submitting the contractor's request to invoke the State's undertaking to buy the apartments from it. The judge's main reason was that this construction was required by the clear language of the clause and also from its being part of clause 6(h). The judge pointed to the identical expressions used by the contract in the three sub-clauses of clause 6(h), and attributed to these expressions in clause 6(h)(3) the same meaning possessed by them in the two preceding clauses (clauses 6(h)(1) and 6(h)(2)), where there was no dispute as to the subject of matters discussed therein. This comparison showed that only the construction proposed by the respondent equated interpreted clause 6(h)(3) consistently with the two preceding clauses. On the other hand, the judge emphasized that the language of the provision contained not even a hint that it referred, as the State argued, to a delay in carrying out the building. By way of comparison, he referred to clause 6(g), which concerns a reduction in price because of a delay in carrying out the building in projects of apartments of the first type; here it is expressly stated that for apartments 'whose building is completed after the end of the performance period in the specific contract… the calculated purchase price under subsection (f) would be reduced by an amount equal to 2% of the price of the apartment for every month of delay'.

7. The argument of the State in the District Court was that the language of clause 6(h)(3) (on its own) was not unambiguous, and that due to the haste with which the programme contract was drafted, no interpretative conclusion should be drawn from the structure of the contract, the position of the clause in the contract and any comparison between the language of the clause and the language used in other clauses. In construing clause 6(h)(3) — the State argued — the construction that is consistent with the purpose of the programme contract should be preferred. Since its purpose was to encourage contractors and to speed up the building, the contracts can be presumed to have intended to provide a sanction for delay in completing the building. The proof of this is that for projects to build apartments of the first type, for which the State was liable to buy only half the apartments, the programme contract provides (in clause 6(g)) for a reduction of the price by a rate of 2% for every month of delay in finishing the building. In these circumstances, it would not be reasonable to assume that, for projects to build apartments of the second type, where the State is liable to buy all the apartments from the contractors, a contractor who is late in finishing the building will escape without any sanction. Surely the need for a sanction with regard to projects of the second type is required *a fortiori*?

The learned trial judge rejected this argument. First, he held that since the language of the contract left no doubt as to the contents of the provisions of clause 6(h)(3), there was no need to ascertain the intentions of the parties on the basis of external circumstances. Second, he further determined that even if the argument were accepted, the result would be that the contract was deficient, since then it would lack a clause providing for a reduction of the price as a result of a delay in presenting the contractor's demand. Therefore, it would be best to leave clause 6(h)(3) as it stands and to construe it according to its plain meaning; and if, in any specific instance, the State should suffer damage as a result of a delay in carrying out the building of apartments of this type, it should sue for compensation for its damages under the laws of contract. He hinted, without needing to do so, that the State might find a remedy for cases of this type even in the 'Supplement to the Agreement', since he was not required to rule on its application to the relationship between the State and the respondents, and he refrained from doing so.

The appeal

8. In the appeal before us, the State once again relies on the argument that clause 6(h)(3) of the programme contract should be construed, not in accordance with the language of the clause, nor on the basis of its position in the text of the contract, but according to the fundamental and main purpose of the programme contract as an overall framework. The purpose of the programme contract, the State emphasizes once again, was to induce contractors to carry out the building. Clearly, this purpose is frustrated unless the contractors comply meticulously with the agreed timetable. The commercial logic of the programme contract therefore requires a construction of clause 6(h)(3) such that it applies to a case of delay in carrying out the building. For this purpose, clause 6(h)(3) should be regarded as parallel to clause 6(g): just as clause 6(g) causes a reduction of the calculated price as a result of a delay in finishing the building of projects of the first type, so clause 6(h)(3) causes a reduction of the calculated price as a result of a delay in finishing the building of projects of the second type. And since the damage caused by a delay in finishing the building of apartments in development areas is greater than the damage caused by a delay in finishing the building of apartments in sought-after areas, the amount of the reduction from the calculated price, prescribed by clause 6(h)(3), is greater than the amount of the reduction prescribed by clause 6(g).

The premise for this argument is that the language of clause 6(h)(3) is unclear and in any case it may be construed also differently from the

construction of the learned judge. But alternatively, the State claimed that even if the language of the clause is clear, a construction based on its purpose should be preferred to its literal meaning. This is required (according to counsel for the State) by the commercial nature of the contract and by commercial logic, which can be presumed to have guided the parties. In this respect, it should be noted that counsel for the State does not dispute that the learned judge was correct in his finding that adopting the State's interpretation would leave the State without any sanction for a delay by the contractor in presenting his demand to invoke the State's undertaking to buy the apartments. But she claims that the State will not have any difficulty in accepting this result. The reason for this is that some delay in presenting the demand does not entail much damage; at times, it might even be in the State's interest that the contractor should delay in presenting its demand. This is not the case when the contractor delays in completing the building by the agreed time. Such a delay is likely to cause great damage, and therefore it cannot reconcile itself to a construction that deprives the State of a means of control over compliance by contractors with a binding timetable.

A literal interpretation of clause 6(h)(3)

9. With regard to the construction of clause 6(h)(3), I agree with the learned judge in the District Court. I too believe that the language of the section is simple and clear. The text of the section and the context in which it is positioned indicate that its provisions apply to a case where the contractor's demand to invoke the State's undertaking to buy apartments, in projects of the second type, is presented to the State by the contractor after the end of the performance period.

10. The language of clause 6(h)(3) refers to a case 'of invoking the purchase undertaking… after the end of the performance period'. There was no dispute between the parties (and this is also implied by the definition of this concept in the programme agreement) that 'the end of the performance period' means the date on which, according to what is agreed between the contractor and the State in the specific contract, the contractor is liable to complete the building of the structure. The words that require construction are 'invoking the purchase undertaking'. In my opinion, there is no doubt that this expression refers to the contractor's demand, presented to the State, to carry out its undertaking to buy the apartments from it (and not, for example, the act of the purchase itself).

This is clearly required by the context in which this expression is used in the first two sub-clauses of clause 6(h); Sub-clause (1) — which applies to

projects of both types of apartment — restricts the contractor's right to payment of interest 'until the end of the performance period' only; whereas sub-clause (2), which applies only to projects of the first type of apartment, provides for a reduction of the calculated price by an amount equal to 2% for each month after the end of the eighteen months during which the contractor should have presented his demand. The two provisions apply to cases where the contractor' demand that the State complies with its purchase undertaking is presented by him at a late date: the first case (governed by sub-clause (1)), refers to a demand presented 'after the end of the performance period'. The provision is that, in such a case, the contractor is only entitled to the payment of interest until the end of the performance period; the same is also true of projects to build apartment of the first type, with regard to which the contractor is entitled to delay his demand to invoke the undertaking for eighteen months from the end of performance, without being deprived of his right to receive the full calculated price (including linkage differentials). The second case (governed by sub-clause (2)), is one where the contractor's demand to invoke the purchase undertaking is presented by him to the State more than eighteen months after the end of the performance period. The clause provides that, in such a case, the calculated price will be reduced by an amount of 2% for each month after the end of the eighteen-month period.

It is not superfluous to add that the term 'invoke the purchase undertaking' (or similar language) appears also in other parts of clause 6 of the programme contract, and wherever it is used the context shows (both literally and contextually) that it refers to the contractor's demand. On the other hand, it appears that whenever the programme contract refers to the State's act of purchasing the apartments, this is stated in different language ('performance of the purchase undertaking', 'date of purchase', etc.).

11. A reading of the provisions of clause 6(h)(3), while attributing the said literal meaning to the first part of the clause, leaves no room for doubt that the deduction in the last part of the clause refers only a case where the contractor's demand to invoke the purchase undertaking is presented to the State after the end of the performance period. The deduction from the calculated price, which the clause prescribes, is clearly designed to encourage the contractor to present his demand — which, as stated, he is entitled to do as early as the completion of the building frame and the partitions ('stage 18') — no later than the end of the performance period. This provision, which relates to projects of the second type, is clearly the parallel of the preceding one (the provision in clause 6(h)(2)), which refers to a reduction in the calculated price,

in projects of the first type, for a delay in the contractor's demand of more than eighteen months after the end of the performance period.

The interpretation proposed by the State, as the learned judge has already pointed out, has no basis in the language of clause 6(h)(3), where the term 'performance delay' (or any similar term) does not appear at all. In view of the necessary comparison of the wording of the clause with the wording of clause 6(g) — which refers to a delay by the contractor in completing the building work on time and which uses for this purpose the express words 'performance delay' — the absence from clause 6(h)(3) of a similar term cannot be accidental.

Moreover, accepting the construction suggested by the State, with regard to the case where the deduction prescribed by the end of clause 6(h)(3) applies, would make the beginning of the clause meaningless. As can be seen from the first part, the clause refers to a 'case of invoking the purchase undertaking… after the end of the performance period'. If it were correct that the section governs cases where the contractor was late in completing the performance, there would be no logic in restricting the reduction of the calculated price to be paid to him only to a case where he presented to the State a demand to invoke the undertaking after the end of the performance period. In other words, if the deduction from the calculated price discussed in the clause is directed at a case of delay in completing the performance, what significance is there to the question of when the demand was presented by the contractor?

The purpose of the contract as reflected in its language

12. Approving the perspective of the District Court with regard to the plain meaning of the text and the clear intention of clause 6(h)(3) exempts me from the need to consider the circumstances in which the programme contract was signed as a separate source of interpretation. The rule set out in section 25(a) of the Contracts (General Part) Law, 5733-1973, applies in this respect, and this provides that:

> 'A contract shall be construed in accordance with the intentions of the parties, as is evident from the contract, and to the extent that it is not evident therefrom — from the circumstances.'

'The "intentions" of the parties are the purposes or objectives which were in their minds at the time of making the contract' (Justice Barak in CA 554/83 *Atta Textile Co. Ltd v. Estate of Yitzhak Zolotolov* [1]), at p. 305). It is also a well-established rule that when a contract has such clear language that it leaves no room for doubt as to its intention, the parties' intentions should be

derived from it, and one should not examine for this purpose the circumstances in which it was made (see the remarks of Justice Barak in *Atta v. Estate of Zolotolov* [1], at p. 304; the remarks of Vice-President Ben-Porat in CA 450/82 *State of Israel v. Hiram Landau Earth Works, Roads and Development Ltd* [2], at pp. 667-668, and in CA 191/85 *State of Israel v. Neveh Schuster Co. Ltd* [3], at p. 579; and recently in CA 5795/90 *Sakali v. Tzoran Ltd* [4], the remarks of Justice S. Levin at p. 830). Note that the significance of this rule is not that clear language prevails over a clear purpose that conflicts with the language, but its significance is that clear language indicates the intentions of the parties and the purpose of their contract. If the language is clear, then the purpose is also known, and the court will not resort further to examine the hidden thoughts of the parties on the chance that in their minds they had a different purpose, to which they did not give expression. In the words of Justice Cheshin in *Sakali v. Tzoran* [4], at p. 817:

> 'The interpreter must pass two stages in assessing the intentions of the parties: the first stage is (assessing) the intentions of the parties as these are evident from the contract, and the other stage is — *in so far as their intentions are not evident from the contract* — (assessing) the intentions of the parties as they are evident from the circumstances' (emphasis added).

13. In her alternative argument, counsel for the State challenged the correctness of the District Court's conclusion, even if it is found that it was correct in determining that the language of clause 6(h)(3) is clear. According to her argument, the judge should have construed the provisions of the clause in the spirit of the purpose of the programme contract, while taking into account the commercial logic that undoubtedly guided both parties.

This argument should be rejected. The rule of section 25(a) of the Contracts (General Part) Law applies also to the construction of contracts, since logic (the logic of the construer) implies that the parties had a certain objective. This is the case, *inter alia*, also with regard to commercial and business contracts, which the court is obliged to construe by applying a criterion of business logic. The remarks of Justice Berinson in this context are well known:

> 'We are concerned with a commercial transaction and we must try to give it logical validity in the same way that businessmen would in view of all the circumstances of the case' (in CA 492/62 *Shahaf Port Shipping Co. Ltd v. Alliance Insurance Co. Ltd* [5], at pp. 1901-1902).

See also the comments of Justice (later President) Y. Kahan in CA 464/75 *Promotfin Ltd v. Calderon* [6], at p. 195. But this can be done and should be done only if the language of the contract is ambiguous, or can support the construction that according to the logic of the construer befits the logical purpose of a contract of that sort. This is not the case if the language of the contract is clear in a manner that leaves no room for doubt as to its meaning; then, the intentions of the parties should be assessed on the basis of what is implied by the language used, and not according to the logic of the construer. This was discussed by Justice Bejski in CA 406/82 *Nahmani v. Galor* [7], at p. 499:

> 'Indeed, it sometimes happens that when the court comes to consider and construe the intentions of the parties, they will examine for this purpose the objective that the parties wanted to achieve, and the intentions that guided them when they drafted the document… but section 25(a) of the Contracts (General Part) Law, 5733-1973, directs us to construe the intentions of the parties as it is evident from the contract, and if it is not evident therefrom — from the circumstances. *If the contract is clear and the language is unequivocal, there is no further need to consider the circumstances, and certainly not the commercial logic or economic viability*, which may have been influenced by personal or speculative considerations of one of the parties, which he is not required to reveal to the other party or set out in the contract' (emphasis added).

This is the law in this case too. When the language of the clause was found to be clear, and its provisions are consistent with all the provisions of the contract, there is nothing to be gained by the argument that logic dictates that the parties intended something else. The apparent objective of the clause prevails over the probable objective that one may wish, to no avail, to fit into the language. In the words of Justice Barak, in *Atta v. Estate of Zolotolov* [1], at p. 304: 'True, interpretation is not limited merely to the words, but the words limit the interpretation'. Such is the case before us. If we were required to construe the clause according to the order of priorities required by the business purpose and commercial logic of the programme contract, I would indeed have inclined to accept the State's position. But the clear wording prevents us from pursuing any external criteria.

14. I would like to emphasize: in my judgment I considered the construction of clause 6(h)(3) only within the framework of the programme contract. I

adopt no opinion about the relief that may be available to the State for a delay in completing the performance of the building in other transactions to which the programme contract applies, whether under the programme law or according to the document entitled 'Supplement to the Agreement' which the State argues does not apply to its relationship with the respondent.

Additional remarks after seeing the majority opinion

15. My learned colleagues do not accept my opinion and I am therefore in the minority. My colleagues think that the provisions of clause 6(h)(3) of the programme contract can and should be construed as applying to a delay in building the apartments in development areas. My colleague, Justice D. Levin, bases this conclusion on the intentions of the parties, which, in his opinion, is implied by the contract, as a complete entity that indicates its purpose. My colleague, the Vice-President, does so — as he thinks should be done in every case — on the basis of a broad interpretative process, in which one should examine and consider not merely the language of the contract as it integrates into all its provisions, but also the external circumstances. In this respect, my colleague unfolds a broad doctrine. He rejects the correctness of the accepted distinction between the stage of assessing the intentions of the parties from the contract, and the stage of assessing their intentions from the circumstances. In his opinion, the time has come to abandon the 'doctrine of the two stages' and to unify the interpretation process. Within the framework of the broader process, the purpose of the contract will be examined and the intentions of the parties will be assessed on the basis of this. The language of the contract is merely a point of origin. The goal is to clarify the purpose of the contract, and where the language is not consistent with the purpose, the judge may depart from the language. Moreover, when the purpose of the contract becomes clear to the judge, but something is lacking in the contractual arrangement prescribed for achieving it, the judge may fill in what is missing.

16. I am of the opinion — and my colleague Justice D. Levin agrees with this — that the path of interpretation, dictated by section 25(a) of the Contracts (General Part) Law is indeed divided into two stages. This does not imply that clear language and a coherent structure of the contract constitute a complete barrier that prevents the court from reaching the external circumstances. At least, one must agree that there may be situations (probably special and unique ones) where external evidence will be needed to clarify the subjective meaning of expressions whose objective meaning is clear. My colleague, the Vice-President, gave a convincing example of this: if in a contract it is written that the parties agree to the sale of a horse, but it becomes

clear from a code commonly used by them that they could only have been referring to a machine called by them 'horse', it is hard to believe that a court could assess the intentions of the parties from the contract (whose language is ostensibly clear) and ignore the true purpose of their agreement, as can be understood from the circumstances. I choose not to consider the overall and complex question of distinguishing between the stages of clarifying the intentions or unifying them. Both parties refrained from presenting any evidence to the District Court, and in any event no circumstances were revealed to the court except for those that are implied by the contract itself. From this it also follows that in summary of my position with regard to the appeal before us, it is sufficient for me to refer to the opinion of my colleagues — for only in this respect, it appears, are they in agreement — that according to the intentions of the parties, as they are evident *from the contract*, clause 6(h)(3) of the general contract should be construed as providing a sanction for a delay in carrying out the building of the apartments in development areas. I have three comments with regard to this position.

17. As my first comment, I would like to point out that I too accept that assessing the intentions of the parties from the contract is not a process limited to a literal construction of the words used by the parties, but a process that seeks to arrive at an examination of the purpose of the contract, as is evident from it, as a whole. Nevertheless, in so far as there is no evidence to the contrary in the other provisions, I attach great importance to the presumption that the parties intended what they actually wrote. In general, I believe that it is proper to assume that people tend to take care and be particular about the wording of their contractual agreements. Where the written word has a clear meaning and its reasonable intention is consistent with the subject of the contract, it is still, in my opinion, the most reliable source for assessing the intentions of the parties, and also the safest guarantee of preserving their reliance interest on written contracts. Therefore, in order to construe a contract according to what appears (to the interpreter) to be the purpose of the contract, there must be at least a basis for this in the language used by the parties; in any event, I cannot support a 'purpose-oriented' construction that is isolated from, conflicts with or is inconsistent with the language. This restriction on the power of the interpreter has particularly great weight when in the contract — and in the same context —repeated use is made of the same expressions. The repeated use of the same expressions cannot be accidental. It attests to the existence of a common denominator between the contexts, which the interpreter cannot ignore.

I am afraid that my colleagues' construction of clause 6(h)(3) of the programme contract does not pass this test. To illustrate this, let us again use the example of my colleague, the Vice-President. Suppose (as an imaginary and remote hypothesis) that an express agreement of parties for the sale of a 'horse' can be interpreted as an agreement for the sale of a machine, even if the circumstances that attest to the parties' lexicon are evident *from the contract*. Now let us assume that in the said contract it was agreed, in identical language, on two different transactions which both concern the sale of a horse, and there is no dispute between the parties that the first of the two does indeed concern the sale of a horse. In such a situation, is it conceivable, on the basis of assessing the intentions of the parties as they are evident from the contract, that in the second transaction the parties were referring to the sale of a machine? And suppose the said contract also included a third sale transaction that expressly spoke of a sale of a machine? Would it not be understood in that case how important it is to restrict the power of the interpreter to determine that the second transaction, even though it speaks of a 'horse' (like in the first transaction), refers to a machine (like in the third transaction)? In view of the use of identical terms, the programme contract is similar to the last case described. In each of the three sub-clauses of clause 6(h) the term 'invoke the purchase undertaking' is repeated, while in clause 6(g) the term 'delay in performance' is used. Since no-one disputes the meaning of the expression 'invoke the purchase undertaking' in clauses 6(h)(1) and 6(h)(2), I cannot accept that the very same term in 6(h)(3) should be interpreted as a 'delay in performance'. It is clear from clause 6(g) that the expression 'delay in performance' was well-known to the drafter of the contract; if clause 6(h)(3) was intended to deal with an issue similar to that dealt with in clause 6(g), the presumption is that the draughtsman would have used this term in clause 6(h)(3) as well. From the use of the term 'invoke the purchase undertaking' in clause 6(h)(3) as well, it can be concluded that the subject of this clause is not similar to the issue set out in clause 6(g), but similar to the issue set out in clauses 6(h)(1) and 6(h)(2).

18. My second comment refers to the scope of the disagreement presented by the parties for the decision of the District Court.

The basis of my colleagues' interpretation of the provisions of clause 6(h)(3) is the assumption that the provisions of clause 6(h)(2) — which provides for the amount of the reduction in the price in cases where the contractor delays in presenting his demand to invoke the purchase undertaking — should be construed as applying both to apartments in sought-

after areas as well as those in development areas. The problem is that my colleagues' assumption with regard to the construction of clause 6(h)(2) is of their own invention. Not only did the State not suggest this construction in its pleadings before the District Court, but even in its pleadings before this Court (as I have already pointed out in paragraph 8 above), counsel for the State did not dispute the correctness of the learned judge's ruling that accepting the State's construction of clause 6(h)(3) will leave the State without a sanction for a delay by the contractor in presenting his demand to invoke the State's undertaking to buy the apartments of the second type (apartments in development areas). Moreover, counsel for the State even explained that the State would have no difficulty in accepting this outcome, since some degree of delay on the part of the contractor in presenting his demand will not cause serious damage and in some cases may even be in the State's interests.

Matters progressed in the following manner: although in the respondent's action that was submitted to the District Court the issues were presented in rather vague language, there was an implied argument that clause 6(h)(2) deals with cases of a delay in a demand to take advantage of the undertaking to buy apartments of the first type. On the basis of this assumption, and relying on identical terms in the two sub-clauses and their proximity to one another within the framework of clause 6(h), the respondent sought to interpret clause 6(h)(3) as dealing with the same topic with regard to apartments of the second type. In its reply and final arguments, the State did not dispute the correctness of the respondent's assumption regarding the contents and the scope of the provisions of sub-clause 6(h)(2); its main argument was that, despite the identical language and proximity of the two sub-clauses, clause 6(h)(3) should be construed as dealing with a different issue. In the absence of an express argument by the State that the respondent's assumption with regard to the construction of clause 6(h)(2) should be rejected, the inevitable conclusion was that with regard to the construction of this clause there was an (at least implied) agreement between the parties. Indeed, the disagreement between the parties, before the District Court and before us, focused merely on the construction of clause 6(h)(3).

No wonder, then, that in construing the provisions of clause 6(h)(3), the learned trial judge was not required to construe the other clauses, including clause 6(h)(2). He was not required to rule on this issue, since *prima facie* it was not in contention, and it would appear that he was not entitled to rule on it. The rule is that a civil court does not rule contrary to a position that is accepted by the litigants, and this rule applies here too: since the litigants only

disputed the construction of clause 6(h)(3) — whereas they presented (at least by implication) a position accepted by both of them with regard to clause 6(h)(2) — the District Court was not entitled, on its way to construe clause 6(h)(2), to go contrary to the construction of clause 6(h)(2) that was accepted by the parties. The contract was made between the parties, and an agreement between the parties with regard to the construction of one of its provisions raises an absolute presumption that the construction of the parties is correct. Just as the court does not make a new contract for the parties, which is different from the one they made themselves, so too it does not construe a provision in the contract contrary to the position accepted by the parties with regard to its construction.

19. My third comment refers to the extent of use of the mechanism of rectifying a contractual lacuna. My colleague, the Vice-President, believes that examination of the programme contract according to the meaning given to it in my opinion leads to the conclusion that the contract has a lacuna that requires rectification. This position also has no support in the State's pleadings, and this in itself should be sufficient to make any consideration of it unnecessary. But in my opinion the conclusion about the existence of a lacuna is not a necessary result of construing the contract as I did. It should be noted that the contractual provisions under discussion do not refer to the definition of the reciprocal obligations of the parties, but to prescribing agreed contractual sanctions for various breaches of the terms of the contract. In this respect, our case is diametrically opposed to the case considered in my opinion in CA 479/89 *Coptic Mutran v. Halamish — Government-Municipal Corporation for Housing Renovation in Tel-Aviv-Jaffa Ltd* [8], cited by my colleague as an example of relying on the principle of good faith as a norm for rectifying a lacuna. The fact that the parties agreed upon a contractual sanction for one kind of breach and left another kind of breach without a similar agreed provision does not constitute sufficient basis for a determination that the contract has a lacuna that requires rectification. When there is a breach without an agreed sanction, does the injured party not have the possibility of suing for relief under the law? Where the injured party may find his remedy by a straight path, the court is not required to pave for him an alternative path, which involves — in any event — a degree of intervention in contractual freedom.

20. In my opinion, the appeal of the State should be denied.

Justice D. Levin

1. In the case before us, my opinion is different from that of my colleague, the honourable Justice Mazza. In my opinion, we should allow the appeal. The appeal before us concerns the construction of the programme contract that was signed between the State of Israel, through the Ministry of Building and Housing, and various contractors and property developers, including the respondent company.

2. In this case the circumstances in which the programme contract was made and the background that led to its drafting are of great importance. This was a period of a large wave of immigration from the Soviet Union, and the Government was concerned that a serious shortage of apartments in Israel might be the consequence. The Government therefore wished to encourage the speedy building of apartments, by means of an incentive programme, which was prepared by the Ministry of Building and Housing, and which was intended to create an incentive for contractors and property developers to build a large number of apartments within a short time. Benefits were given to the companies carrying out the building, in addition to additional incentives for starting to build and reducing the length of the building period.

3. These benefits and incentives are reflected in the programme contract under discussion in various clauses.

The main benefit was an undertaking by the Government to buy from the contractors the apartments that they did not succeed in selling on the open market. In this respect, two types of project were stipulated in the specific contracts signed with the contractors: the first type involved projects -in sought-after areas, where the market risk was not high, and therefore the State gave purchase undertakings only up to 50% of the apartments. The second type involved projects in development areas, where the market risk was relatively high, and therefore the State gave purchase undertakings to up to 100%.

An additional benefit that was given to contractors concerned the date when they could demand that the Government carry out the purchase undertaking. Here too a distinction was made between the two types of projects; for the first type (the sought-after areas), the contract provided that the purchase undertaking could be invoked when the building had been completely built — at the end of stage 40 (clause 6(b)(1)), whereas for the second type (development areas) the contract provided that undertaking could be invoked as soon as the building frame and partitions were finished — at the end of stage 18 (clause 6(b)(2)).

So we see that very significant benefits were granted to companies building in development areas, of which the respondent company was one, both with regard to the extent of the purchase undertaking and with regard to date of invoking it. The purpose for which these benefits were given was, as stated, to encourage contractors to build a large number of apartments, in the shortest possible time, while allaying the contractors' fears about their inability to sell the apartments on the open market. Since this fear is greater in development areas, more substantial benefits were given to contractors building in those areas.

4. Notwithstanding, it cannot be doubted that such a system of benefits and incentives made it necessary to create mechanisms to supervise those contractors and to provide 'sanctions' that would ensure that the purpose of the aforesaid contract, namely increasing the number of apartments in Israel within a very short time, would indeed be realized. A main 'sanction' was stipulated in clause 6(g) of the contract, referring to apartments of the first type — 'apartments bought under clause 6(b)(1)' — which established a reduction of 2% of the calculated price for each month of delay in carrying out the building. An additional supervisory mechanism is found in clause 6(h)(1) of the contract, which states that should the purchase undertaking be invoked after the end of the performance period, the interest would be calculated only up to the end of the performance period. This clause does not refer to a particular type of project, and everyone agrees that it refers to both types.

The logic of this determination is that a contractor who wanted to sell his apartments on the open market could do so, but if he did not succeed and chose finally to invoke the Government's undertaking, he would know that the interest on the amount stipulated would be calculated only until the end of the performance period and not until the date on which the purchase undertaking was actually carried out.

A further sanction was provided in clause 6(h)(2) of the contract, which states:

> 'Should the purchase undertaking be invoked more than 18 months after the end of the performance period, an amount of 2% shall be deducted from the apartment price, that will be determined as stated in sub-clause (f) above, for each month after the end of the period of 18 months as stated.'

This section also does not state that it refers to a particular type of project, and therefore I cannot agree with the conclusion of the learned trial judge, with

which my colleague, Justice Mazza, also agrees, that clause 6(h)(2) applies only to projects of the first type. This section, like the preceding one, is worded generally, and therefore, on the face of it, it applies to both types of projects.

The purpose of this clause is clear: to prevent contractors from excessive delays in submitting the purchase demand and to prevent a situation in which contractors would keep a stock of apartments, that might be in various stages of building, in their possession for more than a year and a half after the end of the performance period, not sell them on the open market and also not demand that the Government honour its undertaking. In such a situation, the main purpose of the agreement, to increase the number of available apartments in Israel, would be thwarted. Therefore the said 'sanction' was provided, whereby as of a year and a half after the end of the performance period, 2% of the price of the apartment would be deducted for each month of delay as stated.

The next 'supervisory clause', which is the clause in dispute in this case, is clause 6(h)(3), which states that:

> 'Should the purchase undertaking be invoked with regard to projects for which a purchase undertaking was given for an amount of 100% after the end of the performance period, an amount of 5% shall be deducted from the apartment price, that will be determined as stated in sub-clause (f) above, for each month after the performance period.'

5. The appellant asks us to find that the said clause 6(h)(3), in the intentions of the parties, was intended to be a parallel provisions to the supervisory mechanism stipulated in clause 6(g). In other words, the clause should be construed in such a way that for companies building in development areas, which received a 100% purchase undertaking and for which the undertaking can be invoked at the end of stage 18, 5% of the purchase price should be deducted for each month of delay in completing the performance of the project. The trial court construed this clause as referring to a delay in presenting the request to invoke the purchase undertaking and not to delay in carrying out the building. In the opinion of the learned judge, the wording of this clause is identical to that of the preceding one (clause 6(h)(2)), and therefore he concludes that it too refers to a delay in submitting the request to invoke the undertaking, but it refers to projects of the second type only, whereas clause 6(h)(2) refers to projects of the first type.

6. This construction results in a situation in which there is no sanction at all for a delay in performance of the building of projects of the second type. Without doubt this outcome is not logical, for there is no reason to stipulate a sanction for a delay in completing the building of projects of the first type, and not to stipulate a corresponding sanction for projects of the second type. A sanction is required for projects of the second type *a fortiori*, since the benefits given to contractors building these are much more substantial, and therefore a more substantial means of supervision is required.

The learned trial judge was aware that his method of construing the contract would mean that there was no sanction for a delay in carrying out the building of projects of the second type, but he thought that:

> 'Clause 6(h)(3) should be construed in accordance with its simple language and its position, and not according to the "intentions of the parties"… were the language of the clause unclear or ambiguous, there would be a basis for considering the background to the contract and the "intentions of the parties" and to assess these. But this sub-clause, even if not absolute perfection, leaves no room for doubt.'

This opinion is shared also by my colleague, the honourable Justice Mazza.

7. My conclusion in this regard is different.

I accept the remarks of my colleague, Justice Mazza, that under section 25(a) of the Contracts (General Part) Law, 5733-1973, the intentions of the parties should be assessed from the contract, and only where it is not evident from the contract, should we consider the circumstances in which it was made. But it is well known that the construction of a clause in a contract from the contract itself does not end with an examination of the literal meaning of the words written in it. Construction of the contract itself has a much wider meaning. In this respect, the remarks of my colleague, Justice Barak, in *Atta v. Estate of Zolotolov* [1], at p. 305, are apposite:

> 'The judge learns of the intentions of the parties, first and foremost, from the contract itself. Indeed, various provisions of the contract may shed light on the purpose and objective of the contractual provision that the judge wishes to construe. A contract is an integrating framework. Its different parts are combined and entwined with one another. Its various limbs affect one other. In construing a contract, therefore, we must, on the one hand, regard it as a whole, with a comprehensive view, and, on

> the other hand, examine the relationships between the various provisions, with the aim of deriving from them the intentions of the parties. In this context, of great importance are the nature of the transaction, its general legal structure and its economic and social objectives. All of these shed light on the intentions of the parties.'

The learned trial judge examined the wording of clause 6(h)(3), compared it with the words appearing in the preceding clauses, and as a result reached the conclusion that the literal meaning of the clause was unequivocal and therefore there was no need to resort to the 'intentions of the parties' and to assess their intentions. But we have already ruled more than once that when a court seeks to construe a term in a contract, it should not confine itself to the narrow, literal meaning of the words, when regarding the contract as a whole, against the background of its objectives and the circumstances in which it was made, indicates an intention other than the one that is derived from the normal literal objective of the words.

The aim is —

> '… to loosen the shackles of the written words and arrive at an examination of the real intention that was before the parties' (see CA 453/80 *Ben-Natan v. Negbi* [9], at p. 145).

Justice Y. Cohn said in CA 46/74 *Mordov v. Schechtman* [10], at p. 481:

> 'A cardinal rule of contract interpretation is that the court is bound to construe the contract in a manner that reflects the intentions of the parties, and although one should approach the examination of the intentions with the assumption that the parties intended what they wrote in the contract, not infrequently have the courts construed contracts in a way that is inconsistent with the ordinary meaning of the words that the parties used.'

In CA 627/84 *Nudel v. Estate of Tzvi Pinto* [11], I pointed out, at p. 482, that:

> 'The words used by persons drafting the document, although important, are not conclusive, for one should read the document as a whole and construe it according to its general idea, and as stated… according to its purpose… the words and expressions used by the litigants should be read in the overall and whole context.'

Admittedly, the first step of the interpretation process is the language of the contract, but when the narrow literal construction leads to a result that is inconsistent with the overall context, we must proceed further to examine other possible constructions. At this stage, we must rely upon the contract as a whole and its underlying purpose and objective.

In this respect, the remarks of President Shamgar in CA 327/85 *Kugler v. Israel Lands Administration* [12], at p. 102, are apposite:

> 'The guideline for interpretation formulated in the rulings of this court is therefore that where a difficulty arises in understanding or implementing one of the provisions of a contract, one should first study the contract in its entirety in order to discover its underlying purpose and objective, and then to return to the concrete provision and to give it the meaning that is consistent with the principles of the contract already recognized.'

8. In my opinion, both a reading of the clause under discussion as part of the context in which it appears and a reading of it as a part of the contract as a whole and in view of its objective and spirit and the background to making the contract make it necessary to construe it as imposing a sanction for a delay in completing the building of projects of the second type. Let me explain:

The system of 'sanctions' prescribed in clauses 6(g) and 6(h) of the programme contract must be regarded as a whole, and clause 6(h)(3) should be construed as a part thereof. This system is divided into 'sanctions' for delay in completing the performance of the building and 'sanctions' for a delay in submitting a request to invoke the undertaking.

Clauses 6(h)(1) and 6(h)(2) deal with delays in submitting the application to invoke the purchase undertaking and they speak generally of the two types of project. One limits the payment of interest only until the end of the performance period (even when the application to invoke the undertaking was submitted thereafter), and the second provides for a reduction of 2% of the apartment price per month, when the application is submitted more than a year and a half after the end of the performance period.

On the other hand, clause 6(g) deals with a delay in carrying out the building and refers to projects of the first type only, whereas clause 6(h)(3), which refers expressly only to projects of the second type, is indeed worded in a manner similar to clauses 6(h)(1) and 6(h)(2), and *prima facie* on the basis of its wording, it too deals with delays in submitting the application to invoke the undertaking. But if we construe it in this way, we will reach a result that is

illogical, since a situation of 'double sanctions' will be created for projects of the second type in cases of delay in submitting the application to invoke the undertaking, *and no sanction at all for a delay in carrying out the building of these projects*.

Undoubtedly, this is not be what the parties intended.

The rule is that:

> '… The words in the contract should be construed in a way that prevents a result that is absurd or that imposes on a party to the contract an undertaking, which it is unreasonable to assume he undertook' (*Mordov v. Schectman* [10], at p. 482).

In his book, *Legal Interpretation*, vol. 1, 'The General Law of Interpretation', Nevo, 1992, Professor Barak explains on page 328 that literal interpretation sometimes leads to a precise and clear meaning, and yet the result may be absurd and inconceivable. In such a case, Professor Barak holds the opinion that:

> 'There must exist an additional means of interpretation — apart from the linguistic means — which will remove the absurd and the illogic. This means must be extra-lingual, because the language is what created the absurd, and therefore it is unable to remove it.'

The result reached is absurd mainly in view of the fact that in projects of the second type the building company can demand that the Government honour its undertaking already when it finishes building the building frame and the partitions. Such a company, that asked the Government to honour its undertaking already at that stage, has no real interest in finishing the building on time, since the purchase undertaking is already in its possession. As a result, a situation is created in which the Government has no means of supervision to ensure that the company complies with the agreed timetable, and it should be remembered that in the circumstances of the case before us there is special importance to complying with the agreed timetable, as has been explained above.

It follows that this is a clear case in which a sanction is required for a delay in completing the building, and this fact is also consistent with what is provided in the clause about a reduction of 5% for each month of delay, in contrast to clause 6(g), which applies to projects of the first type and which provides for a reduction of only 2%. With regard to projects of the first type, the sanction required is indeed less severe, since the purchase undertaking is

given only after the building is completed, and therefore the building companies have a real interest in finishing the building on time.

9. When construing a contract, just as when construing a statute, a will or any other norm requiring interpretation, we must consider the underlying objective and do our utmost to give it effect. In this case we are concerned with a commercial contract, and the rule is that a commercial contract should be construed in a manner consistent with its commercial objective, and it should be given a meaning that is reasonable from the viewpoint of businessmen entering into such a contract.

In *Promotfin v. Calderon* [6], at p. 195, Justice Y. Kahan expressed this idea, noting that:

> 'It is a known rule that a commercial contract should be construed in a manner consistent with the commercial objective of the transaction, and the court should give effect to such a contract in a reasonable way, just as businessmen would do in the circumstances of the case…'

See also the remarks of Justice Bach in CA 552/85 *Agasi v. I.D.P.C. Israel Data Processing Co. Ltd* [13], at p. 245:

> 'Under the aforesaid section 25(a), we are required to construe a contract… "in accordance with the intentions of the parties, as is evident from the contract, and to the extent that it is not evident therefrom — from the circumstances', and in order to comply with this instruction, we must take into account the character and nature of the transaction made between the parties and the purposes of the parties to the contract, both from an economic perspective and from professional, social and other perspectives.
>
> In the absence of direct evidence as to the aforesaid purposes, we must ask ourselves, in view of all the circumstances, what could have led the ordinary reasonable person to enter into a contract of this type, and we must endeavour to construe the contract in a manner best adapted to reaching those desired goals.'

It has also been stated on this subject, in CA 345/89 *Neot Dovrat v. Israelift Elevators Y.M.S. Management and Investments Ltd* [14], at p. 355, by Justice Cheshin:

> 'Our present concern is the construction of an agreement, and we are bound to try and fathom the intentions of the parties to the

agreement as reasonable businessmen trying to achieve a common commercial purpose.'

10. As explained above, the objective and main purpose of the programme contract under discussion were to speed up building processes in Israel and to increase the supply of apartments in Israel with an emphasis on doing this in the shortest possible time. In view of this general purpose, the illogic in there being no sanction for a delay in carrying out the building becomes starker, particularly for the type of projects where the contractors do not have any real interest in finishing the building on time, after they have already received purchase undertakings from the Government.

Therefore the proper interpretation that is also consistent with the purpose of the contract is that the aforesaid clause 6(h)(3) provides a sanction for a delay in completing the building of projects of the second type. In other words, with regard to companies building in development areas that received 100% purchase undertakings which can be invoked at stage 18, if they do not complete the building of the apartments on time, 5% will be deducted from the apartment price for each month of delay in carrying out the building.

We thus obtain a proper relationship between the alternatives set out in the programme contract (the two types of projects): with regard to the rate of interest, in both cases it is calculated only until the end of the performance period. With regard to submitting the request to invoke the undertaking more than 18 months after the end of the performance period — in both types there will be a reduction of 2% from the price for each month of delay in excess of the period of eighteen months. But with regard to a delay in completing the building, for projects of the first type there will be a reduction of 2% for each month of delay, and for projects of the second type there will be a reduction of 5% for each month of delay.

We see that this interpretation gives the contract completeness and creates a reasonable and logical relationship between the parts, a relationship that is completely consistent with the intention and objective underlying the contract.

11. Indeed, clause 6(h)(3) was worded defectively, and this was apparently — so the appellant alleges — because of the haste in which the contract was drafted and because of the urgency in finishing its preparation quickly which was essential at that time.

However, in view of all the aforesaid, it seems to me that the clause should be construed in the manner proposed by the appellant, which is required by a

reading of it in the context, in view of the contract as a whole and in view of the objective underlying it and the background that led to its wording.

In CA 631/83 *HaMagen Insurance Co. Ltd v. Medinat HaYeladim Ltd* [15], at p. 572, I said the following:

> 'No-one disputes that the said method of interpreting the text, according to the literal, simple and reasonable meaning of the words, is a convenient and good point of origin for understanding its significance, for it is natural and self-evident that the parties to a written contract wished to give expression to their true intentions and the scope of their agreements in words that were chosen in the drafting process…
>
> 'However, as I emphasized above, the set of rules is much wider, and we must consider the overall wording and the words chosen to give expression to the intentions of the parties from a general and deep inspection that pierces through to the purpose of the legislation or the text of the agreement and the objective that they sought to achieve. Therefore there are many exceptions to the initial and simplistic rule, to which counsel for the respondent referred, and it appears that, where appropriate, it is permissible and even proper to interpret the text liberally, even if this appears to conflict with the actual words written in the policy. This is done in order to arrive at the logical and true meaning intended by the parties to the policy, and this is the case, naturally, when an overall reading of the text leads us to the conclusion that the words in their simple meaning do not represent the intention of the text.'

These remarks that were made with regard to the interpretation of an insurance policy, are also relevant to the construction of contracts in general. It seems to me that the case before us is one of those cases where it is permissible, and also proper, to give the text a liberal interpretation, even if it appears to conflict with the actual words, in order to reach the logical and true meaning intended by the parties.

12. I have read the comprehensive opinion of Vice-President Barak and I agree with its main points. I regard it as an expansion of the principle and rules that have discussed in this opinion and in other decisions referring to the interpretation of contracts and statutes, from additional and more thorough perspectives, which supplement what I have stated above.

13. I would therefore allow the appeal, and hold that the proper interpretation of clause 6(h)(3) of the programme contract is that which was proposed by the appellant, namely, that the clause concerns a reduction of the price of the apartment as a result of a delay in carrying out the building. In view of the result, the respondent shall pay the appellant's costs in both courts in a total amount of NIS 15,000, and naturally the liability of the appellant for costs in the trial court is cancelled as a result of the appeal being allowed.

Vice-President A. Barak

This appeal raises a classic problem of interpretation. The issue is the proper relationship between the 'body' of the text (*verba*) and the 'spirit' (*voluntas*) that encompasses it. It is the question — that arises with regard to the interpretation of all legal texts (constitutions, contracts and wills) — about the relationship between the text and its purpose. This problem arises in the appeal before us, according to what is stated in the opinion of my colleague, Justice Mazza, in two contexts: *first*, the power of the judge-interpreter to go beyond the letter of the text in order to achieve its objective; *second*, the power of the judge-interpreter to give the language of a document a meaning that it cannot support, in order to realize its objective. Justice Mazza adopted a clear position on both of these questions. In view of his position, he reached the conclusion that the appeal should be dismissed. My position is different from his on both of these questions, and it agrees with the position of my colleague, Justice D. Levin. Therefore I agree with his position that the appeal should be allowed. I will state the reasons for my position, while analysing each of the two problems separately.

A. Clear language and purpose from the circumstances

The position of my colleague, Justice Mazza

1. The appellant argued before us that the language of the provisions of clauses 6(g) and 6(h) of the programme contract should be construed according to the purpose of the programme contract, and that this purpose may be derived from the nature of the contract, the types of arrangements it contains, the social context in which it was made and the circumstances surrounding the contract. To these arguments my colleague, Justice Mazza, replies that 'when a contract has such clear language that it leaves no room for doubt as to its intention, the parties' intentions should be derived from it, and one should not examine for this purpose the circumstances in which it was made'. My colleague further says that this answer is not based on the view

'that clear language prevails over a clear purpose that conflicts with the language.' According to my colleague's outlook, his position is based on the fact that 'clear language indicates the intentions of the parties and the purpose of their contract'. My colleague sums up his approach by stating that if 'the language is clear, then the purpose is also known, and the court will not resort further to the hidden thoughts of the parties on the chance that in their minds they had a different purpose, to which they did not give expression'.

What, then, is the purpose according to my colleague's position?

2. Against this background, the following question immediately arises: what, according to my colleague, is the underlying purpose of the contract, in view of which he interprets its language? In vain have I searched his opinion for an answer to this question. My colleague's opinion analyzes the wording of the sub-clauses of clause 6, compares them with one another, and reaches a conclusion as to the meaning of the text. But what is the purpose that even in my colleague's opinion is essential for the interpretation of the text? What, then, are the intentions of the parties, and what is the underlying purpose in the arrangement that they reached? Despite my efforts, I could not find any. The most that appears in his opinion is that the provision of clause 6(h)(3) was intended 'to encourage the contractor to present his demand… no later than the end of the performance period'. Anyone who looks at the opinion of my colleague will be convinced that this is a conclusion that my colleague reaches after he concluded the interpretative process, and not a criterion (purpose) that guided him in making the interpretation. Indeed, my colleague does not ask at all why the parties want to encourage the contractor, who is building a project of the second type, beyond the incentives that the contract provides for both types of project. An incentive for the contractor to present his demand can already be found in clause 6(h)(2) of the contract. Why is another incentive required? Why is the existing 'sanction' (in clause 6(h)(2)) insufficient in an area of the second type? Moreover, from the language of clause 6(f) of the contract, it can be seen that the parties sought to establish civil 'sanctions' for delays in carrying out the building of the first type of project (sought-after areas). Why is there no similar purpose underlying the provisions of clause 6(h)(3) of the agreement, which deals with the second type of project (development areas)? Moreover, in rejecting the alternative argument of the State, my colleague points out fairly that —

> 'If we were required to construe the clause according to the order of priorities required by the business purpose and commercial logic of the programme contract, I would indeed have inclined to

> accept the State's position. But the clear wording prevents us from pursuing any external criteria.'

How does this approach fit in with his position that 'clear language indicates the intentions of the parties and the purpose of their contract'? In our case, the purpose of the agreement between the parties — this my colleague is willing to accept within the framework of the alternative argument — conflicts with the one that arises from the clear language of the contract. My colleague pointed out, in his opinion, that 'when a contract has such clear language that it leaves no room for doubt as to its intention', it is interpreted in accordance with the intention that arises from it, without resorting to the circumstance. But how can my colleague say that the language of the contract has 'such clear language that it leaves no room for doubt as to its intention' when the external circumstances — to which my colleague referred within the framework of the appellant's alternative argument — indicate that serious doubt exists with regard to the intentions and wishes of the parties, in view of the material conflict between the objective arising from the text of the provision and the objective arising from the circumstances of the contract?

The two stage doctrine and its inherent difficulties

3. My comments are not intended to pick at one detail or another in my colleague's interpretative thinking process. They are intended to point out the inherent difficulties raised by his position. The premise for my colleague's interpretative position is that the interpretation process should be divided into two independent and distinct stages. The first stage concentrates on the wording of the contract and the intentions of the parties that are evident from it. The second stage focuses on the circumstances that are external to the contract and the intentions of the parties that are evident from these circumstances. Passing from the first stage to the second is determined by the 'clear language' test. If the language of the contract is clear, the contract will be construed according to the intentions of the parties to the contract as evident from the clear language, and reference will not be made to external circumstances. If the language of the contract is not clear but is ambiguous, the contract is construed according to the intentions of the parties to the contract as evident from the external circumstances. This two-stage approach — or 'the two-stage doctrine' as I will call it — is not new. Justice Bejski made reference to it and said:

> '… section 25(a) of the Contracts (General Part) Law, 5733-1973, directs us to construe the intentions of the parties as it is evident from the contract, and if it is not evident therefrom —

> from the circumstances. If the contract is clear and the language is unequivocal, there is no further need to consider the circumstances, and certainly not the commercial logic or economic viability, which may have been influenced by personal or speculative considerations of one of the parties, which he is not required to reveal to the other party or set out in the contract' (*Nahmani v. Galor* [7], at p. 499).

In a similar vein, President Shamgar wrote:

> '… The point of origin in the interpretation process can be found in the contract itself… resorting to the text of the contract requires, first and foremost, consideration of the linguistic meaning of the terms and provisions found in the contract… If this does not lead to a clear conclusion, the second stage arrives, in which the court must choose, from the range of possible linguistic meanings, the meaning that achieves the contractual purpose' (CA 3804/90 *Delta Investments and Commerce (Karnei Shomron) Ltd v. Supergas Israeli Gas Supply Co. Ltd* [16], at p. 213).

The 'two-stage doctrine' makes a distinction between 'internal interpretation' (which interprets the language of the contract without referring to external circumstances) and 'external interpretation' (which interprets the language of the contract on the basis of information external to the contract). See CA 702/84 *Yuval Gad Ltd v. Land Appreciation Tax Director* [17]. The criterion that distinguishes between the two types of interpretation is the clear language of the contract. '… There is no basis for hearing external evidence of the parties' intentions when the language of the document is clear…' (Justice Netanyahu in CA 650/84 *Stern v. Ziuntz* [18], at p. 384); 'if the relevant term is clear, then there is no basis for resorting to external circumstances, and the court must decide the meaning of the words as it sees fit… referring to the circumstances is an alternative that arises only when the written text has no clear meaning' (Justice Bejski in CA 170/85 *Zaken Bros. Contracting Co. Ltd v. Mizrahi* [19], at p. 638). The difficulty inherent in this method of interpretation is that the clarity of the language must be established at the end of the interpretative process and not at the beginning. The clarity of the language is not determined by the linguistic intuition of the judge prior to interpretation, but it is the product of an interpretative conclusion that is reached at the end of the interpretative process. Only by referring to external sources may persuade the interpreter that the language is not clear. What

appears on the surface to be clear may turn out to be unclear in view of the circumstances. Since it is universally accepted that the intentions of the parties is a proper interpretative criterion, it can be determined that the language is clear only after the judge completes the interpretative process, i.e., when he has determined the intentions of the parties and interpreted the language of the contract accordingly. The language of the contract is clear only when it implements the intentions of the parties. Indeed, the science of linguistics and the science of law reject the proposition that language is clear 'of itself'. I discussed this in one case, where I said:

> 'No words are "clear" in themselves. Indeed, nothing is as unclear as the assertion that words are "clear". Justice Traynor rightly pointed out that:
>
> > "Plain words, like plain people, are not always so plain as they seem..."
>
> … The meaning of a statute is not clear as long as it is inconsistent with a clear statutory purpose…
>
> The feeling of clarity that arises upon the first reading of the statute is only preliminary and temporary. It gradually disappears when it becomes clear that this "clear" meaning does not achieve the purpose of the legislation' (HCJ 47/83 *Air Tour (Israel) Ltd v. General Director of Antitrust Authority* [20], at p. 176).

These remarks were made with reference to the interpretation of legislation. But they are not restricted merely to statutory interpretation. As my colleague, Justice D. Levin, rightly said:

> 'It makes no fundamental difference whether we are concerned with interpretation of legislation or interpretation of a contract or interpretation of any other document including an insurance policy. The basic rules of interpretation that have been developed and have become part of the case-law accepted by us are set out, *inter alia*, in the comprehensive opinion of Justice Barak in HCJ 47/83…' (*HaMagen v. Medinat HaYeladim* [15], at p. 570).

Indeed, the contract is the law between the parties (cf. article 1134 of the Napoleonic Code), and basic interpretative principles — of which the most fundamental is the principle that the wording of the text must be interpreted according to its objective, and the objective of the text is derived from any reliable source and is developed at the discretion of the interpreter on the basis

of the relative importance of the purposes that arise from the various sources — apply to the interpretation of all legal texts.

The boundary between the two stages is blurred

4. Moreover, the move from the first stage to the second stage is not at all clear. The boundary itself is blurred. Justice Cheshin rightly pointed out that:

> '… the boundary between the "contract" and the "circumstances" in which the "contract" was made can be slender, and the two fields influence one another. When interpreting a contract, we are not concerned with mere linguistic research, and we know that the interpretation is directed at the intentions of the parties. But the intentions of the parties are not an abstract, theoretical concept: it is, *inter alia*, a product of the circumstances in which the contract was prepared.
>
> … in examining the intentions of the parties to a written contract, our first stop is that text, which the parties agreed upon and created, but this is not our final stop in our quest to discover their joint intention. Intentions, joint intentions, assessing the intentions of the parties — and these are the area of our investigations in interpreting a contract — are all abstract concepts that are intangible… since we aim to clarify the extent and scope of that abstract concept — the intentions of the parties — at all events we cannot limit ourselves to the mere literal interpretation of the contract' (*Sakali v. Tzoran* [4], at p. 818).

Indeed, the first stage (extrapolating the intentions from the clear language) may begin the interpretative process. It should not end it. The interpreter must move on to the second stage (extrapolating the intentions from the external circumstances), and return to the first stage and then to the second, back and forth, without any restrictions of 'clear language' or 'vague language', until he is satisfied that he has succeeded in ascertaining the intentions of the parties to the contract. With this vital 'fact', he will proceed to extract the legal meaning from the variety of linguistic meanings of the text. Only then will he be satisfied that the language of the contract is clear.

The two-stage doctrine does not seriously consider the intentions of the parties

5. Moreover, the approach that if the language of the contract is clear we should determine the (joint) intentions of the parties to the contract only from the contract raises difficult questions. If the interpreter seriously considers the

intentions of the parties as an interpretative criterion, why is he limited merely to the language of the contract in establishing its contents? If indeed the underlying purpose of interpreting the contract is 'to reach the true intentions in the minds of the parties' (Justice Türkel in *Ben-Natan v. Negbi* [9], at p. 145), and if the basis of the contract is its 'true intentions' (CA 603/79 *Avargil v. Peleg & Shitrit Building and Development Co. Ltd* [21], at p. 637), and if 'the intentions of the parties controls how we determine the interpretation of an expression in the contract…' (President Shamgar in CA 703/88 *Morgan Industries Ltd v. Batei Gan Leasing Ltd* [22]), and if indeed 'the art of interpretation is designed to ascertain the true intentions of the parties to the contract (President Shamgar in CA 1395/91 *Winograd v. Yedid* [23], at p. 800), and if indeed the job of the interpreter is to 'ascertain the exact intentions of the document's drafters' (Justice D. Levin in *Nudel v. Estate of Pinto* [11], at p. 482), and if indeed 'the essence of interpreting a contract is searching for the intentions of the parties' (Justice Dorner in CA 5597/90 *Cohen v. C.B.S. Records Ltd* [24], at p. 217) — if indeed we are devoted and dedicated to the (joint) intentions of the parties — why should the interpreter be restricted to the language of the contract itself, and only if that language is unclear, he may refer to external circumstances? Does not the approach that, if the language is clear, there is no reason to examine the intentions according to the external circumstances, mask the approach that it is not the intentions that count but it is the clear language that counts? For if the intentions are so essential for interpreting a contract, and if the pursuit of these is the main parameter, is it not vital to give the judge-interpreter the (interpretative) freedom to refer to every reliable source — whether this is the language of the contract or the external circumstances — in order to ascertain from them the intentions of the parties, which is so essential for the art of interpretation? Naturally, in most cases, the intentions that are evident from the language of the contract are 'safer' and more reliable than the intentions derived from the circumstances. It has rightly been pointed out that the court must refrain from giving 'validity and significance to a hidden intention of a party that he kept in his thoughts and hid from the other party and which was not expressed in the contract…' (President Shamgar in CA 765/82 *Alter v. Alani* [25], at pp. 710-711). But this is far removed from the rigid rule much underlying the two-stage approach. No argument has been made that the external circumstances are not sufficiently reliable for ascertaining the intentions of the parties. Quite the contrary: the external circumstances are certainly a reliable source, from which we can ascertain the intentions of the parties, and section 25(a) of the Contracts (General Part) Law expressly refers

the interpreter to this source. Other provisions of the Contracts Law also require ascertaining the intentions of the parties through external circumstances (see, for example, section 13 (contract for appearances sake) and section 16 (clerical error) of the Contracts (General Part) Law). Moreover, if external circumstances are in fact a reliable source for ascertaining the intentions of the parties when the language is unclear, why should the external circumstances be unreliable — to such a degree that referring to them is prohibited — when the language is clear? Who can guarantee that in all circumstances the joint intentions of the parties are indeed enshrined in the 'clear' language? Perhaps it is possible to find the intentions of the parties in the external circumstances? Indeed, what is needed is not a strict rule of evidence about the 'inadmissibility' of evidence about external circumstances — and such is the rule that regards clear language as the criterion for not referring to external circumstances (see *Stern v. Ziuntz* [18], at p. 384, that refers to the laws of evidence in this matter) — but a flexible weighting rule with gives greater weight to evidence of the intentions of the parties deriving from the language of the contract than to evidence of the intentions of the parties deriving from the external circumstances. Of course, among the external circumstances we will take no account of 'individual or conjectural considerations of one of the parties' (see *Nahmani v. Galor* [7], at p. 499), nor of a 'supposed intention that is not translated into the language of the text' (Justice Netanyahu in *Stern v. Ziuntz* [18], at p. 384). The court will not examine 'the hidden thoughts of the parties, in case in their deepest thoughts they had a different purpose that they did not express' (in the words of my colleague, Justice Mazza). The court will rely on reliable data that were openly revealed (in writing, orally or in any other behaviour) with regard to the joint intentions of the parties. Of course, against my approach concerning this move from rules of 'admissibility' to rules of 'weight' it may be argued that it creates insecurity and uncertainty, whereas the two-stage approach reduces insecurity and creates certainty in all those cases where the language of the contract is clear. I cannot accept this argument. The modern tendency in many areas of the law is to move away from prohibiting the admissibility of information to allowing it to be brought while taking into account its reliability for the purposes of its weight: 'Between truth and stability — truth is preferable'. Moreover, the security and certainty of the two-stage doctrine are in fact illusory. The determination whether the language of the contract is clear or not is not made according to legal rules, but by intuition, which naturally leads to insecurity. What is seen by one judge as clear language is seen by another as vague language. An arbitrary examination of the clarity of the

language should not be the main criterion in the interpretation of a legal text. Language becomes clear only in its context, and a rule of interpretation that limits the context to the text itself is, by its very nature, arbitrary. It replaces the intellectual struggle with the meaning of the text with an intuitive conclusion based on a feeling for language (for strong criticism, see M. Zander, *The Law-Making Process*, London, 4th ed., 1994, at p. 126).

The two-stage doctrine is inconsistent with general contract law

6. The two-stage doctrine of contractual interpretation is not consistent with the law of contracts as a whole. It is inconsistent with significant parts of the laws of interpreting contracts. As we have seen, this doctrine is based on the assumption that, for the purpose of interpreting a contract, 'clear language indicates the intentions of the parties and the objective of their agreement'. This establishes a kind of presumption that may not be rebutted that the intentions of the parties is what is evident from the clear language of the contract. The intentions of the parties that can be proven from external circumstances are not taken into account. But this presumption is inconsistent with the law of contracts as a whole. Indeed, formulating the laws of interpreting contracts must fit into the overall fabric of the law of contracts. Laws of interpretation do not stand in isolation. The laws of interpretation do not stand alone. They must be integrated into basic contractual outlooks. Why should we develop laws of interpretation that would result in a contract that according to its contents was never made (because there is no decision to be bound within the framework of the laws of offer and acceptance)? Or what logic is there in making a contract (within the framework of the first stage of the two-stage doctrine) that gives a broad power to one (or both) of the parties to rescind the contract because of a defect in making it (because an operative mistake was made with regard to it)? What purpose is there in determining that the contents of the contract are as they appear from the clear language of the contract (the first stage of the two-stage doctrine of interpretation), if it is also held that such an interpretation conflicts with the principle of good faith?

7. The basic premise is that the law of contracts is based on the autonomy of will of the individual. This autonomy of will of an individual is not the secret desire of the individual. It is his (subjective) will that is given open expression. Indeed, the basis of the contract is the joint subjective intentions of the two parties. When there exist such intentions, it forms the basis for contractual analysis. Only when joint intentions do not exist, and the intentions of one party are different from those of the other party is the contract examined on the basis of objective criteria. The 'objectification' of the law of

contracts begins only when there is no joint subjective basis for interpreting the contract. The objective doctrine of contracts accepted today in the law of contracts (see D. Friedman and N. Cohen, *Contracts*, Aviram, vol. 1, 1991, at p. 156) applies only where there is no joint subjective decision of the two parties. Indeed, the objective doctrine endeavours to protect the reliance interest. Where there is no reliance — because the two parties agreed in accordance with their subjective outlook — there is no basis for the doctrine of objectivity. President Shamgar rightly pointed out that:

> 'It should be remembered that the purpose of the objective test is to protect the party that relies on the representation of the other party. The appellant cannot argue reliance, and therefore there is no basis at all for applying this test in this case' (CA 1932/90 *Peretz Bonei Hanegev — Peretz Bros. Ltd v. Buchbut* [26], at p. 365).

It follows that the logical conclusion is that where there is a subjective decision of the two parties, and this can be proved on the basis of reliable external circumstances (such as written evidence), the existence and contents of the contract are determined on the basis of this decision, and not according to an objective approach (i.e., the behaviour of the parties as reasonable persons) to the contract, which is evident from the clear language of the contract, since otherwise the (objective) construction of the contract will lead to its destruction (in the absence of such a decision). Such a strong suicidal desire is not characteristic of the law of contracts. Consider the following famous example (*Raffles v. Wichelhaus* (1864) [68]: A made a contract with B, to sell him cotton that will be sent to him on the *Peerless*, a ship sailing from Bombay. There are two ships of this name sailing from Bombay. One sails in October, and the other in December. A disagreement arises as to which of the two ships the contract refers. The objective approach to the law of contracts holds, rightly, that the (interpretive) answer to this question is found by examining the parties' behaviour as reasonable persons. The test is objective (see CA 536/89 *Paz Oil Co. Ltd v. Levitin* [27], at p. 627). According to this, it is possible that a valid contract was made referring to carriage on one of the ships, and it is possible that no contract was made at all, because there was no decision made. But the law of contracts stipulates in addition that if the two parties agreed (subjectively) on the ship *Peerless* that sails in December, whereas from their behaviour as reasonable people it can be deduced (by considering the 'clear' language of the contract) that the agreement refers to the ship *Peerless* sailing in October, then the agreement

made by the parties is for carriage on the ship *Peerless* sailing in December, and not in October. This is discussed by Professor Farnsworth, who points out:

> '… a seemingly simple case can be disposed of. Suppose that it is shown that, when the parties made the contract, both had in mind the same ship, say the December *Peerless*… if one party does show this, should that party not prevail? Surely if one party shows that the other party attached the same meaning that the first party did, the other party should not be able to avoid that meaning by showing that a reasonable person would have attached a different one. According to Corbin, "it is certain that the purpose of the court is, in all cases, the ascertainment of the 'intention of the parties' if they had one in common".' (E. A. Farnsworth, *On Contracts*, Boston, Toronto and London, 1990, vol. II, at p. 245)

Against this background, we can understand what is stated in *Restatement*, 2nd, *Contracts* - § 201 (1) that:

> 'Where the parties have attached the same meaning to a promise or agreement or a term thereof, it is interpreted in accordance with that meaning.'

Indeed, a contract is a legal act of two parties. The intentions are of both parties (see CA 154/80 *Borchard Lines Ltd, London v. Hydrobaton Ltd* [28], at p. 223). When the two parties have a joint subjective understanding — which can be deduced from external circumstances — about their intentions, the contents of the contract should be interpreted accordingly, and not according to an (objective) intention that arises from the (clear) language of the contract. Therefore, 'no meaning should be attached to the language of the contract, which, although semantically possible, is accepted by both parties not to reflect their intentions' (CA 832/81 *Ralpo (Israel) Ltd v. Norwich Union Fair Insurance Society Ltd* [29], at p. 45). It also seems to me that the rule of interpretation that 'if a contract may be construed in several ways, a construction according to which it is valid is preferable to a construction according to which it is void', (s. 25(b) of the Contracts (General Part) Law, 5733-1973) also supports this approach. What point is there in ignoring the joint subjective intentions of the parties — intentions that are evident from reliable external circumstances — even if it is not evident from the clear language of the contract? Is it not preferable to recognize the existence of the contract that the two parties wished to make? What purpose is there in declaring the contents of a contract according to the intentions of the parties

that are evident from the clear language of the contract, and afterwards declaring it not to exist, because there is no joint resolve (cf. *State of Israel v. Hiram Landau* [2], at p. 667)? Do we not require a correlation between 'resolve' (within the framework of making the contract) and 'intentions' (within the framework of its interpretation)? We have already seen that the objective test of the law of contracts is designed to protect the reliance interest of the parties to the contract. But where both parties have a joint subjective understanding, what interest are we protecting if we ignore that understanding? President Shamgar rightly pointed out that:

> 'Preferring the objective representation over the hidden subjective intention was designed to promote business certainty and commercial security. As such, the emphasis on the objective representation is to protect the party that relies on the representation of the other party, and therefore if there was no such reliance, there is no reason to prefer the objective representation…' (CA 685/88 *Kotterman v. Torah VaAvodah Fund* [30], at p. 602).

Does it not follow that the language of the contract should be construed according to the joint subjective intentions of the parties, which is evident from the external circumstances, and not according to the objective intentions that are evident from the clear wording of the contract?

8. Take, for example, the case where A says to B: I offer to sell you a horse that I own at a certain price. B replies that he wants to buy A's horse at that price. Both parties intended an old machine in A's possession which, in the parlance of both of them, is called 'horse'. What is the contract that was made? Let us assume that from the clear language of the contract — which concerns the purchase and sale of a horse — it is evident that the intention of the parties is the sale of a four-legged animal which in English is called 'horse'. This would be the understanding of any (objective) reasonable reader. What point would there be in recognizing a contract with this content, when both parties resolved to sell an old machine, which external circumstances show them to have called 'horse'? It is a rule that —

> 'In establishing the scope of linguistic meanings of a contractual text… the interpreter acts as a linguist. He asks himself, what are the meanings that can be attributed, in the language in which the contract was made — and if the parties have a private parlance of their own, within the framework of this parlance — to the language of the contract' (CA 708/88 *Shelomo Schepps & Sons*

Ltd v. Ben-Yakar Gat Engineering and Building Co. Ltd [31], at p. 747).

Why should we not allow the parties the opportunity to show, within the framework of reliable evidence (such as prior correspondence) as to external circumstances, that in the contract between them the word 'horse' has a special meaning? Surely, if a mistake had been made in the contract, and instead of writing 'machine' the parties had written 'horse', the law would allow the mistake to be rectified, and the error is not a ground for rescinding the contract (see section 16 of the Contracts (General Part) Law). Why should it be impossible to reach the same result when the parties made no mistake at all, but in their special parlance they used the word 'horse' for what everyone else calls a 'machine'? What legal logic is there in the approach that we should force on the two parties a contract, which according to their joint intentions they did not want at all, when it is possible to point to a contract which according to their joint (subjective) intentions they did want?

9. As stated, we should aim for harmony between the rules of interpretation and the general law of contracts. Take, for example, the subject of mistake. The mistake acts in the gap between the subjective intention of a party and the objective meaning of the contract:

> 'Even if a contract is made, according to the objective test, it is possible that it may still be rescinded by the party for whom there was a gap between his subjective intentions and the intention that is evident from the representation that he made. The laws of defects in chapter 2 of the law were designed for this' (President Shamgar in *State of Israel v. Neveh Schuster* [3], at p. 603).

What point is there in opening and expanding this gap, when the two parties have a joint subjective intention that is not evident from the clear language of the contract? What interest does such an interpretive approach protect? It does not protect the reliance interest, nor does it promote security and certainty. It merely allows one of the parties, for whom the terms of the transaction have ceased to be convenient, to extricate himself from it. This outcome is not desirable. A harmonious interpretation of the law of contracts must take account of all of the laws. It must create a harmony between the rules of interpretation and the laws of mistake. Such a harmony does not exist if we adopt the two-stage doctrine for interpreting contracts. After completing the first stage, the court may give the contract an (objective) interpretation, whose result would allow the parties to extricate themselves from it (because of an operative mistake) without this being warranted by the balance of

interests that require protecting. Moreover, section 16 of the Contracts (General Part) Law states that 'if the contract contains a clerical error or any other similar mistake, the contract should be amended in accordance with the intentions of the parties, and the mistake is not a ground for rescinding the contract'. But how can the Court know the intentions of the parties if it can only learn this from the clear (but mistaken) language of the contract? Clearly this provision assumes a possibility of referring to external circumstances in order to derive from them the intentions of the parties. But how will this information be obtained if the Court determines (at the outset), according to the two-stage doctrine, that the language is clear and there is no basis for referring to external circumstances? And how will the judge determine that the contract is merely for the sake of appearances (s. 13 of the Contracts (General Part) Law) if the only appearance that the judge sees is the clear language of the contract?

The two-stage doctrine is inconsistent with the principle of good faith

10. A principle central to civil law in general, and to the law of contracts in particular, is the principle of good faith. The provision regarding 'good faith' is a 'multi-faceted, "majestic" one' (see HCJ 1683/93 *Yavin Plast Ltd v. National Labour Court* [32], at p. 708). One aspect of the principle of good faith is that a contract should be interpreted in good faith (see *Ben-Natan v. Negbi* [9]; *Coptic Mutran v. Halamish* [8], at p. 845; CA 5559/91 *K.Z. Gas and Energy Enterprises (1982) Ltd v. Maxima Air Separation Centre Ltd* [33], at p. 649; CA 5187/91 *Maximov v. Maximov* [34], at p. 186). In several legal codes, this is stated expressly (see, for example, article 157 of the German Civil Code (the B.G.B.), which states that contracts shall be interpreted reliably, faithfully and taking account of accepted practice; article 1366 of the Italian Civil Code, which states that a contract shall be interpreted in good faith). In Israel, this is derived from the general principle of good faith (see D. Pilpel, 'Section 39 of the Contracts (General Part) Law, 5733-1973, and its Relationship to German Law,' *Hapraklit*, 36 (1984-1986) 53, at p. 63). The interpretative requirement that a contract shall be interpreted in accordance with the principle of good faith has several ramifications. As we shall see (in paragraph 18, *infra*), the purpose of the contract is also its objective purpose. This was determined, *inter alia*, on the basis of the principle of good faith. Therefore the assumption is, for example, that there is equality between the parties. Moreover, the principle of good faith acts as a springboard for filling a lacuna in a contract (see paragraph 33, *infra*). For our purposes, what is important is another interpretative aspect: interpreting a

contract in good faith means giving a meaning to a contract that is consistent with the joint intentions of the two parties. Professor Shalev discussed this, noting that:

> 'In Israel we derive this rule of interpretation from the general principle of good faith… the foremost of these rules is that the art of interpretation was intended to ascertain the true intentions of the parties to the contract. Searching for this intention, by freeing oneself from the burden of the literal interpretation, is consistent with the principle of good faith' (G. Shalev, *The Laws of Contracts*, 2nd edition, 1994, at p. 316).

In a similar vein, President Shamgar noted that:

> 'The art of interpretation was designed to ascertain the true intentions of the parties to the contract. The search for this intention, by freeing oneself from the burden of the literal interpretation, is consistent with the principle of good faith' (*Winograd v. Yedid* [23], at p. 800).

But how can this rules of interpretation be reconciled with the approach — which underlies the two-stage doctrine — that where the language of the contract is clear, the intentions of the parties are also clear and the contract will be interpreted accordingly. Certainly, the meaning of the principle of good faith is not that the 'intentions of the parties' — which we wish to uphold — are merely the intentions that arise from the language of the contract. Quite the contrary: the entire purpose of the principle of good faith is to prevent one of the parties from invoking a meaning that can be derived from its language ('the literal meaning'), which is inconsistent with the (subjective) intention known to the other party. Indeed, internal harmony within the framework of the laws of contracts requires a correlation between the principle of good faith and the laws of interpretation. Such a correlation is inconsistent with the two-stage doctrine.

The two-stage doctrine is inconsistent with the preference of intention over language

11. A golden thread that runs through case law and legal literature is the principle that: 'in a conflict between the language of the contract and the intention of its makers — the latter prevails over the former' (Shalev, *The Laws of Contracts*, *supra*, at p. 303). This principle is not ours exclusively. It is accepted in other legal systems. Thus, for example, article 1156 of the French Civil Code ('the Napoleonic Code') provides that, in interpreting a

contract, one should seek the joint intentions of the parties and not stick to the language of the contract. Similarly, article 133 of the German Civil Code, the B.G.B., provides that, when interpreting a declaration of intention, one should ascertain the true intention and not hold fast to the literal meaning of the expression. In a similar vein, article 1362 of the Italian Civil Code provides that a contract should be interpreted according to the joint intent of the parties, which is not restricted by the literal meaning of the words. Article 18 of the Swiss Code of Obligations provides that in interpreting a contract, one should investigate the true and joint intentions of the parties without being restricted to expressions or terms used by them. A similar approach has existed in Israel for a long time. More than thirty years ago, Justice Berinson discussed this, holding that:

> 'The first rule of interpreting a document is to attempt to fathom the author's true intention on the basis of what is written in the entire document, and taking account of the known background to the case. The literal meaning of the words used is not always decisive. The written words should not be regarded as the only factor, when the context and the circumstances surrounding the case indicate a contrary intention to the one that is evident from the ordinary meaning of the text' (CA 324/63 *HaLevy Segal v. Georgiani Maggi Co. Ltd* [35], at p. 373).

In approving these remarks, Justice Y. Kahan added:

> 'An important rule in the laws of interpretation of contracts is that it is the duty of the courts to interpret the contract in a way that reflects the intentions of the parties, and although one should approach the examination of the intention with the assumption that the parties intended what they wrote in the contract, more than once the court has interpreted contracts in a way that is inconsistent with the ordinary meaning of the words used by the parties' (*Mordov v. Schectman* [10], at p. 481).

Similar statements have been made by judges in this court since the enactment of the Contracts (General Part) Law (see, for example, *Avargil v. Peleg & Shitrit* [21], at p. 737). The following remarks of Justice Türkel are well-known:

> 'It appears that the rulings of the courts in recent years point increasingly to that trend of relaxing the constraints of the written

> word and reaching the true intention that was in the minds of the parties' (*Ben-Natan v. Negbi* [9], at p. 145).

In a similar vein, my colleague Justice D. Levin wrote:

> 'As far as possible, it is desirable to interpret a document from within, on the basis of what is stated in it and on the basis of its text, language and spirit. However, there is nothing sacred about words in themselves and, if it is necessary to consider all the circumstances that surrounded the making of the contract in order to establish its objective, it is permissible and even desirable to consider these as well, and thereby to reach the intentions of the parties when they entered into the contract…' (CA 655/82 *Grover v. Farbstein* [36], at p. 743).

See also *Nudel v. Estate of Pinto* [11], at p. 482.

President Shamgar also discussed this cardinal rule of contractual interpretation. In one instance he wrote:

> '… Indeed, it is a rule that the intentions of the parties is learned, first and foremost, from the language of the contract, but, in the words of Professor G. Shalev, *The Laws of Contract*, Din, 1990, 311:
>
> > "In a conflict between the language of the contract and the intentions of its makers, the latter prevails. The proper interpretative trend is to 'relaxing the constraints of the written word and reaching the true intention'. Therefore, there may be cases where the construction of the contract according to its purpose will override its literal construction, and this is when the context indicates an intention different from the one evident from the words".' (*Winograd v. Yedid* [23], at p. 799).

If this is indeed the case, then how this be reconciled with the approach that 'If the language is clear, then the purpose is also known, and the court will not resort further to examine the hidden thoughts of the parties'. If in fact we are not to regard the written words as the whole picture, and if we can give a contract an interpretation that is inconsistent with the ordinary meaning of the words, how can we persist with the outlook that if the words are clear then the purpose is clear, and if the purpose is clear then the words should be given their clear meaning? How, according to this approach — which is the two-

stage doctrine — will the interpreter ever reach the conclusion that there is a conflict between intention and language? If the intention is what is evident from the clear language, how can there be an intention that conflicts with the clear language? How can we relax the constraints of the words that are written and arrive at the true intention, if the rule is always that the true intention is merely what is evident from the clear words that are written? How then can we hold that, in a conflict between the language of the contract and the intentions of its makers, the intention prevails, if the intention is what arises from the ordinary language and if from the very definition of these terms such a conflict, in the first stage, is impossible? Indeed, it appears to me that the answer to these questions is that the two-stage doctrine is inconsistent with the basic rule that 'in a conflict between the language of the contract and the intentions of its makers — the latter prevails' (Shalev, *The Laws of Contracts*, *supra*, at p. 330).

The two-stage doctrine is based on an outdated interpretative approach

12. The two-stage doctrine is an interpretative doctrine that was accepted in nineteenth-century English law. It is the 'literal rule', whereby a legal text (statute, contract) is interpreted according to the intention of its maker. The intention may only be learned from the clear language of the text. Only when the language is not clear may one go beyond the framework of the text to learn the intent of the maker (the rule in *Heydon's Case* (1584) [69]). A more moderate version of this rule can be found in the 'golden rule', according to which one may go beyond the framework of the text in order to learn the intention of the maker of the text even when the language is clear, but only if the literal interpretation leads to an absurd outcome (see F. A. R. Bennion, *Statute Law*, London, 2nd ed., 1983, at p. 91). This doctrine has been subject of severe criticism in England (see M. Zander, *The Law Making Process*, *supra*, at p. 108; *The Interpretation of Statutes* (Law Com. No. 21), paragraph 80). It is no longer applied strictly to the interpretation of legislation (see F. A. R. Bennion, *Statutory Interpretation*, London, 1984, at p. 325). It has been largely abandoned in the interpretation of contracts. The modern approach to contractual interpretation finds expression in the following remarks of Lord Wilberforce:

> 'The time has long since passed when agreements, even those under seal, were isolated from the matrix of facts in which they were set and interpreted purely on internal linguistic considerations… We must inquire beyond the language and see what the circumstances were with reference to which the words

> were used, and the object, appearing from those circumstances, which the person using them had in view' (*Prenn v. Simmonds* (1971) [70], at pp. 1383-1384).

In another case, he added:

> 'No contracts are made in a vacuum: there is always a setting in which they have to be placed. The nature of what it is legitimate to have regard to is usually described as "the surrounding circumstances" but this phrase is imprecise: it can be illustrated but hardly defined. In a commercial contract it is certainly right that the court should know the commercial purpose of the contract and this in turn presupposes knowledge of the genesis of the transaction, the background, the context, the market in which the parties are operating' (*Reardon Smith Line v. Hansen-Tangen* (1976) [71], at pp. 995-996).

13. A similar trend exists in the United States. At first the English literal rule was adopted, with its exceptions, in the interpretation of laws and contracts. In view of the severe criticism levelled at it, it was abandoned for the interpretation of legislation (see R. Dickerson, *The Interpretation and Application of Statutes*, 1975, at p. 230). A similar trend exists with regard to the interpretation of contracts. No longer is it required, as a condition for ascertaining the purpose of the contract from external circumstances, that the language of the contract should be unclear. It is always permissible to refer to external circumstances. Professor Farnsworth wrote:

> 'The overarching principle of contract interpretation is that the court is free to look to all the relevant circumstances surrounding the transaction… Since the purpose of this inquiry is to ascertain the meaning to be given to the language, there should be no requirement that the language be ambiguous, vague or otherwise uncertain before the inquiry is undertaken' (E. A. Farnsworth, *On Contracts*, *supra*, at pp. 255-256).

14. A similar process has taken place in Israeli law. During the Mandate period, we assimilated the English rules of interpretation for interpreting a legal text (law, regulation, contract, will). When the State was established, we continued this tradition (see HCJ 15/56 *Sofer v. Minister of Interior* [37], at p. 1221; CA 161/59 *Balan v. Executor of Litwinsky's Will* [38], at p. 1916). With time, the law has also changed. The feeling grew that 'the time had come to remove the thorns from our vineyard' (Justice Silberg, in HCJ 163/57 *Lubin*

v. Tel-Aviv Municipality [39], at p. 1065; see also G. Tedeschi, *Research in the Law of our Land*, M. Newman, 2nd ed., 1959, at p. 51). Israeli rules of interpretation have been developed to reflect the fundamental outlooks of Israeli law. With regard to the interpretation of legislation, it seems to me that the accepted approach is that a statute is interpreted according to its purpose. The interpreter may ascertain the purpose of legislation from any reliable source:

> 'Any question of interpretation begins with the statute, but it does not end with it. The human brain must assimilate all information that is relevant and give weight to it according to its reliability' (my opinion in *Air Tour v. Antitrust Authority* [20], at p. 175).

A similar tendency should apply to the interpretation of contracts. A contract is interpreted according to the intentions of the parties. 'One can learn of the intentions of the parties from any reliable source' (in *Atta v. Estate of Zolotolov* [1], at p. 304). We must not turn back the clock to the methods of interpretation that were accepted in nineteenth-century England.

The two-stage doctrine is not required by section 25(a) of the Contracts (General Part) Law

15. It may be argued that the two-stage doctrine is enshrined in section 25(a) of the Contracts (General Part) Law. The interpreter is not allowed to deviate from the provisions of statute. Indeed, were the two-stage doctrine enshrined in the provisions of statute, we would, as faithful interpreters of the law, be required to obey its provisions. In my opinion, the two-stage doctrine is not enshrined in the provisions of the statute, which is worded as follows (s. 25(a)):

> 'A contract shall be construed in accordance with the intentions of the parties, as is evident from the contract, and to the extent that it is not evident therefrom — from the circumstances.'

Examination of this provision shows that it contains no reference to a distinction between clear language and language that is unclear. It does not say that the interpreter learns of the intentions of the parties from the clear language of the contract. It does not say that 'if the language is clear then the purpose is clear'. Nor does it say that 'if the language of a contract is clear to an extent that it leaves no room for doubt as to its intention, the intentions of the parties should be derived from it, and no reference should be made for this purpose to the circumstances in which it was made'. The clause does not create two stages of evidence that are separated by the clear or unclear

language of the contract. Section 25(a) of the Contracts (General Part) Law does not discuss the laws of evidence at all. It is not a section that concerns the admissibility of information. It does not adopt any position about the sources (the language of the contract or external circumstances) from which the interpreter learns of the intentions of the parties.

16. The normative message deriving from section 25(a) of the Contracts (General Part) Law is twofold: *first*, the main criterion for the interpretation of a contract is the intentions of the parties to the contract. These intentions are the (subjective) purposes, objectives, goals and interests (that found external expression) that the parties wished (jointly) to achieve through the contract. This intention may be evident from the contract, and it may be evident from the circumstances. *Second*, if after examining the language of the contract and the external circumstances, there still remains a conflict between the intentions of the parties as evident from the contract, and the intentions of the parties as evident from the circumstances, the intentions of the parties as evident from the circumstances prevails. Indeed, section 25(a) of the law establishes a deciding principle, which gives absolute preference to the intentions as evident from the contract over the intentions as evident from the external circumstances of the contract. Note that section 25(a) of the law does not provide that after ascertaining the intentions of the parties (as evident from the contract), no reference is to be made to circumstances external to the contract. Section 25(a) of the Contracts Law does not forbid any reference to the external circumstances in order to understand better the intentions that is evident from the contract. All that section 25(a) of the law establishes is a deciding principle that interpretative validity will be given first and foremost to the intentions that are evident from within the contract; and, only if such intentions are not evident from it —from the circumstances. Therefore, if it is possible and proper to avail oneself of the circumstances external to the contract in order to understand better the intentions of the parties as evident from the contract, one should do this. This was discussed by Professor Zeltner, when he said:

> 'One should, therefore, carry out a twofold act: first one must clarify what the parties wished to say, and after that one should qualify the result with the question: did this wish find expression in the declaration' (Z. Zeltner, The *Law of Contracts in the State of Israel*, Avuka, 1974, at p. 103).

In the same vein, in an attempt to clarify the English 'literal rule' (which underlies the two-stage doctrine), Professor Glanville Williams wrote:

> '… it is a misleading formulation of the problem of interpretation to say that there are two separate questions to be asked: first, "Is the Act plain and unambiguous?" Secondly, if it is not, "Can the words be interpreted so as to further the probable intention of parliament?" The first question is not independent of the second, and sometimes it better reflects the actual process of interpretation to reverse them. The primary question then is "What was the statute trying to do?" Next comes the question: "Will a particular proposed interpretation effectuate the object?" and only, lastly "Is the interpretation ruled out by the language?"' (G. Williams, 'The Meaning of Literal Interpretation', 131 *New L. J.*, 1981, at pp. 1128, 1150).

Note that there is no fixed timetable for arriving at the intentions of the parties. One interpreter may refer first to the language of the contract and thereafter to the external circumstances. Another interpreter may first refer to the external circumstances and thereafter to the language of the contract. Whatever the order — and usually it will be an oscillating movement from the language to the circumstances and from the circumstances to the language — the final result must be the intentions as evident from the contract. If the intentions as evident from the contract are irrelevant for solving the interpretative problem that is before the judge, he will refer to the intentions implied by the external circumstances. In all of these cases, moving from the language of the contract to the external circumstances is not at all dependent on the question whether the language of the contract is clear or unclear.

Interim summary

17. In summary, a contract is interpreted according to the intentions of the parties. These intentions are the purposes, the goals, the interests, and the plan that the parties wished to achieve together. The interpreter learns of the intentions from the language of the contract and the circumstances external to it. Both these sources are 'admissible'. With their assistance, the interpreter can ascertain the joint intentions of the parties. Moving from the internal source (the language of the contract) to the external source (the external circumstances) is not dependent on the fulfilment of any preconditions. No preliminary examination is required as to whether the language of the contract is clear or not. The answer to that question will become apparent only at the end of the interpretation process. I discussed this in one instance when I stated:

> 'We can learn about the purpose of a contract from within it, from the nature of its provisions and its structure, and also from

> sources external to it, such as the negotiation process between the parties and their behaviour after making the contract, other contracts that exist between them, the commercial practice that was known to them or that we can presume them to have known, and from other sources that may indicate the objective of the contract and its purpose' (FH 32/84 *Estate of Walter Nathan Williams v. Israel British Bank* (*London*) (*in liquidation*) [40], at p. 274).

See also *Borchard Lines v. Hydrobaton* [28], at p. 223.

After the interpreter has ascertained the (joint) intentions of the parties, he examines whether these intentions are 'evident' — i.e., they are enshrined — in the contract. If the answer is yes, the contract will be interpreted according to these intentions, which were ascertained by using a fusion of information that came from the contract and from outside it.

18. Before I end this part of my opinion, I would like to make two points: *first*, in this decision — as in all case-law — the terms 'intentions' of the parties and 'purpose' of the contract are used interchangeably (see, for example: *Ralpo v. Norwich Union* [29], at p. 55; *HaMagen v. Medinat HaYeladim* [15], at p. 572; *Grover v. Farbstein* [36], at p. 747; *Nudel v. Estate of Pinto* [11], at p. 482; *Atta v. Estate of Zolotolov* [1], at p. 305; HCJ 306/86 *State of Israel v. National Labour Court* [41], at p. 664; CA 783/86 *Reuven Gross Ltd v. Tel-Aviv Municipality* [42], at p. 597; CA 719/89 *Haifa Quarries Ltd v. Han-Ron Ltd* [43], at p. 312). Within the framework of this decision, there is no need to clarify these concepts. I will, however, say this: a contract is interpreted according to its purpose (see the opinion of Lord Diplock in *Antaios Compania S.A. v. Salen A.B.* (1985) [72], at p. 201, where he states that the method of 'purposive construction' has been transferred from the interpretation of legislation to the interpretation of contracts). This purpose is a normative concept. It is a legal construction. It includes a subjective purpose and an objective purpose. The objective purpose is the intentions of the parties. These are the purposes, the interests and objectives that the parties decided upon and to which they gave external expression in their behaviour (and therefore not hidden thoughts and secret feelings: *Cohen v. C.B.S. Records* [24], at p. 218). Section 25(a) of the Contracts (General Part) Law is concerned with these intentions. Notwithstanding, the interpretation of a contract should not be restricted merely to the criterion of the intentions of the parties. Section 25 of the law does not constitute a closed list of rules for interpreting a contract. The vast majority of rules for

interpreting contracts are found in case-law and are outside the framework of section 25(a) of the law. Indeed, sometimes the intentions of the parties cannot be ascertained. We should always remember that the relevant intentions are not the subjective intentions of one of the parties, but the joint subjective intentions of both of them, or at least the (subjective) intentions of one of the parties of which the other party is aware and which he knows is the basis of the first party's understanding of the contract party (see *Borchard Lines v. Hydrobaton* [28], at p. 223; *Atta v. Estate of Zolotolov* [1], at p. 305; CA 819/87 *Development of part of Parcel 9 Block 9671 Co. Ltd v. HaAretz Newspaper Publishing Ltd* [44], at p. 344; *Maximov v. Maximov* [34], at p. 186 ('a meeting of wills requires a joint intention' — Justice Dorner); *Cohen v. C.B.S. Records* [24], at p. 218: '… a contract is not interpreted on the basis of the subjective, internal intention of one party to the contract, but on the basis of the external manifestation of the joint intention of the two parties' — Justice Dorner). Therefore, if the (subjective) intentions of one of the parties differs from that of the other, there is no basis for ascertaining the joint subjective intentions. The contract will be interpreted in this case, as in other cases where the joint subjective intentions are irrelevant for solving the interpretative problem before the judge, according to its objective purpose. The objective purpose of a contract consists of the purposes, interests and goals that a contract of this sort or type is designed to achieve. The objective purpose is deduced from the 'character and nature of the transaction made between the parties' (Justice Bach in *Agasi v. I.D.P.C.* [13], at p. 245; CA 196/87 *Shweiger v. Levy* [45], at p. 20). This is the 'common sense of reasonable and honest businessmen…' (Justice M. Cheshin in *Sakali v. Tzoran* [4], at p. 819). Indeed —

> 'This objective purpose means the typical purpose that takes into account the usual interests of fair parties to a contractual relationship. It may be learned from the kind of agreement and the type of contracts to which it belongs. It is derived from its logic. It is deduced from its language' (my opinion in CA 779/89 *Shalev v. Selah Insurance Co. Ltd* [46], at p. 228).

This is an objective test. It is influenced by the principle of good faith and the value system which it expresses. It is deduced from logical considerations (see CA 226/80 *Kahan v. State of Israel* [47], at p. 471 ('one should prefer the interpretation that, more than any other interpretation, is consistent with logic…' (*per* Justice D. Levin); CA 702/80 *Galfenstein v. Avraham* [48], at p. 119 ('one should prefer the rational interpretation over the interpretation

that does not allow any possibility of performing the contract, not only according to the text and the language, but also according to its spirit' (*per* Justice Sheinboim)). When the contract has an economic or commercial purpose, the objective purpose is determined according to the 'economic logic' or the 'commercial logic' underlying it (see CA 757/82 *Israel Electricity Co. Ltd v. Davidovitz* [49], at p. 223; CA 565/85 *Gad v. Nevi'i* [50], at p. 430; *K.Z. Gas v. Maxima Air Separation* [33], at p. 649). The objective purpose is established on the basis of considerations of reasonableness (see CA 449/89 *Flock v. Wright* [51], at p. 102: 'one should choose also the most reasonable interpretation of the contract' (*per* Justice Malz); CA 2738/90 *Yahav v. Ben-Tovim* [52], at p. 703; *Cohen v. C.B.S. Records* [24], at p. 219: '… a commercial contract is designed to achieve a business purpose, and should be given an interpretation that facilitates this purpose, as reasonable persons would do…' (*per* Justice Dorner); CA 530/89 *Bank Discount v. Nofi* [53], at p. 125); 'in ascertaining the objective purpose, we must take account of business efficiency and similar considerations 'as fair parties, protecting their typical interests, would have designed it' (*Shalev v. Selah Insurance* [46], at p. 229). 'It is the purpose that reasonable and decent parties would have aimed to achieve' (*per* Justice Or, *ibid*., at p. 237). The (ultimate) purpose of the contract is ascertained on the basis of the subjective purposes ('the intentions of the parties') and the objective purposes of the contract. Notwithstanding, in a conflict between them, the subjective purpose ('the intentions of the parties') will prevail. This, as we saw, is the central message that is derived from section 25 of the Contracts (General Part) Law. Moreover, within the framework of the subjective purpose, normative preference is given to the intentions that are evident from the ordinary and natural language of the contract, over the intentions that arise from its unusual use of language or external circumstances. 'The presumption is that the purpose of the contract will be achieved, if the language of the contract is given the ordinary meaning that it has in the language used by the parties. The burden is upon the party who claims a special meaning' (my opinion in *Estate of Williams v. Israel British Bank* [40], at p. 274); 'There is a presumption that the ordinary meaning of the language chosen by the parties in the contract reflects what they agreed between them, and that effecting what was agreed between the parties is also the purpose of the contract' (Justice Or in *Shalev v. Selah Insurance* [46] at p. 238). It follows that the correct test is not the two-stage test where the clear or the unclear language of the contract acts as a cut-off point for evidence of the meaning of the contract, but a one-stage test, involving unceasing movement from the language of the contract to the

external circumstances, while creating a rebuttable presumption that the purpose of the contract is what is evident from the ordinary language of the contract. This presumption can be rebutted by all the circumstances.

19. *Second*, examination of decisions that I myself have written in the past shows that I too at times relied on formulae that resemble the two-stage doctrine. This, for example, is what I wrote in one case:

> 'Indeed, just as a law is construed according to the "intentions" of the legislator, the creator of the law, so a contract is construed according to the "intentions" of the parties, the creators of the contract. The intentions of the parties can be derived from any reliable source. The most reliable source, and therefore also the first and foremost, is the contract itself. But it is not the only source. The court may — where the contract itself is insufficient to indicate the intentions of the parties — refer to the "circumstances", i.e., the factual framework within which the contract was made. Note that in all these situations the judge is confronted with a contract, i.e., a "text" (express or implied, written or oral) and the question before him is, what meaning should be given to the contract and what is its scope. The court discovers this meaning according to the "intentions of the parties", which it learns from the contract itself and from the circumstances' (*Atta v. Estate of Zolotolov* [1], at p. 304).

The stipulation that reference to the circumstances is only possible 'where the contract itself is insufficient to indicate the intentions of the parties' is, of course, influenced by the two-stage doctrine. Even though I did refer to the concept of clear/unclear language, there is an echo of this approach in the wording of the decision. I regret this. I will merely point out that at a relatively early stage of developing the case-law, I noted that —

> 'My colleague distinguishes between "internal interpretation" and "external interpretation". Even this distinction raises very difficult problems, and I would like to reserve judgment with regard thereto' (my opinion in *Alter v. Alani* [25], at p. 715).

Reference to external sources should be done in every case, and it is not limited merely to cases where the contract itself does not indicate the intentions of the parties. Notwithstanding, section 25(a) of the Contracts (General Part) Law mandates that, in a conflict between the intentions evident from the

contract and the intentions that can be derived from the circumstances — the former prevail.

From the general to the specific

20. It transpires that we may refer to all the data — the contract as an integral entity and the external circumstances — in order to ascertain the purpose of the 'programme contract'. This purpose — so it appears from all the date presented to the District Court — is to effect the rapid building of apartments for sale by contractors to new immigrants and young couples on the open market. The plan is based on incentives designed to encourage the building of a large number of apartments in a short time and their sale on the open market. The main incentive is the undertaking that the State made to buy from the contractors those apartments that are not sold on the open market (in desirable areas (type A) — half of the apartments, and in development areas (type B) — all the apartments). This reduces the marketing risk of the building companies. An additional benefit that was given to the contractors allows them to demand that the State honour its undertaking (for type A, when the building is finished, and for type B, upon completion of the walls and the partitions). The contract is also based on additional incentives to encourage contractors to start building, such as special grants if the building is completed within a relatively short time, and partial financing of the building. Together with these (positive) incentives, several sanctions (or negative incentives) were stipulated, which were designed to motivate the contractors to comply with every stage of the timetable and sell the apartments on the open market. The main 'sanction' that the State reserved for itself — in order to encourage contractors to complete the building on time and to sell the apartments to new immigrants on the open market — was a reduction of the purchase price if the contractors were late in carrying out the building. This main sanction, according to the language of the contract, applies only to a delay in the desirable areas. This is a 'presumed purpose' that is evident from its wording. This presumption, although strong, conflicts with the (objective) purpose that is evident from the other parts of the contract, and from a reading of the contract as an integrating entity, based on positive and negative incentives that integrate with one other. This purpose was to give the State a (civil) sanction in the form of a price reduction should the performance be delayed, for all types of apartment. Indeed, accordance to the nature and the internal logic of the contract, this sanction should apply to both types of projects, and it should not be restricted only to the first type. Inspection of the contract in view of its circumstances shows that the main mechanism available to the State to make the contractors

comply with the timetable for building in development areas is its power to reduce the purchase price if the contractor is late in performance. An additional 'sanction' is a reduction of the apartment price if a long period of time passes between completing the performance period and invoking the government's purchase undertaking. In ascertaining this purpose, the interpreter is helped by the language of the contract and the external circumstances, as presented by the parties to the District Court. In view of this purpose, we can proceed to the second question that arises in this appeal, which concerns the accomplishment of the said purpose within the framework of the programme contract.

B. Accomplishing the purpose within the framework of the contract

Accomplishing a purpose that the language cannot support

21. As I stated at the beginning of my opinion, my colleague, Justice Mazza, established two propositions. The *first* concerns the purpose of the programme contract. My colleague sought to establish that the purpose of the contract is what is evident from the clear language of the contract. On the face of it, it is not the purpose of the programme contract to provide sanctions for building delays in development areas. I have until now been discussing this proposition. My conclusion was — and in this I agreed with the opinion of my colleague, Justice D. Levin — that the judge should not be restricted to the language of the contract in ascertaining its purpose, and that we may determine the purpose of the programme contract on the basis of all the data (whether internal or external). Consequently, I discussed the purpose of the programme contract, which includes also a provision for a sanction for a delay of the contractor in carrying out the building. Against this background, the *second* (and alternative) proposition determined by my colleague arises. This is the proposition that the purpose of the contract — as derived from all of the circumstances — may be ascertained by the judge-interpreter 'only if the language of the contract can be interpreted in different ways, or can sustain the interpretation which according to the logic of the interpreter is appropriate for the logical purpose of a contract of that sort'. In this context, my colleague quotes my remarks in a different case, (*Atta v. Estate of Zolotolov* [1], at p. 304), that 'the words restrict the interpretation'. In my colleague's opinion, one should not force into the language of the programme contract (clause 6(h)(3)), which refers to apartments with regard to which the contractor has invoked the purchase undertaking of the State ('Should the purchase undertaking be invoked… after the end of the performance period'), any reference to apartments for which there was a delay in completing the building

(their performance 'was completed after the end of the performance period'). A provision (section 6(h)(3)) relating to invoking the undertaking the undertaking of the State to buy apartments cannot, according to its language, sustain a meaning that refers to a delay in completing the building of the apartments. 'The clear words of the clause block our path to external criteria.' It transpires that the main sanction (reduction of the price) that is available to the Government should there be a delay in performance in the first type of cases (desirable areas — clause 6(g) of the programme contract) is not available in the second type of cases (development areas). Therefore, when a contractor who is building in a development area, submits a demand to invoke the Government's undertaking — a demand that he is entitled to make upon completion of the walls and partitions — the State must pay the price that was determined, without any ability to reduce the price because of the delay. This conclusion is problematic. True, it is evident from the language of the contract, and in this my colleague is correct. The language of clause 6(h)(3) of the programme contract cannot — as a text written in Hebrew — sustain the meaning required by the whole purpose underlying the contract. Does it follow from this, as my colleague Justice Mazza is correct in saying that the appeal must be denied? In my opinion the answer is no. My colleague limits himself merely to interpretation in its narrow sense. He does not widen the scope of his examination to interpretation in its broad sense. Within the framework of this distinction lies the answer to our problem. This answer is different from that of my colleague, Justice Mazza. It accords with that of my colleague, Justice D. Levin. I will now clarify my train of thought.

Construction in the narrow sense and construction in the broad sense

22. Normative judicial activity with regard to a legal text is of various kinds. At the centre of this activity is interpretation in its 'narrow sense' (see *Borchard Lines v. Hydrobaton* [28], at p. 223; *Atta v. Estate of Zolotolov* [1], at p. 299; *Haifa Quarries v. Han-Ron* [43], at p. 312). This deals with attributing a meaning to the language of the text. When the legal text is legislative (a constitution, statute or regulation), this activity focuses on giving a (legal) meaning to the variety of (linguistic) meanings of the law. When the text is a contract or a will, this activity focuses on giving a meaning to the language of the contract or to the language of the will. This activity is considered in part in section 25(a) of the Contracts (General Part) Law and in section 54 of the Inheritance Law, 5725-1965. As we have seen, the accepted criterion, whereby a legal meaning is 'plucked' from among a variety of linguistic meanings, is the purpose underlying the norm that is 'imprisoned' in

the text. This interpretative activity is 'narrow' because it does not add to, nor detract from, the language of the text. All it can do is to give a meaning to a particular text. In addition to this judicial activity, other normative judicial activities are recognized, that relate also to the legal text. These can be called interpretation in the wide sense. The list of these is not a closed one. I will mention three types of extra-textual activity: *first*, sometimes the critical issue is not merely the meaning of the text (i.e., its narrow interpretation) but mainly its validity. Thus, for example, the question may be may the validity of a lower norm as opposed to a higher norm (a statute *vis-à-vis* a constitution, a regulation *vis-à-vis* a statute, a personal contract *vis-à-vis* a collective one). Sometimes, the question that arises is the validity of conflicting norms of equal normative status (for example, a conflict between two statutes or between two contracts or between two wills). There could even be a problem of validity within the framework of one text, such as a conflict between two parts of a statute or between two parts of a contract or two parts of a will. The dividing line between questions of meaning and questions of validity is thin. Sometimes the distinction is difficult. Every issue of validity must deal with questions of meaning, but not every issue of meaning gives rise to questions of validity. *Second*, sometimes the decisive question is not merely the meaning of the language of the text (i.e., its narrow interpretation), but the possibility of changing this meaning by adding or detracting language or giving a meaning to the text that is inconsistent with its meaning in the language in which it is expressed. The judge is asked to amend the language of the text, and thereby bring about a change in its meaning. The natural authority to change the language of the text belongs, of course, to the author of the text. Notwithstanding, there are various situations in which the legal system recognizes the power of the judge to alter the legal text. He may, in special circumstances, add words to the text or take words out of the text, or give it a meaning that its original language cannot sustain. Thus, for example, a judge may amend a mistake in a will (s. 30(b) of the Inheritance Law) or a contract (s. 16 of the Contracts (General Part) Law) or a linguistic mistake in the text of a statute (s. 10A of the Government and Justice Arrangements Ordinance, 5708-1948). The judge may also add or detract from the language of the ('private' or 'public') text in order to prevent an absurdity or a frustration of the purpose underlying the text. The analytical classification of this activity is determined according to the legal tradition of the legal system. In Israel, we refer to this activity as interpretation. This is interpretation in its broad sense. Here too, the dividing line between interpretation in the narrow sense and interpretation in the broad sense is thin. Frequently there is no importance at

all to the specific characterization of the activity. *Third*, sometimes a void or a lacuna is discovered in the legal norm. In certain situations, the judge may complete what is missing. A lacuna in a law is completed according to the tests in the Foundations of Justice Law, 5740-1980. A lacuna in a contract is completed according to the tests set out in the Contracts (General Part) Law. The interpretative activity (in the narrow sense) identifies the lacuna. The completion thereof — which involves the creation of a new (judicial) text that completes the (original) text — is not interpretative activity in the narrow sense. The judge does not satisfied himself by giving a meaning to an existing text, but by adding a new text. The legal tradition of the judicial system must, of course, classify the type of this activity. In one case (see *Haifa Quarries v. Han-Ron* [43], at p. 312), I referred to this activity — following the continental tradition — as supplementary interpretation (*ergänzende Auslegung*). It belongs to the interpretation family in the wide sense, but it is different from interpretation in the narrow sense. Against the background of these analytical distinctions — whose sole importance is merely to clarify the nature of the judicial activity, in view of the variety of criteria used by it — we must examine the position of my colleague, Justice Mazza.

Interpretation in the narrow sense

23. Indeed, within the framework of interpretation in the narrow sense, my colleague, Justice Mazza, is correct. When the interpreter attributes a meaning to a legal text (a constitution, statute, contract, will), he is restricted by the meaning of the language in which the text is expressed. The interpretative activity is dictated by the limits of linguistic activity. 'Of the linguistic options that the text presents, one should choose the linguistic option that upholds the purpose of the contract…' (my opinion in *Ralpo v. Norwich Union* [29], at p. 45); similarly —

> 'The starting point for all interpretation — whether of a statutory norm or of a contractual norm — is in the language of the norm. Admittedly, interpretation is not limited only to the words, but the words limit the interpretation' (my opinion in *Atta v. Estate of Zolotolov* [1], at p. 304).

'… The court must choose, from the variety of possible linguistic meanings, the meaning that achieves the contractual purpose…' (President Shamgar in *Delta Investments v. Supergas* [16], at p. 213). Indeed, the interpreter is not merely a linguist, but he must take account of linguistic constraints. The legal meaning of the language, which is designed to achieve the purpose of the legal norm derived from the language, must be consistent

with one of the linguistic meanings of the text. I discussed this in one case, where I said:

> 'The basic rule of interpretation in the law of contracts is that, of all of the different linguistic meanings of the contractual "text", the interpreter must choose the legal meaning that reflects the "intentions of the parties"… in determining the range of linguistic meanings of the contractual "text" (whether it is oral or in writing), the interpreter acts as a linguist. He asks himself, what are the meanings that can be given, in the language in which the contract was made — and if the parties have a special parlance of their own, in that parlance — to its language? From among the variety of linguistic meanings, the interpreter must select a single (legal) meaning. This "rule of extrapolation" is the intention of the parties, i.e., the purpose the contract was intended to achieve' (*Shelomo Schepps v. Ben-Yakar Gat* [31], at p. 747).

In the absence of a claim that a special parlance exists — and such a claim was not made in this case — the interpreter may not give the language of the contact a meaning that it cannot sustain in the Hebrew language. My colleague, Justice Mazza, rightly pointed out that it is not possible (linguistically) to force into a text that speaks of invoking an purchase undertaking after the end of the performance period, a meaning that concerns the completion of the building of apartment after the end of the performance period, i.e., a 'performance delay'. Indeed, were judicial activity limited to interpretation in the narrow sense, it would have been possible to agree with my colleague that the appeal should be denied. But judicial activity with regard to a legal text is not restricted to interpretation in the narrow sense only. Let us now turn to interpretation in the broad sense, and to its ramifications on the appeal before us.

Amending a mistake in a contract

24. Section 16 of the Contracts (General Part) Law states:

> 'If a clerical error or similar mistake occurs in a contract, the contract shall be amended according to the intentions of the parties, and the mistake is not a ground for rescinding the contract.'

This provision was intended to bridge the gap between the joint subjective intentions ('the intentions', the subjective purpose) of the parties, and the expression given to it in the language of the contract:

> 'The assumption is that there was agreement between the parties, but the written document does not reflect this agreement. The mistake under discussion is not, therefore, in the wishes of the parties or in the agreement between them, but in putting these things into writing' (Friedman & Cohen, *Contracts*, vol. 2, 1993, at p. 759).

'The goal embodied in section 16 is to give expression to the true intentions of the parties and to overcome errors and mistakes that occurred in the process of translating these intentions into writing' (Shalev, *The Laws of Contracts*, *supra*, at p. 208). This provision is designed to examine 'whether what was finally incorporated into the document that was supposed to reflect the contract made between the parties is different from the real contract that was made, or not' (Justice D. Levin in CA 424/89 *Farkash v. Israel Housing and Development Ltd* [54], at p. 39). It follows that if the conditions prescribed in section 16 of the Contracts (General Part) Law exist, the judge may amend the language of the contract, add to it or detract from it, in order to adapt the meaning of the contract (according to its interpretation in the narrow sense) to the intentions of the parties. It should not therefore be said that in all cases the words restrict the interpretation. They do this only with regard to interpretation in the narrow sense. They do not do this with regard to amending a mistake (within the framework of interpretation in the broad sense).

25. Can we apply the provisions of section 16 of the Contracts (General Part) Law to the case before us? The judgment of the District Court contains several statements that support this. Justice Tal points out that 'one should interpret the agreement according to the simple meaning of its language and according to its context and not according to the "intentions of the parties".' It can be concluded from this that the intentions of the parties are different from the linguistic meaning of the contract. Elsewhere the judge points out that he assumes that the 'pressure, mentioned by counsel for the State, on the drafters of the contract had an effect, and as a result without anyone noticing the sanction clause for a delay in carrying out projects of the second type was omitted'. Notwithstanding, there was no finding of fact that the (subjective) intention of the parties was to determine a 'sanction' provision (i.e., a civil sanction) in both types of project. I cannot determine which parts of the (final) purpose are an expression of the subjective purpose (the 'intentions' of the parties) and which parts are an expression of the objective purpose (for example, the business efficiency and commercial logic). The burden in this

respect rests with the party alleging the mistake (see Friedman and Cohen, *Contracts*, *supra*. at p. 761). This burden was not discharged in this case. The 'blame' for this lies with both parties, for they made a procedural agreement that prevented external evidence from being submitted with regard to their joint intentions, and they relied primarily on the language of the contract and several clarifications with regard thereto. For this reason, there is no basis. in the case before us, to make use of the provisions of section 16 of the Contracts (General Part) Law.

Changing the language of the contract

26. The author of the text chooses his wording. As a rule, the interpreter is not permitted to introduce a change into the language of the text. The change in the text should be made by its author. Notwithstanding, our legal tradition recognizes the power of the court to make changes to a legal text in appropriate cases. Thus, for example, the court is recognized to have the power to change the language of a statute '… when the intention of the legislator is clear and a literal interpretation of the statute leads to a result that is contrary to the intention of the legislator as expressed in other sections of the statute, the court may… add to the law what the legislator left out…' (Justice Etzioni in CA 403/72 *HaMeretz Automobile Chassis and Metalworks Ltd v. Grayev* [55], at p. 431). The accepted approach is that it is possible to change the language of the statute 'when the mistake is absolutely clear to everyone, and a failure to amend it, even in the form of judicial interpretation, would lead to a frustration of the clear purpose of the legislator or to real harm to the interests recognized in that statute…' (Justice H. Cohn in BAA 64/72 *Sofran v. Bar Association Tel-Aviv District Committee* [56], at p. 129). Justice Berinson expressed this well by saying:

> 'We are interpreters and not merely linguists. Who is a good interpreter of a law? Someone who gives effect to the wishes of the legislator. The legislator is himself only a combination of flesh and blood and he may err. A mistake, of course — if it can be amended without injustice — should always be rectified. When a mistake in a statute is blatant, one should pierce the body of words to find the spirit that gives them life, and give precedence to the spirit over the body. The purpose of genuine and enlightened interpretation is discovering the truth and establishing the right interpretation. The means are the rules of interpretation, which are based on the foundation of logic and

> experience and penetrating heart and soul' (HCJ 188/63 *Batzul v. Minister of Interior* [57], at p. 350).

Indeed, when the legislator fails in his purpose, the judge may ensure that the purpose is achieved. He should not sit idly by and report the failure (see K. Diplock, *The Courts as Legislators*, 1965, at p. 10). It is frequently said that the court may amend the law in order to prevent an absurd, unreasonable or inoperable result, or one which is inconsistent with the law as a whole (see CA 126/79 *Fried v. Appeals Committee under Nazi Persecution Victims Law, 5717-1957* [58], at p. 27).

27. The aforesaid is all the more applicable with regard to a contract made between the parties. Their application is mainly in all those cases where the laws of the 'clerical error' in the Contracts (General Part) Law do not apply, because the subjective purpose has not been proved. The amendment of the text will be made, in these circumstances, in order to achieve the objective purpose of the contract. This was discussed more than one hundred years ago by Justice Halsbury, who said:

> 'Looking at the whole of the instrument, and seeing what one must regard… as its main purpose, one must reject words, indeed whole provisions, if they are inconsistent with what one assumes to be the main purpose of the contract' (*Glynn v. Margetson & Co.* (1893) [73], at p. 357).

Justice Berinson wrote in a similar vein:

> 'When we approach the interpretation of a document, we should not uproot a sentence or a passage from its context and interpret it literally as if it stood on its own, without taking account of the whole document and the context. The first rule of interpreting a document is to try and ascertain the true intentions of the author on the basis of what is written in the whole document, and taking account of what is known of the background of the case. The literal meaning of the words used is not always decisive. One should not regard the words written as the whole picture, when the context and the circumstances surrounding the case indicate a contrary intention to the one evident from the ordinary meaning of the text' (*HaLevy Segal v. Georgiani Maggi* [35], at p. 373).

My colleague, Justice D. Levin, expressed this approach most impressively in one case, when he said:

> 'No one disputes that the aforesaid method of textual interpretation, according to the literal, simple and reasonable meaning of the words, is a convenient starting point for understanding their meaning, for it is natural and obvious that the parties to the transaction to which the text refers wished to give expression to their true intentions and the areas of agreements between them, in words that they chose in the process of drafting…
>
> But… the system of rules is far wider, and the entire wording and the words chosen to give expression to the intentions of the parties should be seen as a whole and in depth, in order to penetrate through to the purpose of the legislation or the text of the agreement and the purpose which they wished to accomplish. There are many exceptions to the basic and simplistic rule… and it will become clear, that in an appropriate case, it is permissible, and even proper, to give the text a liberal interpretation, even if this appears to be contrary to the express words written in the policy. This is in order to arrive at the logical and true meaning that the parties intended in the policy, and this is naturally the case when a reading of the document as a whole leads us to conclude that the words, in their simple sense, do not represent the intention of the text' (*HaMagen v. Medinat HaYeladim* [15], at p. 572).

At times, this idea is expressed in the rule that it is permissible to depart from the language of the contract if a literal interpretation will lead to an absurd result (see HCJ 932/91 *Central Pension Fund of Federation Employees Ltd v. National Labour Court* [59], at p. 436; see also *Mordov v. Schectman* [10], at p. 482; and CA 72/78 *Israel Land Administration v. Raab* [60], at p. 789). The word 'absurd' is vague. It is not defined. What to one person seems absurd, seems to another a proper arrangement. Indeed, it is usual in case-law to have additional expressions accompany the word 'absurd', such as inconsistency, inconvenience (see the classic expression of this in *Grey v. Pearson* (1857) [74], at p. 1234; see also HCJ 305/82 *Mor v. District Planning and Building Committee, Central District* [61], at p. 148). In my opinion, all that lurks behind these and other expressions is a (literal) meaning that is inconsistent with the purpose of the contract. Literal interpretation leads to absurdity, inconsistency and inconvenience, when it does not achieve the purpose of the contract. Indeed, a judge who interprets a

contract made by the parties may, in special circumstances, change the language of the contract. He will do so in order to achieve the purpose that underlies the contract. Needless to say, this power should be exercised with the utmost care. The court is not allowed to write contracts for the parties. It should respect the requirements of form and the rules of evidence with regard to disproving a document. The activity of the judge in 'amending' the text that was made by the parties must, naturally, be restricted to extreme cases, where the purpose would be thwarted if the language of the document is not changed.

28. Indeed, my colleague Justice Mazza acted in this way when he interpreted the programme contract. Clause 6(h)(2) of the programme contract provides:

> 'Should the purchase undertaking be invoked more than 18 months after the end of the performance period, an amount of 2% shall be deducted from the apartment price, that will be determined as stated in sub-clause (f) above, for each month after the end of the period of 18 months as stated.'

It appears from the language of this clause that the reduction of 2% applies 'should the purchase undertaking be invoked more than 18 months after the end of the performance period'. There is no hint in this clause that this provision is restricted to the desirable areas (type A). According to its language it is a general provision that applies in any case where a purchase undertaking has been invoked more than 18 months after the end of the performance period. Notwithstanding, my colleague was prepared to restrict the application of this provision to the first type of buildings only. This approach seems to be based on his interpretation of clause 6(h)(3). The meaning that my colleague attributes to clause 6(h)(3) which applies expressly to buildings in development areas (type B) led him to read into clause 6(h)(2) a restriction of its application to type A only. This interpretative approach (in the wide sense) is proper. A contract should be read as a complete and unified document. We must aim for a correspondence between its various parts. One provision should not be singled out and regarded as the whole picture:

> A contract is an integrating framework. Its different parts are combined and entwined with one another. Its various limbs affect one other.' (my opinion in *Atta v. Estate of Zolotolov* [1], at p. 305).

Therefore, the interpreter may read into a provision of a contract additional words that are not found in it, or he may delete existing that are in it, in order

to give the provision of the contract a meaning that achieves the purpose of the contract as one unit, which seeks to achieve a known purpose. Indeed, I think I am not wrong if I say that if the location of clause 6(h)(3) of the programme contract had been, like that of clause 6(h)(2), after the existing clause 6(g), my colleague would have had no difficulty in determining that there would be a basis for some change in the language of the clause, so that it could be interpreted to apply to a delay in performance. In my opinion, we should arrive at the same result even within the framework of the existing location of the clause.

29. Indeed, one should adopt interpretation (in the broad sense) in order to construe clause 6(h)(3). The construction given to this provision in accordance with its language misses the purpose underlying the contract. It deprives the State of a central sanction that the contract sought to grant it, and which was designed to ensure its central purpose — the quick construction of apartments for immigrants in development areas and offering them for sale on the open market. The literal interpretation of the provision of clause 6(h)(3) leads to two anomalies: *first*, it creates a repetition with regard to invoking the undertaking after the end of the performance period. As we have seen, this issue is covered (with regard to both types of apartments) in sub-clause (2). The literal interpretation of sub-clause (3) leads to a situation where an opposite arrangement with regard to the very same matter, for apartments in development areas, is found in sub-clause (3). There is also no logical explanation for the change in the ranking of the two types of apartments. From the perspective of the order of the contract, it would have been proper — according to the interpretation given to sub-clause (3) by Justice Mazza — to have sub-clause (3) precede sub-clause (2), since according to its contents it applies to invoking the undertaking after the end of the performance period, whereas the provision of sub-clause (2) applies to invoking the undertaking after eighteen months. It would only be natural to discuss invoking the undertaking after the performance period next to sub-clause (1) which discusses similar material. *Second*, and this is the main issue, a literal interpretation of the provisions of clause 6(h)(3) results in the basic purpose of the contract being undermined. While the 'benefit' aspect of the contract applies fully to both types of apartments , the 'sanction' aspect is truncated, and it operates only with regard to one type of apartments. The internal equilibrium of the contract collapses. Its internal structure fails. The 'carriage' conveying the contract loses one of its four wheels. In these circumstances, it is legitimate for a judge — as did my colleague Justice D. Levin — not to read sub-clause (3) literally. To this end, a judge may amend the language of the

clause in order to achieve the (business) aim that underlies the contract. The following remarks of Lord Diplock are appropriate to our case:

> '… if detailed semantic and syntactical analysis of words in a commercial contract is going to lead to a conclusion that flouts business commonsense, it must be made to yield to business commonsense' (*Antaios Compania S.A. v. Salen A.B.* [72], at p. 201).

Filling a lacuna in a contract

30. A legal norm may be incomplete. This is a norm that contains a lacuna or an 'empty space'. There is a lacuna in a norm where the legal arrangement is incomplete, and this incompleteness conflicts with the purpose of that norm. 'A lacuna exists where the legislative arrangement is incomplete, in a way that conflicts with its purpose' (my opinion in BAA 663/90 *A v. Bar Association Tel-Aviv District Committee* [62], at pp. 404-5). Not every silence of a normative arrangement about a particular issue constitutes a lacuna for that issue. The silence of a norm speaks in different ways. At times, silence constitutes a 'negative arrangement', i.e., the silence is an expression of a purpose that precludes a specific arrangement. This is known as 'intentional' silence (see HCJ 4267/93 *Amitai — Citizens for Good Government and Integrity v. Prime Minister* [63], at p. 457). Sometimes, silence amounts to not taking a stand on a specific issue, while leaving its arrangement to the normative systems that are outside that norm. But sometimes silence points to a lacuna. The author of the norm built a normative wall, but forgot to complete it (see W. Canaris, *Die Feststellung von Lücken im Gesetz*, Berlin, 1983, at p. 25). A judge reaches the conclusion that a legal norm contains a lacuna as a result of interpretation activity (in the narrow sense). The judge interprets the legal text against the background of its purpose. He reaches the conclusion that the silence of a legal arrangement for a certain issue constitutes an omission in that issue:

> 'Interpretation is, therefore, a process that precedes completion. Only when the judge is satisfied that the parties did not agree with regard to the omission, and he reaches this conclusion by interpreting the contract — only then may he resort to the process of filling it' (Friedman & Cohen, *Contracts*, *supra*, at p. 270).

31. Is a judge permitted to fill a lacuna in a legal norm? The answer to this question varies in different legal systems. It depends on the tradition of the legal system. It is determined by its legal culture. Sometimes, it is resolved by

an express provision of statute. The law in Israel is that a judge may fill a lacuna in legislation (s. 1 of the Foundations of Justice Law, 5740-1980). In doing this, the judge interprets the legislation (construction in the narrow sense). He reaches the conclusion that the statutory norm contains a lacuna. He fills the lacuna. He adds additional text to the text of the statute, which fills it. This is 'supplementary interpretation', or interpretation in the broad sense.

32. Is a judge permitted to complete a lacuna in a contract? The answer of the Israeli legal system to this question is yes. I discussed this in one case, where I said:

> 'At times, there is no answer (positive or negative) to the question, which requires a determination, in the text itself according to its construction (in the narrow sense). In this situation, it is possible in appropriate cases to add to what is stated in the contract provisions that are not in it… in all of these we are not construing an existing contractual norm, but we are adding a new contractual norm. We are therefore concerned with interpretation in its broad sense' (*Borchard Lines v. Hydrobaton* [28], at p. 224).

In another case, I added:

> 'Interpretation of the contract by the court is done in two stages. In the first stage — which we have called interpretation "in the narrow sense" — the judge tries to make the most of the contractual text. This stage is governed by section 25 of the Contracts (General Part) Law. In the second stage – which we have called interpretation "in the broad sense" — the judge fills a lacuna that was discovered in the first stage. This lacuna exists only if the construction of the contract in the first stage does not give a positive or negative answer to a problem that needs resolving. Where a lacuna is discovered in a contract, the court may fill the lacuna' (*Atta v. Estate of Zolotolov* [1], at p. 303).

My colleague, Justice Mazza, said in one case that the judge may fill a lacuna in a contract, and he continued:

> 'Although this entails a certain degree of judicial intervention in the contractual relationship, no-one would say that, from the perspective of the law of contracts, such an interpretative process is illegitimate' (*Coptic Mutran v. Halamish* [8], at p. 845).

Note that the silence of the contract on a certain issue is insufficient to give the judge authority to complete the contract. '… before filling the lacuna in the contract under discussion, we must first ascertain, from the agreement and from the circumstances, that there is indeed a lacuna, for only then is it possible to fill what is missing with a new contractual norm… because if we are not dealing with a lacuna that the parties to the agreement overlooked at the time of the contract, it is clearly not within the court's jurisdiction to "make a new contract, different in its nature, contents or scope and application from the one made by the parties themselves' (Justice Goldberg in CA 528/86 *Polgat Industries Ltd v. Estate of Yaakov Blechner* [64], at p. 826).

33. What are the guidelines for (judicially) filling the contractual lacuna? What is the legal construction that underlies this process? Of course, the process begins with the activity of interpretation (in the narrow sense). The judge interprets the contract and reaches the conclusion that the silence of the contract on a certain issue constitutes a lacuna — as distinct from a (positive or negative) arrangement or the inapplicability of the contract — for that issue (see R. Ben-Natan (Kleinberger), 'The Law of the Implied Term in Present Law — A further study', 17 *Mishpatim*, 1987, at p. 571). This conclusion gives rise to the question: how is the lacuna in the contract to be filled? Professor Farnsworth discussed this as follows:

> 'Interpretation is necessarily the first step in that process, since a court will supply a term only after it has determined that the language of the agreement does not cover the case at hand. It follows that any term that a court would supply can be derogated from by agreement of the parties, either explicitly or by necessary inference. Such terms are therefore suppletory rather than mandatory' (Farnsworth, *On Contracts*, *supra*, at p. 303).

When the judge reaches the conclusion that the contract has a lacuna, how should he fill it? In the past, filling a lacuna was done according to the doctrine of the 'implied term'. This doctrine was imported into Israeli law from English common law, by way of the 'import conduit' of section 46 of the Palestine Order in Council, 1922 (see, for example, CA 39/47 *Asher v. Birnbaum* [65], at p. 539). The courts developed a number of tests — like the officious bystander test or the business efficacy test — that assist in determining whether an implied term may be read into a contract, thereby filling what the parties omitted (see Shalev, *supra*, at p. 294). Since the enactment of the Contracts (General Part) Law, there is no longer any place for this construction of implied clauses to fill a contractual lacuna. The

Contracts (General Part) Law established another tool — of greater strength and more general applicability — for filling a lacuna in a contract. This is the principle of good faith provided in section 39 of the Contracts (General Part) Law. I discussed this in one case as follows:

> 'But what is the law in the absence of an express provision? Some of these questions can be answered using "ordinary" interpretation (or construction in the narrow sense), i.e., understanding the meaning of the contractual text in view of the intentions of the parties ("the purpose of the contract", see section 25(a) of the Contracts (General Part) Law). Some of the questions have no answer in the contractual text that the parties themselves made. "Supplementary interpretation" (or construction in the broad sense) is required, i.e., filling the lacuna that exists in the contract between the parties. This omission is filled by custom (s. 26 of the Contracts (General Part) Law) and by non-binding provisions in legislation (for example, sections 41, 44, 45, 46 of the Contracts (General Part) Law). In the absence of external supplementary provisions, the lacuna is filled by the principle of good faith' (s. 39 of the Contracts (General Part) Law) (*Haifa Quarries v. Han-Ron* [43], at p. 312).

In a similar vein, my colleague, Justice Mazza, referred to 'the principle of good faith as a supplementary norm for filling a void' in a contract (*Coptic Mutran v. Halamish* [8], at p. 845). Ben-Natan also refers to this possibility in his excellent article on this subject (Ben-Natan, *ibid.*, at p. 590). An important question — on which I wish to reserve judgment — is whether filling the lacuna by means of supplementary interpretation precedes filling it by means of accepted practice and by means of regulatory provisions of statute (of a non-binding nature) enshrined in legislation — see, for example, sections 41, 44, 45, 46 of the Contracts (General Part) Law — or should it be used only after filling the lacuna (if this happens) by means of accepted practice and by means of regulatory provisions of statute were insufficient to fill the lacuna.

34. What does the principle of good faith imply with regard to filling a lacuna in a contract? The normative message that arises from the principle of good faith for filling a lacuna in a contract is that the contractual lacuna should be filled in a way that achieves the (subjective and objective) purpose of the contract. We should start with an attempt to complete the contract

according to the joint subjective purpose of the parties ('the intentions of the parties'). Professor Farnsworth discussed this as follows:

> 'If the court is persuaded that the parties shared a common expectation with respect to the omitted case, the court will give effect to that expectation, even though the parties did not reduce it to words…' (Farnsworth, *supra,* at p. 305).

If this attempt fails — should the joint subjective purpose ('the intentions') of the parties be unknown, or should it be irrelevant to the problem requiring a decision — the lacuna in the contract should be filled according to the objective purpose of the contract. As Professor Farnsworth states, *ibid.*:

> 'However, if the parties' expectations were significantly different or if one party had no expectations, the court will substitute for the subjective test of shared expectation an objective test…'

In both cases, we must act according to the criterion of fair contracting parties. Good faith is not designed to change the contractual arrangement. It does not aim to make a new contract for the parties. Its purpose is to fill what the parties omitted. For this purpose, it follows the guidelines that the parties determined, according to their internal logic. The court uses, for this purpose, the criteria and premises that the parties themselves determined. It seeks to maintain the contractual balance that the parties determined between themselves. With reference to filling a lacuna with regard to the revaluation of a contractual obligation, Justice Mazza said:

> 'Reliance on the principle of good faith as a supplementary norm is permitted even for attributing an intention to revaluate. Clearly, it is not possible to interfere with the terms of the contract in this way if interpreting it according to the intentions of the parties shows an intention that the obligations should not be revaluated. But interpretation of the contract, from within and according to the circumstances in which it was made, does not indicate a probable intent of this kind, and if sticking to nominal values will clearly breach the equilibrium of the mutual interests that found expression in the terms of the contract or which are implied by the circumstances the prevailed at the time of making it, the principle of good faith may fill the lacuna in the contractual stipulation' (*Coptic Mutran v. Halamish* [8], at p. 846).

The principle of good faith does not aim to transform a defective arrangement into a proper one. It aims to achieve, according to the guidelines

laid down in the existing contract, what the parties omitted. It aims to remedy a 'clear breach of the equilibrium of mutual interests' (in the words of my colleague, Justice Mazza, in *Coptic Mutran v. Halamish* [8], at p. 846), created by the existence of the lacuna and its not being filled. It does not aim to create a new justice between the parties. It aims to give expression to the contractual justice that the parties determined.

35. In this context, I would like to make two observations: *first*, the principle of good faith has various ramifications in the life of the contract. As implied in my opinion, the principle of good faith has three aspects for the purposes of contractual interpretation. The first aspect is that good faith requires the contract to be given a meaning that is consistent with the joint intentions of the two parties. This aspect of the principle of good faith affects the subjective purpose of the contract (see paragraph 10 *supra*). A second aspect is that a contract should be given a meaning that is consistent with the basic principles of the legal system (such as equality). In the context of this aspect good faith has an effect on the objective purpose of the contract (see paragraph 18 *supra*). The third aspects concerns filling a lacuna in a contract. This aspect assumes that the contract was interpreted (while taking account of the principle of good faith) and the result of the interpretation is the existence of a lacuna. Now, the principle of good faith appears in a new garb, this time with regard to filling a lacuna. This is the aspect that we are addressing now. This aspect is connected with the general approach that the principle of good faith is not restricted merely to outlining a proper method of performing contractual obligations, but it also constitutes a source for adding rights and duties to the existing contract. '… section 39 of the Contracts Law may impose additional duties on the parties to the contract that are not mentioned in the contract itself, but which are required by the need to bring about the realization of the contract according to accepted practice and in good faith…' (my opinion in HCJ 59/80 *Beer-Sheba Public Transport Services Ltd v. National Labour Court* [66], at p. 836). Likewise —

> '… the provisions of section 39 of the Contracts (General Part) Law is a "majestic" multifaceted provision. Sometimes it imposes duties that are not expressly mentioned in the contract between the parties…' (my opinion in *Yavin Plast v. National Labour Court* [32], at p. 708).

Within this framework, and as one of its aspects, the principle of good faith is seen as filling a lacuna in the contract. Alongside these three (interpretive) aspects, the principle of good faith has additional influence on the life of the

contract. (See A. S. Hartkamp, 'Jurisdictional Discretion Under the New Civil Code of the Netherlands', 40 *Am. J. Comp. L.*, 1992, 551 at p. 554). Thus, for example, it has the power to change the express language of the contract, 'while changing the contractual obligation itself' (*Atta v. Estate of Zolotolov* [1], at p. 300) or to restrict the exercise of a contractual right. We should distinguish well between these different ramifications — some of which are of a non-binding nature and some of which are of a binding nature — of the principle of good faith. A good example of a proper distinction between the different aspects of the principle of good faith is the 'revaluation' that my colleague, Justice Mazza, discussed in *Coptic Mutran v. Halamish* [8]). My colleague said in that case, that a contract may be revaluated, by virtue of the principle of good faith, by means of interpretation (in its narrow meaning). This was done in *Atta v. Estate of Zolotolov* [1]. The rules of revaluation can be formed on the basis of the principle of good faith as a principle of supplementary interpretation (filling the lacuna — interpretation in the broad sense). This was done in *Coptic Mutran v. Halamish* [8]. Revaluation may be done by virtue of the principle of good faith, as a principle 'external' to the contract, without any interpretative nature, but expressing its binding power to change the contents of the contract.

36. *Second*, the principle of good faith, which the court uses to fill a lacuna in a contract, serves the role in the life of the contract that in the past was filled by implied terms. This issue arose in one case where Justice H. Cohn said:

> '… since the Sale Law, 5728-1968, and the Contracts (General Part) Law, 5733-1973, came into effect, I fear that we no longer read implied terms into contracts — or at least we no longer call them implied terms' (CA 627/78 *Weizman v. Abramson* [67], at p. 298).

We should pay attention to this cautious language. Indeed, the problem of a lacuna in a contract, which the doctrine of the implied term aimed to solve, did not disappear when the Contracts (General Part) Law was enacted. The existence of lacunae is inherent to the existence of contracts. It is a result of the shortcomings of men, who are unable, and are sometimes even unwilling, to predict and prepare for what may happen. Notwithstanding, a change has occurred in the legal approach to the technique of solving the problem. Justice H. Cohn rightly said that, since the enactment of the Contracts Law, 'we no longer call them implied terms' (*ibid.*). The normative process is no longer that of inserting an implied term into the contract, but of filling a lacuna in a

contract according to the principle of good faith. That is what Justice H. Cohn did in that case, stating that:

> '… I too see the answer to the legal question in the provisions of the law that require good faith in performing a contract…' (*Weizman v. Abramson* [67], at p. 299).

The tests created by case-law — before the Contracts (General Part) Law was enacted — with regard to an implied term must be examined to discover to what extent they conform to the principle of good faith. If they are consistent, there is no reason not to use them as subsidiary tests in defining good faith. In any event, I do accept the approach that, since the enactment of the Contracts (General Part) Law, the only means for filling a lacuna in a contract is accepted practice (prescribed by section 26 of the law) or supplementary provisions prescribed by statute. These are tools that are limited in their application. There is a need for the principle of good faith as a criterion for filling a lacuna in a contract.

From the general to the specific

37. Does the programme contract contain a lacuna in so far as the civil 'sanction' for a delay in performance in development areas (type B) is concerned? The answer to this question depends, of course, on the interpretation (in the narrow sense) of the programme contract. If we follow my approach, that contractual interpretation — by changing the language in order to achieve its purpose (paragraph 25 *supra*) — leads to the conclusion that clause 6(h)(3) of the programme contract refers to a civil sanction for a delay in performance, then the programme contract does not contain a lacuna in this respect, and there is no basis to fill it. The result is that filling in a lacuna in this case can only be considered on the basis of the assumption, with which I do not agree, that interpretation of the contract leads to a conclusion that clause 6(h)(3) of the programme contract deals only with invoking a purchase undertaking that occurs after the end of the performance period. According to this assumption — which is the assumption of my colleague, Justice Mazza, does the contract contain a lacuna, can it be filled, and what is the result of filling it?

38. It seems to me that on the basis of the premises that were adopted by the trial court and by my colleague, Justice Mazza, there is a lacuna in the programme contract with regard to a (civil) sanction for a delay in building the apartments in development areas. The trial court commented about this that:

> 'It should be noted that if we do this, and accept the interpretation of counsel for the State, then there will be a lacuna of a clause providing a sanction for a delay in invoking the purchase undertaking. Either way, there will be a lacuna of one clause. If so, it is better to leave this sub-clause in its context and with its plain meaning.'

Indeed, as the trial court rightly noted, if the trial court's interpretation is accepted, there will be a lacuna of a clause for a sanction for delay in performing the building of apartments in development areas. By contrast, the trial court made a mistake — and this mistake was repeated also by my colleague, Justice Mazza — by holding that if the position of the State was accepted, there would be a lacuna for a clause providing a sanction for a delay in the demand to invoke the purchase undertaking for apartments in development areas. The sanction for a delay in the demand is found in clauses 6(h)(1) and (2) of the programme contract, which state:

> '(1) Should the purchase undertaking be invoked after the end of the performance period, the interest shall be calculated as stated above only until the end of the performance period;
>
> (2) Should the purchase undertaking be invoked more than 18 months after the end of the performance period, an amount of 2% shall be deducted from the apartment price, that will be determined as stated in sub-clause (f) above, for each month after the end of the period of 18 months as stated.'

These two sub-clauses apply to all the apartments. They are not limited merely to type A apartments. Therefore, we indeed find in these sub-clauses an arrangement regarding a delay in invoking the undertaking for type B apartments, and there is no lacuna in this respect. However, by giving sub-clause (3) a meaning whereby it too refers to invoking the purchase commitments after the end of the performance period, we create, on the one hand, an unexplained repetition (which requires us to restrict the scope of application of sub-clause (2) to type A apartments only, contrary to its language), and on the other hand a lacuna is created with regard to a delay in performance — and not a purchase demand — for apartments in development areas (type B). The trial court was aware of the 'lacuna' that was created. Its solution was as follows:

> 'And if you say: is it possible that a delay in performing the projects of the type under discussion can be left without any

> sanction? It is possible that the answer lies in the law of contracts. As with any contract where there is no special sanction for a particular breach, the party injured by the breach is entitled to prove his damage and receive compensation from the party in breach.'

This answer is unsatisfactory. There is no basis — within the framework of the purpose of the programme contract — for the assumption that this central issue was left merely to the application of the general laws of compensation. What reason could there be for leaving the sanction for a delay in building the apartments in development areas to (lengthy) litigation in the courts, while at the same time providing for a 'civil sanction' — that involves an element of 'do-it-yourself' — for a delay in building the apartments in desirable areas? This distinction makes no business sense, it contradicts the (objective) purpose of the programme contract and it cannot be held to be the purpose of the contract.

39. Indeed, an examination of the programme contract according to the test applied by Justice Mazza leads to the conclusion that this contract does contain a lacuna with regard to the (civil) sanction in the event of a delay in performance in the desirable areas (type A). As we have seen (in paragraph 16 *supra*), the programme contract distinguished between two types of project: the building of apartments in desirable areas (type A) and the building of apartments in development areas (type B). For each of these two kinds the contract provided performance dates and dates for invoking the State's undertaking to buy the apartments that would not be sold on the open market. An incentive mechanism was prescribed to speed the building of the two types. A sanctions mechanism was also prescribed for the case where the purchase undertaking was invoked after the performance for both types. And to our surprise, with regard to the (civil) sanction for a performance delay, an arrangement was prescribed for a delay apartments in desirable areas (type A) but no arrangement was prescribed for a performance delay in development areas (type B). My colleague even stated — within the framework of the alternative argument — that he tends towards the opinion that this situation is inconsistent with the business purpose and the commercial logic of the programme contract. Indeed, the carriage of the programme contract is missing its fourth wheel. The contract — according to the interpretation given to it — is not balanced. It has no internal logic. It has no business logic. The thinking processes developed in it, if followed logically, should lead to the existence of a civil sanction also (and mainly) in the event of a building delay

in development areas (type B). The silence of the programme contract with regard to the (civil) sanction for a building delay in development areas is not evidence of a negative arrangement. It also does not indicate the absence of an arrangement, which would leave the matter to the general law. This conclusion is inconsistent with establishing a (civil) sanction in the event of a building delay in desirable areas. Indeed, the silence of the programme contract — according to the interpretation of my colleague, Justice Mazza — with respect to a delay in carrying out the building in development areas conflicts the purpose of the programme contract; the programme contract is incomplete without this arrangement, and this incompleteness conflicts with the purpose of the programme contract. We therefore have a lacuna in the programme contract.

40. How will the lacuna in the programme contract be filled? No accepted practice has been proven in this respect. Filling the lacuna will therefore be done according to the principle of good faith. The question is what arrangement would fair parties have prescribed in the programme contract, on the basis of the internal structure, internal logic, and basic assumptions of the programme contract? It seems to me that the answer is that the natural arrangement implied by the internal structure of the Programme Contract is the one provided in clause 6(h)(3), i.e., a deduction of 5% from the demanded price for every month of delay in performance. In this way, we establish contractual symmetry between a delay in invoking the purchase guarantee and a delay in performing the building. In both cases, a certain percentage is deducted from the price of the apartment; in both cases the deduction in desirable areas is 2%; in both cases the deduction in development areas is 5%. Contractual equilibrium is restored. The contractual carriage regains its missing wheel. It may set out on its way.

41. With regard to filling a lacuna in the programme contract, I would like to make two comments: *first*, this construction is, from my perspective, merely an alternative one. The main solution in my opinion is one that interprets clause 6(h)(3) of the programme contract as a legal source for a (civil) sanction for a delay in carrying out the building in development areas. This interpretation is achieved by altering the language of the contract (see paragraph 26 *supra*), in such a way that the provisions of clause 6(h)(3) apply (directly) to a delay in performance. I discussed the construction of filling a lacuna merely to show that, even following the approach of my colleague Justice Mazza, we should accept the position of the State. I am aware that the two solutions (interpretation and filling a lacuna) — although they result in the

same conclusion in the case before us — may lead to different results in other cases. Thus, for example, if the contractor is late in invoking the undertaking in development areas, the question is whether the reduction should be 5% for each month after the performance period (the approach of my colleague Justice Mazza) or 2% for each month after 18 months have passed from the end of the performance period (the approach of my colleague, Justice D. Levin, as well as my own). *Second*, the construction of filling a lacuna was not raised in the District Court. It was also not raised before us. In my opinion, it should be seen merely as an aspect of interpretative examination (in the broad sense) that was considered in both courts. Notwithstanding, because no arguments were presented on this issue — and in view of the difference between 'ordinary' interpretation and 'supplementary interpretation' — I do not wish to rely on this construction in the judgment. As stated, it was only discussed to show that even according to the interpretative premises (in the narrow sense) of my colleague, Justice Mazza, the appeal should be allowed.

For these reasons I agree with the reasoning of my colleague, Justice Levin, and the conclusion that he reached, that the appeal should be allowed.

Appeal allowed by majority opinion (Vice-President A. Barak, Justice D. Levin), Justice E. Mazza dissenting.

6 Nissan 5755.

6 April 1995.