The long or short of it: Contract law and the interplay between words, customs and behaviour*

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1. Some background

We, the writers of the below, decided to cooperate with respect to the present article. We have both in various contexts been involved in the drafting of contracts subject to both Swedish and English law.

As is well-known, contracts may turn out to involve disagreement related to their interpretation. Words may mean different things depending on the context, including the commercial or trade setting in which a particular contract is concluded. Different issues may form part of a contractual pattern, where several factors may play a role, which at least to some extent varies between jurisdictions. Aside from what can be established in a semantic exercise, contractual patterns harbour a variety of issues, where trade usage as well as the behaviour by and between the parties may play a role in the search of meaning.

Such factors taken together thus form one basis for the understanding of a contract. These are issues which may have to be considered by a judge, and in his capacity as Supreme Court Justice Svante O. Johansson has had to take related matters into regard in certain cases, and they have also had an impact, where his role as researcher or arbitrator has been involved. Whether this might also be true in those cases where he acted as average adjuster may be more doubtful.

This is the reason why in the present article in his honour we have chosen to approach certain questions that may arise in the context as now outlined.

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Especially, the interplay between contract drafting, interpretation and what can broadly be referred to as market practice in English and Swedish law has played a role with respect to our considerations below. Our perspective has moved between the use of more specific wording, and the impact of a particular commercial setting, which along with other factors may give rise to an overall understanding of the intention of the parties.

In order for a contract to be effective, it should be clear and unambiguous. This may well generally appear as evident to the parties in the negotiation phase and when concluding a contract. In some cases, ambiguity may emerge with the passage of time.

In their negotiations the parties would typically see the concluded contract as beneficial to both of them, since this, at least as a basic principle, seems to be what the parties try to achieve. Even so, they may under certain circumstances decide not to try to come to a clearly pronounced common solution with respect to certain issues, because they find themselves unable to reach such solution.[1] Parties may hence consciously choose to conclude a contract knowing that there are issues where they disagree. They may also consider it awkward in the negotiation phase to discuss negative scenarios, or to suggest that either party may in the future be in breach or default. Bringing such contingencies up may be felt to suggest or create a lack of trust.[2]

Another point is that for different reasons the parties may, further down the line, no longer agree with respect to their contractual rights and obligations.

If courts or arbitrators would then be involved to solve the differences between the parties, they will have to apply various approaches. In this perspective, the analysis will be based, inter alia, on what the parties have wished to achieve by the contract, how they have formed such wishes into different contractual provisions, and the unravelling of various circumstances related to the performance of the contract. In this contribution, we discuss how the parties' drafting strategies influence, and are influenced by expectations of, that analysis.

[1] This is a situation which Jan Ramberg in *Medveten otydlighet som avtalsrättsligt problem*, Juridisk Tidskrift (JT) 1992–93 p. 358 referred to as "medveten avtalsotydlighet" (in English roughly "consciously chosen ambiguity"). Also see Bernheim, B.D. & Whinston, M.D., *Incomplete Contracts and Strategic Ambiguity*. American Economic Review 88(4): 902–932 (1998).

[2] Halonen-Akatwijuka, M. & Hart, O., *More is Less: Why Parties May Deliberately Write Incomplete Contracts*, Cambridge University Press (2024) p. 2.

In another perspective we were influenced by a recent study, where Ryan Catterwell proposes a unified approach to contract interpretation. The study is, in our view, an interesting contribution to elucidate how the adjudicator may arrive at an understanding of wordings used in specific contracts and the impact of such understanding.[3]

Catterwell describes contract interpretation as a "technique employed to infer objective intention from the choice of words in a contract. It is the primary means through which the rules in a contract are defined. It is how the court determines what the parties intended by choosing the words in the contract."[4]

We do not suggest that the findings of Catterwell may be applied with respect to Swedish conditions without considering the differences between the two jurisdictions, but we believe that his ideas may be useful in a perspective beyond common law.

In his study Catterwell i.a. takes into account the development of wordings used in specific trades or businesses, but which have also evolved between certain contracting parties. He reviews cases from different common law jurisdictions, as a result of which certain lines of development appear.

Catterwell sets out the following meanings related to contractual wording as used in different contexts:

1) Ordinary meaning.
2) Customary and trade meaning.
3) Scientific or technical meaning.
4) Meanings for foreign or invented terms.
5) Party-specific meanings (i.e. meanings for words that are unique for the parties).
6) Statutory meanings, both presumed and contextual.
7) Legal meanings (i.e. legal terms of art).
8) Meanings derived from precedent.

[3] Catterwell, R., *A unified approach to contract interpretation*. Hart Publishing 2022 (paperback) (first published in 2020). His study is based in common law, in his case with a basis in Australian law, and this means that he has used as sources a great number of cases appearing in common law jurisdictions. For comparative purposes cf. also sections 1 and 2 in the Unidroit Principles of Commercial Contracts (2016) (below PICC), covering various general provisions in relation to contract law and various principles related to the interpretation of contracts.

[4] Catterwell p. 10 et seq.

Obviously, these are meanings arising in different contexts where the judge or arbitrator will have to determine how a particular phrase or word has been used in the individual contract. In an overall perspective, it would seem possible to adopt a similar approach in a Swedish contract law context. Since much fewer cases are available in Swedish law however, it may be somewhat more cumbersome to find enough examples to establish a sufficient basis.

Our considerations follow more haphazardly our respective experiences. Hence, it may be of some interest to see the use of different words in the various contexts in which they are applied, since words or expressions may not always mean the same thing, neither more generally where contract parties would set out their views in a particular respect and context nor with regard to different trades. This is also how we have understood relevant parts of the Catterwell study in view of our considerations.

2. Some overriding considerations with respect to the interpretation of contracts in Swedish and English law

2.1 Different weight traditionally given to the objective wording of a contract

It is, of course, impossible to outline in few words the differences between Swedish and English law concerning the respective approaches to contract interpretation. In the circumstances, however, it is justified to briefly account for certain basic differences and similarities. The common law perspective is ubiquitous in relation to agreements concluded in an international commercial or financial context, where English language documents and English or U.S. trained lawyers continue to exercise a significant influence on legal practice.[5]

Under both Swedish and English law, contract interpretation aims to establish the parties' agreement. However, the routes leading to a conclusion differ, especially for written B2B contracts. Different jurisdictions may weigh and balance interpretation factors differently.

In their approach to finding the proper meaning of the contract both English and Swedish courts would generally try to establish the intention of

[5] Pistor, K., *The Code of Capital*, Princeton (2019) p. 143. See also Wood, P. R., *International loans, bonds, guarantees and legal opinions*. Sweet & Maxwell, 3rd ed. (2019) p. 47 et seq.

the parties, which is, however, in many cases hard.[6] As a point of departure however, English courts would to a higher degree use the wording of the contract to establish its meaning, whereas Swedish courts would use a broader spectrum of circumstances when deciding the meaning of the contract. In a Swedish law setting, the wording of a contract plays an important but far from exclusive role.[7]

Furthermore, aspects of reasonableness and the impact of good faith reasoning in Swedish law play a more important role both in the interpretation and following the use of art. 36 in the Contracts Act.[8] This represents a difference in approach traditionally ascribed to Swedish and English law. Even if, as the following paragraphs will demonstrate, there is some narrowing down with respect to those differences they probably still exist. Furthermore, even though differing views remain among English judges and lawyers regarding the principles applicable, concepts such as "certainty" and "foreseeability" are still often referred to in judgments related to the interpretation of contracts.[9]

6 See for instance Adlercreutz A., Gorton L., & Svensson, O., *Avtalsrätt II*, 7th ed. Lund, 2024 in 2.4.3. A similar approach is referred to in the Unidroit Principles of International Commercial Contracts (PICC 2016) sec 2.1.17 and 2.1.18.

7 See e.g. *Pacific Gas & Elec. Co v. G.W. Thomas Drayage & Rigging Co.* 442 P.2d 641, 645 (Cal. 1968) (Traynor, J.) and conversely the Swedish Supreme Court in NJA 2024 p. 52: "In the interpretation of a term in a standard insurance agreement, one must consider a number of factors. The central aspect is often the wording of the disputed term, primarily the objective meaning based on its normal linguistic meaning. When the wording based on its normal linguistic meaning is open to different interpretation, guidance may be sought from…." (our translation). See also Johansson, S.O., & Herre. J., *Svensk rättspraxis: Avtals- och obligationsrätt, 2005–2019*. SvJT p. 868: "The wording constitutes a limit to the interpretation. In cases regarding the interpretation of contract, the court does not readily go further than what the wording allows." (our translation). See Adlercreutz et al. p. 123 et seq. and also Ramberg, C. & Ramberg, J., *Allmän avtalsrätt* 12th ed. Norstedts Juridik (2022) p. 169 et seq.

8 The Contracts Act herein refers to *lag (1915:218) om avtal och andra rättshandlingar på förmögenhetsrättens område*. In a very broad perspective reference may be made to Skarpsvärd, M., *The costs of legal certainty. A forensically informed methodology on how to identify the relevant costs in exclusionary abuse cases*. Stockholm 2023 (diss.) Even if the study mainly covers competition law aspects there may also be certain viewpoints which may have an impact with respect to the understanding of unreasonableness in a contract law perspective.

9 So, for instance Cartwright, J., *Contract law: An introduction to the English law of contract for the civil lawyer*. Electronic version 23-08-24. In his treatise Cartwright approaches the law of contract in a somewhat different way than in more traditional law textbooks. He involves himself with issues related to negotiations through the contracting procedure, and he approaches several of the matters, which we also discuss in this brief article.

Since we have fallen back primarily on certain international business contracts where English law has played a particular role, there may arise differences in the approach and the outcome of interpretation disputes where English law and Swedish law respectively would be applied. These differences have also formed a basis for our thoughts below. So, we shall give some short summary of how we have understood the English interpretation principles adopted in recent case law.[10]

In the famous case *Investors Compensation Scheme v. West Brownwich Building Society*[11] Lord Hoffmann softened up what used to be regarded as the traditional literal interpretation of a contract and explained: "The meaning which a document (or any other utterance) would convey to a reasonable man is not the same thing as the meaning of its words. The meaning of words is a matter of dictionaries and grammars; the meaning of the document is what the parties using those words against the relevant background would reasonably have been understood to mean."

His explanation has since had an impact with respect to the interpretation of contracts in English law, but there still seems to be some outstanding disunity with respect to how far his more "purposive approach" has been adopted.

In more recent case law, *Arnold v. Britton*[12] Lord Neuberger may have nuanced Lord Hoffman's opinion somewhat when explaining that English courts will focus on the meaning of the relevant words used by the parties "in their documentary, factual and commercial context" in light of a number of considerations.

Further, in the case *Federal Republic of Nigeria v. JP Morgan Chase Bank NA* Professor A Burrows, sitting as a High Court Judge, summarized the modern approach to contract interpretation considering the following: "The modern approach is to ascertain the meaning of the words used by applying an objective and contextual approach….Business common sense and the purpose of the term …may also be relevant. But the words used by the parties are of primary importance so that one must be careful not to place too

[10] There appeared in English legal literature a prominent debate between Lord Sumption and Lord Hoffman through two important articles. Lord Sumption, *A question of taste: The Supreme Court and the interpretation of contracts*. (2016–2017) 8 The UK Supreme Court Yearbook 74 based on his lecture at Keble College, Oxford (Harris Society Annual Lecture Keble College, Oxford of May 8, 2017) and Lord Hoffman replied to this article in *Language and lawyers*. (2018) 134 LQR 553.

[11] [1998]1 WLR 896.

[12] [2015] 2 WLR 1593.

much weight on business common sense or purpose at the expense of words used and one must be astute not to rewrite the contract so as to protect one of the parties from having entered into it a bad bargain."[13]

In spite of remaining differences in views among courts it seems that in an overall perspective "business common sense" will continue to play an important role in contract interpretation in English law.

Both English and Swedish law recognize the principle that commercial contracts may be agreed irrespective of form (i.e. by tradition oral or written), but particularly large B2B contracts are generally made out in writing. Often B2B contracts also spell out explicitly that the contract shall not be binding upon the parties until signed by them (agreed written form). They also often expressly set out that only what is in the contract (within the "four corners" of the contract) shall be regarded to form part of it. English courts would often set out explicitly that they will not rewrite the contract for the parties.[14] Also, it is often underlined that English courts would not generally apply a requirement of good faith and fair dealing in the parties' negotiations or in their respective performance of the contract.[15]

2.2 The textual approach particularly with respect to loan agreements and bonds

In essence, under English law, if it is clear and obvious within the contract as to the meaning of the wording, the court will not override these provisions even if, on its face, the contract may not make commercial sense. This approach has been reiterated in a recent case in *Dooba Developments Ltd. v.*

[13] In a recent article, Lars Gorton gives an account of the discussion between Lord Sumption and Lord Hoffman and also refers to certain recent English caselaw. See *Ord betyder något – men vad? Lord Hoffmann v. Lord Sumption. Några reflektioner kring avtalstolkning i engelsk rätt och rörande tillämpningen av vissa avtalsklausuler*, JT 2020–21 p. 855 et seq.

[14] See for instance Cordero Moss (ed.), *Boilerplate clauses, international commercial contracts and the applicable law*. Cambridge University Press (2011), where several authors discuss related issues in different perspectives.

[15] In the present days English courts seem to be more prone to accept such requirement of fairness particularly in so-called relational contracts, see e.g. *Yam Seng Pte Limited v. International Trade Corporation Limited* [2013] EWHC 111 (QBD). Cf, however, *Bates v. Post Office* [2019] EWHC 606 (QB), where the court did not imply a duty of good faith, whereas in *Nehayan v. Kent* [2018] EWHC 333 (Comm) it did. Anyhow there still remains a difference between common law and civil law jurisdictions with respect to fairness, and there is also a distinction between different common law jurisdictions, in this respect.

MacLagan Investments Ltd.[16] Here the court held that where the meaning of the words in a contract is clear and unambiguous, it is not necessary to consider commercial common sense.

The textual approach has been particularly prominent in relation to contracts that are entered into between commercial parties in the financial markets.[17] "Textualism" in contract law can be summarized as the view that (a) contractual obligations stem from the objective meaning of the parties' express obligations, (b) writings take precedence over oral communications, and (c) a text's meaning must be inferred from a restricted evidence base (sometimes limited to the "four corners" of the contract itself).[18]

The literal approach used by English courts may be at least partly explained by the fact that debt instruments are traded on a secondary market. The pattern applies not only to bonds but also to B2B bank loans of a certain size.[19] Corresponding principles may be used with respect to other forms of contracts that form part of a web of interrelated rights and obligations even if concluded without much individual negotiations. In the American case *Sharon Steel*, Judge Winter set out:

> "Whereas participants in the capital markets can adjust their affairs according to a uniform interpretation, regardless of whether it is correct or not as an initial proposition, the creation of enduring uncertainties as to the meaning of boiler-plate provisions would essentially decrease the value of all debenture issues and greatly impair the efficient working of capital markets. Such uncertainties would vastly increase the risks and, therefore, the costs of borrowing with no offsetting benefits either in the capital markets or in the administration of justice."[20]

In relation to intricate debt agreements, a focus on determining the mutual intent of the parties might be regarded as inefficient.[21] They often involve intermediaries and multiple parties, many of whom have never directly inter-

[16] [2016] EWHC 2944 (Ch). See also the case *Chartbrook Ltd v. Persimmon Homes* [2009] AC 11.01.

[17] Pandya, S. & Talley, E. L., *Debt Textualism and Creditor-on-Creditor Violence: A Modest Plea to Keep the Faith* (January 4, 2023). European Corporate Governance Institute – Law Working Paper No. 673/2023, p. 1.

[18] Markovitz, D., *The philosophy of Contract Law*, in the Stanford Encyclopedia of philosophy. (2021) (available at https://plato.stanford.edu/entries/contract-law/).

[19] Andrews, O., *Borgenärskollektiv*. Jure (2022) p. 149 et seq.

[20] 691 F2d. 1039 (2 CCA. 1982).

[21] There may be some difference between loan agreements and certain other financial contracts in this respect.

acted with each other. The extensive use of standardized clauses in debt securities, which are widely traded on capital markets, underscores the need for a consistent interpretation of such clauses across different types of agreements and jurisdictions.

At the same time, the constraints on interpretation that follow from a textual or traditional common law approach means that parties become prone to writing ever more extensive documents.[22] Connected to this, a trait that has long been said to characterize B2B contracts under English (and for that matter American) law is that they used to be much longer than Swedish contracts.

We suggest that the underlying differences both in interpretative approach and in the incentives to engage in detailed negotiations may have evened out at least partly in recent times. This also leads us to the question of whether long detailed contracts may contribute to less disputes and will therefore be more business efficient than less elaborate contracts. This will be discussed in sections 4 and 5 below, especially in relation to financial contracts.

2.3 Summary of English and Swedish principles for contract interpretation

As a starting point, courts applying Swedish law as well as those applying English law aim to determine the intention of the parties, if this will be possible to establish, but they will follow somewhat different routes in order to reach a conclusion.

Compared to the English law approach, a Swedish court will generally use a broader spectrum of circumstances when deciding the meaning of the contract, where the wording plays an important but far from exclusive role. Hence, this represents a divergence in approaches traditionally ascribed to Swedish and English courts when interpreting contracts.

These differences may no longer be as clear and obvious as they used to be, and there are also considerable variations in the views on contract interpretation between different common law jurisdictions.

However, in summary, English courts still appear to allow to a higher extent than Swedish courts the freedom of contract to prevail, e.g. in that the parties by various contractual provisions could make sure that what has been agreed between them through the use of various boilerplates will be accepted

[22] For one view on such developments, see Ayotte K. & Badawi, A. B., *Loopholes in Complex Contracts* (September 21, 2023). SSRN: https://ssrn.com/abstract=4579276.

by the courts.[23] It is possible to argue that the Swedish approach may increase the tension between freedom of contract, legal certainty, and what could be described as fairness or a margin for basing judgments on a requirement on the parties to act in good faith.[24]

3. Managing the unknown and directing behaviours in commercial contracts

3.1 What do the contract draftsmen do?

As indicated above, the parties to a contract in their negotiations try to specify, often in some detail, the various provisions to be made part of the contract. Sometimes their negotiations are carried out on the basis of previous contracts between the parties, and frequently there will be some basis in the use of standard contracts.[25]

A particular feature is that at least certain B2B contracts are often very comprehensive and detailed. It is then not always easy during long negotiations of such contracts, sometimes encompassing several different documents, to achieve that they are in all details coherent and unambiguous. The time of the negotiations and the length of a contract may for example lead to contractual issues being covered in different provisions which may turn out to be in conflict with each other.

Related issues are far from unknown with respect to interpretation disputes. Sometimes the parties may have understood the language used in different ways. Such different views may arise with respect to particular general or technical language but also when at a later stage the parties find that they did not mean the same thing, when applying a particular wording used in the contract, or more bluntly they may wish to avoid the contract. So, there may arise various circumstances and views with respect to the understanding of the contractual provisions. Then various steps may also be taken to reduce the risk of misunderstanding or to manage the risks of unforeseen developments.

[23] See i.a. above in footnote 14, Cordero Moss (ed.), where related issues are approached from different angles.

[24] Where in Swedish law art. 36 of the Contracts Act may play a particular role beside the interpretation of the contract.

[25] From an economic perspective, see Hart, O. & Moore, J., *Contracts as Reference Points*, The Quarterly Journal of Economics, Volume 123, Issue 1, February 2008.

It is not unusual that present days' international B2B contracts contain "principles on definitions and interpretation", with a view to creating a common basis for the understanding of the expressions and terminology used in the contract. These may include legal as well as business and technical vocabulary. Those definitions serve to prevent later objections by any of the parties with respect to the effects of the wording used. Some few examples may be mentioned just to give a flavour.

In the Loan Market Association standard forms of facilities agreement (the LMAA), such method is demonstrated by sec. 1 (Interpretation), where a significant number of expressions are listed and defined. They form a basis for the understanding and application of the ensuing contractual provisions.

For example, the word "facility" is specified in the catalogue of defined terms, while cross-referencing the operational provisions where such term is primarily used, notably under the heading "The Facilities" in sec. 2.

> This is an example of how a word may mean something (or nothing in particular) in ordinary language, but carry a significant and well-established meaning in a certain industry. A "facility" is a loan or a credit limit, the utilisation of which is the subject of the agreement in question. Longer term credit may be extended under a term facility, whereas the lenders may cater to a varying liquidity need through revolving or overdraft facilities. The borrower's refinancing risk in the capital markets may be mitigated by a swingline facility, while products related to trade finance can be provided under a guarantee facility. These terms are subject to detailed descriptions to specify the obligations of the parties.[26]

The operational or substantial provisions thus have to be read in conjunction with the sections on definitions and interpretation. Admittedly, the solution chosen is not always easy to follow, and it may take a lot of training to find the way through the documentation. In the end the contractual structure probably serves its purpose, but it must be recognized that the complexity of extensive B2B contracts may lead to problems in the interpretation.

Similar solutions are found in a variety of international standard documents, e.g. the Uniform Customs and Practice related to letters of credit (UCP 600), FIDIC, Orgalime, GAFTA and various contracts designed and

[26] Wright, S., *The Handbook of International Loan Documentation*, Palgrave MacMillan, 2nd ed. (2014) p. 6 et seq. and 78 et seq. Issues related to the LMAA are found in e.g. Mugasha, A., *The law of multi-bank financing. Syndicated loans and the secondary loan market*. OUP 2007 5.03 and 5.04, and Wood, 4-002 – 4.004. The LMA has also produced User's guides to facilitate understanding of the documentation.

drafted by ICC, even if the solutions in the different individual contracts may vary.

> In relation to the UCP 600 and URDG [Uniform Rules on Demand Guarantees] reference may e.g. be made to the development of the ISBP [International Standard Banking Practice], where continuous updates are being made with respect to the understanding of the various contractual provisions applied. This is an interesting representation of how the wording in certain contracts should be understood and applied where new considerations are called for in order that expressions and words will be gradually better explained. Such procedure may involve legal questions, such as whether and to what extent courts may be bound by such gradually developing interpretation patterns.

The vocabulary of a B2B contract is often based on wording which may appear as reasonably clear in an overriding legal sense but which may not be sufficiently unambiguous without specifying in more detail the understanding thereof when applying it in relation to individual contracts. Also, contracting parties will often fall back on wordings that are reasonably understandable but perhaps not sufficiently precise to be applied without further ado, and that do not prevent differences in opinion between the parties.

As a complement to elaborating on the more technical terms, parties often use less precise expressions such as "efforts" or "endeavours", "in the discretion of" or "in the reasonable discretion of".

The parties may not mean exactly the same thing by such expressions at the outset. Further, the time between the making of the contract and the moment when there is a dispute may have involved some kind of change with respect to their respective understanding (or as indicated above their willingness to perform in accordance with the contract). Hence the language such as "endeavour" means something different than "reasonable endeavour" and "best endeavour" respectively depending on the context, but there may not be any exact common understanding in the case involved.[27] Further, one

[27] As a recent example the Supreme Court Mur Shipping case could be mentioned (*RTI Ltd. v. MUR Shipping BV* [2024] UKSC 18). In this case there was a force majeure clause also containing a "reasonable endeavours" provision, in spite of which the Supreme Court reached the conclusion that the shipowner was not obliged to accept a payment in euro instead of in USD even where the charterer had also undertaken to meet all costs and also any shortfall in exchange rates. This would probably be a case where one might assume that a Swedish court applying Swedish law would have come to a different conclusion.

judge may have a different view compared to another when approaching a related dispute.[28]

Generally, these types of contractual provisions will be used in connection with and related to more specific wording. The particular words will be used in conjunction with language such as "x units shall be delivered to…", but in order to reach a better result the parties then also further agree to an obligation to achieve a minimum quantity but including also a further obligation to use "best endeavours" to achieve something more.[29] This would generally mean that the fixed number of units shall be produced and delivered, but the seller, distributor etc. will also undertake to use best efforts to achieve something better, the exact undertaking then having to be determined taking into account the circumstances of the case. If instead "reasonable endeavours" or "endeavours" would be used (since this may be a particular issue in the negotiations), this means that the requirement is less but still not specified, and it will then be up to the court to determine the difference in the individual cases occurring.

As examples of other but related boilerplates which are often found in international B2B contracts the following may be mentioned: "entire agreement clauses" and "no oral amendment clauses", "in the absolute discretion of…", "in the opinion of the…", "in the reasonable discretion of…"[30]. Such phrases may have to be interpreted against the background in the individual case, as it would be hard to understand and apply them in a general way.

In Swedish law those various expressions are also well-known in international B2B contracts, but there are far fewer cases reported covering their use. But, of course, if there would be a difference in opinion it will either fall upon the parties to agree or the court or arbitration tribunal to deal with the difference in opinion.[31]

[28] This is of course nothing particular with respect to vocabulary used in a contract, but a court may meet corresponding issues when approaching vocabulary in legislation.

[29] Let us here only refer to the cases *Jet2 com. v. Blackpool Airport Ltd* [2011] EWHC 1529 (Comm), *IBM United Kingdom Ltd. v. Rockware Glass Ltd* [1980] and *Brooke Homes (Bicester) Ltd. v. Portfolio Property Partners Ltd.* [2021] EWHC 3015 (Ch).

[30] See for instance in Cordero Moss (ed.).

[31] In Swedish law such cases may be determined in a number of arbitration cases, but since arbitration awards are not generally public, they will only be available for scrutiny in particular circumstances. In his article *Boilerplate på svenska* in Svensk Juristtidning (SvJT) 2001 p. 172 et seq., Lars Edlund suggested a certain selectivity for Swedish law purposes in their use in order to prevent confusion rather than achieving clarification.

Since in common law there are substantially more cases involving language vagueness or differences compared to Swedish law, such problems have been approached and sorted out to a substantially greater extent (but sometimes giving rise to new problems). What we are here referring to concerns issues such as what is meant by "endeavours", "best endeavours" or "reasonable endeavours" in a legal context, how exemption clauses should be interpreted in different circumstances, what contractual "good faith" actually means[32], when consent would be regarded to be unreasonably withheld, and how glossary in contracts should be applied.

Another example of how more sweeping language is used to manage future contingencies are the Material Adverse Change (MAC) or Material Adverse Effect (MAE) clauses.[33] Related wording is used mostly in connection with loan agreements and share purchase (corporate acquisition) agreements, and they serve to express what will happen when there is a change of circumstances materially affecting the performance of the contract. The LMA forms of loan agreements typically leave it to the parties to set out specifically in the definitions section of the agreement the meaning of a material adverse effect in the individual contract.[34]

3.2 How do courts deal with related issues?

Before giving some examples of how such issues related to contractual practices as described above have been dealt with in the common law realm, it must be reiterated that Swedish case law concerning contract interpretation is far less abundant than what is found in common law, in particular if extending the coverage beyond English law.[35] Our examples are selected

[32] As indicated above "good faith" would not generally be part of English common law (except in particular circumstances, such as in connection with relational contracts), but if used in a contract an English court would have to determine its meaning in the particular contract, see for instance the discussion on good faith in Cartwright III.4.

[33] See Cordero Moss, i.a. p. 120 et seq., Tamasauskas, A., *MAC klausuler – vilkår i låneaftaler om ophaevelse som følge af aendrede forhold*, Erhvervsretslig Tidskrift 2019 p. 059 et seq. and Gorton, L., *Material adverse change-klausuler*. in Flodgren, B. et al (eds.) Vänbok till Axel Adlercreutz, Lund (2007) p. 120 et seq.

[34] See reference in the LMA User's guide, and e.g. the discussion in Wood, 9-008-9010 and 14-027-14-033 with reference to certain caselaw.

[35] In Adlercreutz et al, an effort has been made to approach various interpretation methods developed by the Swedish Supreme Court. These methods may not be similar to those set up by Catterwell in his above-mentioned study, but there are strokes of similar thinking in parts of corresponding Swedish caselaw. In particular in sec. 5 and 6 more particular

somewhat haphazardly, with related matters being the subject of court proceedings that address particular issues in individual cases.[36]

It must be recognized that the wording used in one type of contract may not necessarily have the same meaning in another type of contract, but the vocabulary used may have different connotations depending on the context in which it is being used. As a consequence, the same word may be understood differently in e.g. construction contracts and franchise agreements. This may not be surprising, since particular words may be given different meanings depending on the legal or business framework.

The case of *Smith v Wilson* is a popular example of where customary meaning may override the semantic understanding of a word. There, the court allowed evidence outside the four corners of the contract to show that "in that part of the country" 1,000 rabbits denoted 1,200 rabbits.[37]

Another example is that if using the expression "ton", which would generally mean 1,000 kilograms, it may, depending on the circumstances and where charter agreements are involved have to be specified whether "metric ton" or "long ton" is concerned.[38]

In English law related issues have lately further been disputed in the case *BM Brazil & Ors v. Sibanye BM Brazil & Anor*.[39] In this case the English Commercial Court decided that a buyer was not entitled to rely on an MAE clause to terminate a corporate acquisition agreement. Other cases that illustrate various issues related to MAC-clauses are *BNP Paribas v. Yukos Oil Co.*[40] and *Groupo Hotelero Urvasco SA v. Carey Value Added SL*.[41]

issues of the character here mentioned have been considered. Such in some ways similar exercise has been carried out by Lundberg, K. in *Avtalets innebörd*, Jure (2019).

36 In the context particular reference may be given to the well-known cases, *Prenn s. Simmonds* [1971] 1 WLR 1381 (HL) and *Investors Compensation Scheme Ltd v. West Bromwich Building Society* [1998] 1 WLR 896 (HL), both cases discussed by Catterwell in various parts of his study.

37 *Smith v Wilson* (1832) 3 B & Ad 728, 732; 110 ER 266, 267 (KB).

38 As a particular example without any reference to the question of ton some reference may in Swedish law also be made to the Supreme Court case NJA 2002 p. 244 related to what may be understood by "on demand", and in NJA 2005 p. 142 the Supreme Court set out that if a lessor according to the contracts was entitled to increase the lease fee as a consequence of higher interest rates it also had a duty to decrease correspondingly the lease fee if interest rates decreased.

39 [2024] EWHC 2566 (Comm). In the case reference was being made to much American case law.

40 [2005] EWHC 1321 (Ch.).

41 [2013] EWHC 1039 (Comm).

Conclusions that are based on how issues of this nature have been resolved in common law jurisdictions do not immediately translate into a Swedish context. The English language in a contract may not always mean exactly the same thing in an English law context as in a Swedish law context both for language reasons more generally but also for reasons following as a result of the differences in approach with respect to interpretation discussed in section 2 above. And it must be recognized that language differences with respect to legal vocabulary in an overriding perspective may be hard to align.

4. On the interplay between contract drafting, interpretation and market practice

4.1 On the evolution of drafting practices

As described above, contracts under English law are by tradition longer than those made out under Swedish law. This can be seen as a consequence of the differences in legal structure between the two systems, where a lack of firmer guiding principles applied in an English law context has incentivized contracting parties to develop to a higher extent contractual provisions that are supposed to ensure predictability.

It is also possible to follow in English contract law a development, where new clauses have been adopted by contracting parties to reduce the effect of court decisions, thus creating a kind of contractual ping pong.

This is a development that has been obvious in English contract law, where e.g. charter parties have contributed to the gradual development of new contractual provisions in response to case law.[42] This may also be seen as an effect in English legislation where e.g. the Sale of Goods Act reflects the gradual development of new clauses in relation to new case law. The English legislation technique at least in some respects mirrors a different approach by the legislator than is the case in Swedish law.[43]

Contract practices have evolved not only as a response to case law, but also to real world crises. This means, for example in the LMA template, that

[42] An example from the financing context is the interpretation of release provisions in inter-creditor agreements. See *Barclays Bank Plc & Ors v. HHY Luxembourg SARL & Anor* [2010] EWCA Civ 1248.

[43] Swedish sales law is for example regarded to be more principle oriented than corresponding rules in the English SGA. This may also be a reason why the UK has not adopted the CISG. The same goes for example with respect to the English Marine Insurance Act, which more reflects the drafting of an insurance contract.

unexpected events that have occurred in the past are dealt with, as opposed of course to those that will materialize in the future. Contracts may in this respect be read as a history of financial turmoil. One of the most well-known examples of this dynamics is the language included in the LMA suite in 2009 to deal with the case where a lender (as opposed to the borrower) does not perform under a loan agreement, colloquially referred to as the "Lehman provisions."[44]

Such developments may also be seen as reflected in an area where there is little private law legislation, such as construction law, where Swedish contracts are not considerably shorter than those governed by English law.

There is, of course, no absolute truth with respect to the question of whether a shorter less detailed business contract subject to Swedish law would in the overarching perspective be more efficient than the longer one used under English law. But from a party perspective the question may be raised whether it is more efficient to put your money into the drafting of a contract or for dispute resolution. Is there such a relationship between *ex ante* efforts and *ex post* costs?

We believe that from a party point of view it would not be a sensible thing to suggest as a legal advisor the use of a short contract just because it is presumably cheaper, if there is a greater risk of a dispute arising. The better approach in our view would be to negotiate and eliminate as best possible the risks apparent at the time of negotiations.

In section 5 below, we attempt to corroborate our view by invoking some of the literature on incomplete contracts, using traditional Swedish credit forms and the LMA template as representatives of the short and open versus the extensive and potentially less flexible.

4.2 Remarks on gap-filling or interpretation based on market practice

In cases where the parties have left the contract without specific rules for a situation that has arisen, the adjudicator must rely on trade usage, customs, or non-mandatory law (if they exist) to fill the gaps in the contract.[45]

[44] Association of Corporate Treasurers / Slaughter & May: *A Borrower's Guide to the LMA's Investment Grade Agreements*, 6th ed. November 2022 p. 377. The ACT Guide was available on-line via the ACT website (www.treasurers.org) at the time of this publication.

[45] The expressions custom and usage are found in e.g. UCP 600 related to documentary letters of credit, but the wording probably has broader implications.

In Swedish law the concepts of "handelsbruk" and "sedvänja" (roughly corresponding to usage and customs) are found in a number of provisions in the legislation.[46] Furthermore there may have developed different customs between the parties through repeated contracting. Contract interpretation may involve particularities stemming from expressions and practices used in various trade segments.[47] A similar approach even if not entirely the same may be found in English case law.[48]

One of the particular themes that Svante O. Johansson has addressed in his role as Supreme Court Justice is the distinction between, on the one hand, market practice and standards that may inform a conclusion as to the most plausible interpretation of a contract, and on the other, such practices that have the status of customs and usage so as to form part of the background law.[49] In this contribution, we are not concerned with that distinction, but more generally with the paths that such practices will travel in order to affect the conclusions in a case of contract interpretation.

Should the matter be regulated, but the parties disagree on the meaning of a certain contractual rule, trade usage, customs, and market practice may contribute to an argument that goes to the typical function and commercial understanding of such rule.

Such factors may also be relevant where the contract does contain a rule for the contentious situation that has arisen, and the typical function of the rule is undisputed. However, the meaning of the words used in the contract may still be subject to different points of view.

The term market practice is wider and more flexible than customs or usage and is taken here to signify methods and processes for negotiating,

[46] Article 9 CISG, 1 § 2nd paragraph in the Contracts Act, 3 § in the Sales of Goods Act (Sw: *köplagen (1990:931)*) and 2 § 3rd paragraph *kommissionslagen (2009:865)*. NJA 2022 p. 574 para 17. See for instance, in Swedish law, Karlgren, H., *Kutym och rättsregel*. Norstedts 1960.

[47] Cf e.g. PICC art. 1.9. Bernitz, U., *Standardavtalsrätt*, 9th ed. Norstedts Juridik (2018) p. 69 on the incorporation into a contract of terms that have applied in previous dealings between the same parties (sw. *partsbruk*).

[48] In English law see e.g. Goode, R., *A new international lex mercatoria*. JT 1999–2000 p. 257 et seq. and Schmitthoff, C.M., *Commercial law in a changing economic climate*. 2nd ed. Sweet & Maxwell (1981).

[49] NJA 2022 p. 574. It is beyond the scope of this article to discuss the difficulty in determining when a certain practice within a commercial sphere has gained such stability and circulation that the relevant actors generally believe that such practice amounts to binding norms. See e.g. Adlercreutz et al. p. 113. Heidbrink, J., *Sedvanans betydelse i modern förmögenhetsrätt*, SvJT 2020 p. 770 et seq.

documenting, and executing commercial agreements that are known to and considered established among professional participants within a specific market. What constitutes market practice in a particular situation can be subject to different opinions and change over time.[50] It shares common traits with the concept of soft law but should not be confused with it. Many elements of market practice originate from laws, regulations, and transaction mechanics and thus spread naturally into templates or common forms of agreement.[51]

In addition, many types of commercial agreements that are based on standard forms or templates benefit from explanatory notes or guidelines.[52]

These kinds of facts may belong to several categories suggested by Catterwell. Primarily, such considerations would fall under the headings of customary and trade meaning, scientific or technical meaning, or party-specific meanings.[53] In the model proposed by Catterwell, this exercise signifies one of the commonly seen strategies for contract interpretation the primary purpose of which is to determine an objective meaning of a contractual term.

The trade or customary meaning of words may in fact override an ordinary meaning arrived at through a semantic interpretation. This can be described as an interpretation exercise, but methodologically may also be framed as permitting an implied term of custom and trade usage.[54]

[50] Göthlin, S., *Prioritet och avtal*. Jure (2023) p. 69. Cf. also above p. 303 with respect to Catterwell.

[51] One of many examples of such influence from the public to the private sphere is anti-money-laundering legislation, leading to the inclusion of promises to deliver know-your-customer documents to counterparties.

[52] In relation to various international standard contracts, there is a growing use of preparatory works and/or gradually used explanations re how particular expressions shall be understood and applied. Such practice may be found in relation to various types of contracts, see for instance UCP 600, The Gafta Conditions, the various FIDIC contracts, the BIMCO Shipsale 22 etc. For example, in relation to the BIMCO Shipsale 22 Agreement there is a document containing explanatory notes, where the intention with respect to various contractual provisions is set out and explained. One may of course ask, why the contractual provisions in an agreed document have to be explained, and then whether such explanations will only serve pedagogical purposes, or whether they will also have a legal effect. If it is clear that the explanatory notes form part of the contract they will probably have legal implications, but if they are only there as information to the parties, this may be more questionable. Furthermore, in relation to the UCP 600 and the URDG there may be found layers of explanations to the understanding of the UCP rules in that there is within the ICC a trade finance group regularly convening to discuss various issues related to the understanding of the rules in relation to particular cases.

[53] Catterwell 3-09.

[54] As illustrated by the cases referred to in notes 37–38 above.

In other words, one may rely on aspects of market practice to resolve a problem of detailed interpretation. This may include asking how the relevant words are typically employed in similar situations and between similar parties. Does that not, then, render the need for complex and privately negotiated agreements superfluous? Or would it instead suggest that more precise drafting is required, which is capable of covering specific meanings needed in the individual case?

Furthermore, there is an obvious tension there, that can be seen to exist also in a Nordic context. That is, how can the behaviour of parties after the conclusion of an agreement, and by parties in other transactions, form the basis for a view on the objective meaning of the disputed contractual wording?[55]

4.3 The Norwegian case Eksportfinans ASA v. Rem Ship AS[56]

Even though LMA templates represent well-known expressions of market practice they are typically not considered as the custom of the trade or common usage.[57] One of the reasons for this is that the forms are used as starting points for negotiation, leaving out most of the commercial terms such as interest rates, financial undertakings and security. In light of the typical LMAA and the captioned case, one may however argue that some of the contents of an LMA template may be considered part of market practice so as to heavily influence an interpretation of the meaning of terms.

In the Eksportfinans v. Rem Ship case, a shipping company had taken up loans from Eksportfinans ASA to finance newly built ships. The loans were state-subsidized and carried interest according to the so-called CIRR rate, provided under conditions set by the OECD. When the borrower repaid the loans early, Eksportfinans demanded compensation for break costs.[58]

The borrower contested the calculation of such compensation, which according to the contract was to represent the difference between the interest

[55] See discussion in Catterwell i.a. pp. 79–85.

[56] Borgarting lagmannsrett, LB – 2010–189962.

[57] Gorton, L., *Globalization and the Law Related to Credit and Finance – some Remarks*, in Wahlgren (ed.), Scandinavian Studies in Law, Volume 57, 2012 p. 71 et seq. Also see Andrews p. 363 et seq. in relation to the status of common terms and conditions of bonds, especially in relation to investors being bound by restrictions in their rights against the issuer.

[58] Break costs are losses due to repayment of an interest-bearing loan prior to an agreed repayment or interest re-setting date.

that the lender had lost because of the early repayment and the "reinvestment rate" (No: *reinvesteringsrente*).

At the core of the dispute was the word reinvestment rate. Whereas (in simplified terms) Eksportfinans claimed that the word referred to the hypothetical re-allocation rate that could be obtained on the interbank market, the borrower claimed that it represented the rate that could have been obtained in a transaction similar to the CIRR based financing entered into between Eksportfinans and Rem Ship.

The Court of Appeal found that the word in itself did not favour either of the two offered interpretations. It did however – along with other reasoning – find that the agreement had to be interpreted in accordance with established market practice, which Eksportfinans had used as the basis for its calculations.

This practice was demonstrated by a clause on break costs from an LMA based loan agreement, which the Court concluded represented such common market practice that both parties would have been familiar with it. Among other things, the Court mentioned that the LMA has over 500 member organisations, among them several Norwegian banks and law firms.

This case demonstrates some of the problems associated with basing the interpretation of a contractual term on market practice. The LMA does indeed produce well-known templates.[59] Where parties have chosen *not* to use them, one may however question whether it is wise to still rely on them for interpretation.[60]

Further, it can be questioned whether past behaviour is a sound indication of the present meaning of contractual rules. In the case of break costs, the market is currently undergoing a fundamental shift away from forward-looking interbank rates to risk-free overnight rates.[61] Template agreements and market practices are continuously developing, making their role as evidence of the "right" meaning of a word or a phrase unreliable.

The Rem Ship case provides an example of where it would probably have been advantageous, if a definition of re-investment rate had been included

[59] See e.g. Cranston, R., Avgouleas, E., van Zwieten, K., Hare, C. & van Sante, T. *Principles of Banking Law*, OUP 3rd ed. (2018) p. 416.

[60] See in this vein the Swedish case NJA 1975 p. 484.

[61] Riksbanken: *Den svenska finansmarknaden 2024* p. 28. Lidman, E. & Fjäll, A., *Om ändring av obligationsvillkor*, in Lidman et al, Festskrift till Svante Johansson (2024) p. 156. Göthlin, S., *Break costs and the End of the Matched Funding Fiction*, Ahlinder & Chen (eds.) Scandinavian Studies in Law, Volume 71 (2025), p. 43 et. seq.

in the contract, instead of having to lean on background law and market practice in case of a dispute. This would have allowed the borrower to better estimate its refinancing costs, and the potential dispute would likely have been more limited.

As a final note, the influence on the interpretation of a contract by *other* privately negotiated agreements might be controversial from a theoretical point of view. Such a method can be argued to offer a backdoor for market practice to influence the law even where such practices have not achieved the status of trade customs or usage, and be applied without having gained the legitimacy provided through a legislative process.

Against this background, let us move on to discuss the merits and drawbacks of extensive definitions and party-specific interpretative guidance.

5. Definitions in loan agreements in light of the incomplete contracting problem

5.1 Introductory notes

It can be argued that it would be more efficient for society as a whole, if parties could reach an agreement and start transacting with less time and costs invested *ex ante*. In cases where disputes would arise, the adjudicator would interpret the agreement in a way which provides the most economically efficient solution.[62]

In the real world however, there is no generally accepted and unified theory of interpretation and gap-filling to provide the parties or the relevant markets with sufficient predictability.

When discussing the use of extensive definitions catalogues as a way of addressing future uncertainties, one may also observe that regardless of the time and effort put into drafting, contracts are almost never complete.[63]

The time and effort dedicated by the parties to a loan agreement in the contracting phase is perhaps assumed to be a cost to the parties as well as society as a whole. In such case, the efficiency calculation becomes a comparison

[62] Such guidance for interpretation and gap-filling aiming to maximise value has been proposed by e.g. Runesson, E.M. in *Rekonstruktion av ofullständiga avtal: särskilt om köplagens reglering av risken för ökade prestationskostnader*, Stockholm (1996).

[63] Halonen-Akatwijuka & Hart, p. 1. Heaton, J. B., *Incomplete Financial Contracts and Non-contractual Legal Rules: The Case of Debt Capacity and Fraudulent Conveyance Law*, Journal of Financial Intermediation 9, 169–183 (2000) p. 169.

between costs up-front and *ex post*, when something has gone wrong. This comparison is however overly simplistic.

In the following sections, we explore some of the features of loan agreements that sets them apart from other agreements and that may affect an efficiency argument. We discuss in particular the minimalistic drafting style traditionally used by Swedish banks in comparison with the lengthy descriptions found in an LMA style facilities agreement.[64]

In a standard form for Swedish commercial loans, the lender has a right to accelerate the loan if the borrower is in breach of its obligations towards the lender, but also if the "security is no longer adequate" or "there is reason to believe that the borrower will not fulfil its obligations under the credit agreement or otherwise towards the lender".[65]

This can be contrasted with the extensive catalogue of events that give rise to a right for lenders, after a certain grace period where the borrower may cure its breach, to demand immediate repayment of all loans and enforce any security under an LMA style agreement. The circumstances that constitute a breach (default) are so fully described as to give the impression that they are exhaustive.

In our experience, practicing lawyers sometimes tend to believe that parties to an agreement governed by Swedish law are not as well served by lengthy contracts that aim to capture all known contingencies, since they may rely to a larger extent than their common law counterparts on reasonableness or fairness standards. Especially, the use of definitions catalogues is lamented as being highly inefficient.

The view that differences in legal culture and contract law are such that they justify a divergence in drafting philosophy can be challenged. We shall attempt to discuss this based on pieces of the incomplete contracting literature.

64 The word "facility" is explained in section 3.1 above.

65 By standard forms, we refer to terms and conditions attached to common forms of corporate credits that are not documented through bespoke agreements or LMA style templates. This practice is the basis for the account of market practice given in Lennander, G., *Kredit och säkerhet* 12th ed., Iustus (2020). Especially, see p. 26 and 37 on the banks' right to terminate a loan. Further, see Göthlin (2023) p. 71.

5.2 Drafting styles and the incomplete contracting problem applied to loan agreements

The negotiation of a loan agreement is carried out by the parties themselves, assisted by legal counsel. In contrast, a dispute is resolved in court (banks do not tend to opt for arbitration). This means that the costs for this phase become a negative externality.

Whereas a sale and purchase agreement, which often forms the basis for analysis in the law and economics realm, deals in risk allocation, it is possible to argue that the fundamental idea of a debt contract is different. In debt finance, the lender extends the credit and accepts the risk that the borrower becomes insolvent and unable to repay its debt. However, absent insolvency, the borrower should bear all costs for the credit and no risk for changes in circumstances should be allocated to the lender.[66]

We accept that in law and economics, a certain type of agreement may need to serve as a point of reference in order to reach a theoretical suggestion. In many cases, the financial contract is one of continuous cooperation rather than a series of transactions.[67] However, there is a difference between executory contracts and credit agreements, in that the first – typically – rests on an exchange of performances by both parties instantaneously or over time, whereas credit agreements typically entail that the lender performs fully at the start of the contract term and the borrower then performs over time.[68]

The key to our reluctance to accepting the suggestion that time invested in the negotiation of agreed definitions *ex ante* is inefficient is however another aspect of debt documents generally.

That is, that most financial contracts are traded on a secondary market. Recalling the discussion in section 2.2 above on debt textualism, this element underscores the importance of documents that do not rely on subjective factors for determination of their contents.

In addition, the holder of a monetary claim will often be satisfied with the performance of its counterparty if the debt is discharged in full and on time. Disagreement, therefore, on the interpretation of a finance contract will typically arise in connection with the borrower's financial distress. At that time, re-negotiation or interpretative disputes threaten more value destruction than a lengthy negotiation would have caused *ex ante*. Financial distress

66 Cranston p. 428.

67 Lalafaryan, N., *Orchestrating finance with Material Adverse Changes*? *Legal Studies*. 2022;42(1):1–22. doi:10.1017/lst.2022.6. p. 18 on relationship lending.

68 Heaton p. 170.

creates extreme time pressure and limits the options available to the parties, both financially and legally.[69]

That is not to say that a borrower cannot decide to default for strategic reasons, such as to take advantage of improved financing conditions or to prepare for a future re-negotiation of its financing arrangements.

Rather than aiming for as complete a contract as possible there is an alternative demonstrated by the traditional Swedish banks' standard terms and conditions. The control rights are here to a greater extent assigned to one of the parties. This often comes in the shape of such language that was discussed in section 3.1 above, invoking varying degrees of "efforts", "reasonableness" and "discretion". The conditions under which the bank may terminate a loan prematurely are – except for payment defaults – not defined. Instead, the bank is vested with the discretion to determine whether certain broadly expressed circumstances have occurred.

A measure of discretion may serve to incentivize re-negotiation.[70] This however comes with obvious inefficiencies as well. First, banks wish to avoid the risk of being sued for damages on account of having accelerated a credit without due cause. This may lead to an overly cautious use of termination rights, allowing the borrower's situation to continue to deteriorate before any action is taken. Secondly, the law requires a party vested with such discretion to exercise its power loyally.[71] Any use of power that the borrower does not accept may therefore be challenged, and instead of cutting off deliberation such a clause will have encouraged litigation.

5.3 The loan agreement as governance tool

The negotiation phase serves as a plan for the parties' cooperation over the contract term. For debt investments, the agreement is the main governance tool, since, in contrast to equity investors, the lender has no formal rights to

[69] In financial distress, parties must – among other things – take care not to act in favour of any particular creditor at the expense of others, which can lead to transactions being clawed-back under bankruptcy law and to criminal liability for individual managers. From an American perspective, see Heaton p. 169 et seq. On the incomplete contracting problem and financial distress, see Casey, A., *Chapter 11's Renegotiation Framework and the Purpose of Corporate Bankruptcy* (March 16, 2019). 120 Columbia Law Review 1709 (2020).

[70] Cf. SOU (Government committee) 1974:83 p. 167 et seq.

[71] See e.g. NJA 2005 p. 142.

information or to restrict management decisions other than those explicitly agreed.[72]

Engaging in detailed planning for future business opportunities and "known unknowns" may work to overcome one of the inefficiencies ascribed to the pre-contractual stage in debt finance; being the asymmetrical access to information about the borrower.[73]

If, for example, the lender suggests a prohibition against intra-group loans, the borrower is incentivised to explain its cash management strategy for its actual practices to be reflected in the loan document.

In his Nobel Prize Lecture from 2016, Oliver Hart recollects the realisation that a critical question in relation to incomplete contracts is who has the right to decide about the matters that are missing from the contract.[74] Grossman and Hart refer to this right as the residual control or decision right. This right is connected to the idea of ownership, meaning that the party that owns an asset is the one deciding how to use that asset unless the contract specifies otherwise. The residual rights over assets or situations that arise within the realm of a certain contract, but that are not directed by that same contract, is like any other good in the sense that there is an economically optimal allocation of such rights.[75]

Applied to the financing context, there are two main types of assets over which one of the parties will hold control rights. The first one is money. When the lender transfers an amount of money to the account of the borrower, the borrower becomes, for all relevant purposes, the owner of that money.[76] This means that the borrower has control rights over money held by it, to the extent that the contract does not specify otherwise.

[72] The contract itself as a plan, see Hart, O., *Firms, Contracts, and Financial Structure*. Clarendon Press, Oxford (1995) p. 23. Heaton p. 170.

[73] Lalafaryan p. 5 et seq.

[74] Hart, O., *Incomplete Contracts and Control*, Prize Lecture, December 8, 2016, p. 373. There is of course more to Hart's and Grossman's models than can be discussed in the context of this limited contribution.

[75] We assume that the discussion on residual rights within the incomplete contracting problem are only relevant in relation to assets that are somehow affected by the contract in question.

[76] Lindskog, S., *Betalning*, 3rd ed. Norstedts Juridik (2022) p. 75. Håstad, T., *Sakrätt*, 6th ed. Norstedts Juridik (1996) p. 153 does not say that the borrower becomes "the owner", but rather that the borrower, having received the money in its own interest, has a right to freely dispose over it and an obligation to return property of the same kind and in the same quantity (our translation).

Contract terms that specify a certain liquidity reserve or indeed periodical payments of interest to the lender may be understood in this context to limit the control rights of the borrower. Another common form of restriction on the use of money is a limit on the payments that the borrower may make on subordinated debt.

> Permitted payments on subordinated debt is an area where less rigorous drafting may lead to disputes, and the opinion of a court is hard to predict. If the parties have only specified that, for example, a shareholder loan shall be subordinated to the main lender's claims, different views may be held as to whether the borrower may make instalments and interest payments on such subordinated debt as long as the borrower is solvent. In the borrower's view, a repayment leads to a reduction in overall debt and hence an improvement in the senior lender's position. The senior lender meanwhile, is concerned that the borrower has disposed of liquidity and reduced what was in fact not an insolvency risk for the senior lender since the debt was subordinated. On the contrary, the senior lender thought of the shareholder debt as a disciplining layer for loss-absorption in addition to the equity of the borrower.

The second category of assets over which control rights matter for purposes of a debt contract is property the value of which has a bearing on the capacity of discharging the debt. This is potentially all the property of a borrower, as well as assets owned by third-party guarantors and security providers. The borrower may assign control over its assets in three ways:

i) By providing security that is perfected by effectively cutting off the borrower's ability to dispose of or otherwise trade with the asset;
ii) By providing security through registration or other means, allowing a certain degree of *de facto* control over the asset to remain with the borrower; or
iii) By contractual obligations, that do not *de facto* transfer control to the lender but that are enforceable against a solvent borrower.

The first method above is presumably what Hart refers to as collateral, the use of which can reduce the problems associated with incomplete contracts and with the limited governance tools available to a debt investor.[77] A care-

[77] Hart, Nobel Prize Lecture p. 379 on protections against strategic defaults. The legal difference between contractual rights and rights in rem is less explored, we believe, in the law and economics literature dealing with incomplete contracts. If assets are subject to security, who is, in Hart's model, the "owner"? Further, the description of control presup-

fully drafted contract may play a role in reducing renegotiation or dispute resolution costs especially in relation to the second and third methods for assigning a degree of control under a financial contract, where the borrower retains *de facto* control.

In loan agreements based on LMA format, the borrower will undertake not to raise additional financial indebtedness except "permitted indebtedness". Further, it will promise not to provide third parties with security, except "permitted security".

The definition of what is permitted in terms of increasing the lender's credit risk or otherwise altering the capital structure of the borrower hence becomes a key theme for negotiation. While a Swedish bank's standard terms and conditions only stipulate that the value of the lender's security must not seriously deteriorate, the LMA format forces the parties to consider their plan for raising new funds over the term of the relevant loan.

In our experience, lenders do not object to allowing the borrower the flexibility needed to realistically run its business and preferably even expand it. In case more financing is needed which is not subordinated to the original facilities however, it is reasonable for the lenders to have an option as to whether to increase their participation or permit dilution. Importantly, the definitions of permitted indebtedness and security provide a framework within which the borrower may expand its balance sheet without consulting the lender. Beyond that limit, the original lenders have a right to be involved.

Although we have emphasised the benefits of this kind of detailed plan for the parties' cooperation when compared with a broad general clause, the complexity of the contract may in itself be a source of conflict. In particular, the combination of detailed provisions and a strictly objective approach to contract interpretation has led to the exploitation of loopholes in financial contracts. The question in such cases has been whether there is really no obligation of the borrower to apply the agreement in good faith.[78]

Under Swedish law, there is no doubt that a party to a contract is under an obligation to observe a certain degree of loyalty towards its counterparty.[79]

poses that contractual rights equal control, which means that the rights must be legally enforceable. This is not always the case, and certainly does not stop the holder of an asset from trading it away in breach of contact. Also see Johansson, S. O., *Peter Benson, Justice in transactions: A theory of contract law*, Harvard University Press 2019 (review) JT 2022–23 p. 187 et seq.

[78] See Pandya & Talley.

[79] NJA 2021 p. 943. Also see NJA 2005 p. 142. The contractual duty of loyalty was the

The problem rather arises either because the actions described above occur in close proximity to insolvency, meaning that claims against the borrower for breach of contract may not be worth pursuing, or because they occur when the borrower is solvent, meaning that the aggrieved lender may find it difficult to demonstrate any losses. It may be that the market price of claims against the borrower has dropped, leading a lender that has to divest its claim to realise a loss in the secondary market.

One aspect of this dynamics is discussed in a recent paper by Halonen-Akatwijuka and Hart. In their hypothesis, a contract is a point of reference that defines what the parties feel entitled to.[80] This may create a resistance to initiating or accepting a re-negotiation that alters the initial bargain, even if a certain change in positions would be beneficial to both parties in the long term. From that perspective, an incomplete contract is better, since it does not give rise to as many expectations.

In a recent contribution on the law and economics effect of material adverse change (MAC) clauses in debt finance, Narine Lalafaryan adds yet another perspective to the question of drafting philosophy.[81] Lalafaryan argues that MAC clauses have the potential to work well as governance tools, but that one of the factors preventing their usefulness is the lenders' tendency to add a host of detailed protections on top of the MAC.

Although the MAC clause does offer protection and bargaining power for lenders under dramatic and unforeseen circumstances, they do not typically impose restrictions on the business dealings of the borrower.[82] We are therefore not necessarily convinced that the usefulness of MAC clauses as a governance tool is threatened by attention to detail in the aspects of a financing arrangement that are particular to the borrower and its assets.[83]

subject of a keynote speech by Svante O. Johansson at the 2024 Stockholm Oxford Law Symposium.

80 Halonen-Akatwijuka & Hart p. 2.

81 See Lalafaryan.

82 Lalafaryan p. 11 et seq. contain examples of commonly seen MAC clauses. The overview illustrates that MAC clauses exist both as conditions precedent to borrowing (no adverse changes in the market) and as subsequent grounds for termination. One may discuss of course if those two functions belong to the same category of contractual clauses.

83 Ganglmair, B. & Wardlaw, M., *Complexity, Standardization, and the Design of Loan Agreements* (April 13, 2017) (SSRN: https://ssrn.com/abstract=2952567) p. 2 have found that larger credits often contain firm-specific provisions, so that contracts to the same borrower, but from different lenders, are significantly closer to each other than contracts from the same lender to different firms.

The extensive use of definitions to pin down the agreed meaning of terms in a contract is however only justified if rules are drafted well enough to cut off deliberation at the time of application. The contractual rules must be clear enough to not require discussions to fill them with meaning at the moment of their being activated. The drafting method where substantive provisions are "buried" in a lengthy set of definitions and instructions on interpretation set by the parties themselves is also likely to be more difficult to analyse for third parties, including in data and market analysis.[84]

6. Some concluding remarks

In this article, we have sought to discuss the interplay between words, customs and behaviour in the drafting and interpretation of commercial contracts.

It seems that even if there may arise disagreement between the parties, B2B disputes are still comparatively rare, since the parties will in most cases be able to settle outstanding differences out of court. Nevertheless, the cases that do appear provide an important foundation for the evolution of contractual practices and reasonable expectations by the parties as to the meaning of a certain term.

In the drafting of a commercial contract, the parties may be influenced by time pressures, personal preferences and market practice when settling on a format for their agreement. Regardless of the length of the document and the time spent negotiating, unforeseen events may still occur – events that are therefore not properly regulated in the contract.

In this article, we have discussed two ways of approaching the vagueness of language and the reality of incomplete contracts. First, the draftsmen may include guiding principles or provisions for rule creation at a later stage. Let us for example refer to the above-mentioned expressions "best efforts" or "best endeavours" as one example, which are used frequently in different kinds of B2B contracts. These expressions may not be particularly technical in nature, but they play an important role in various circumstances and must be understood and applied considering the context.

Secondly, the parties may engage in more detailed planning to specify a framework for interpretation and a governance structure through their

[84] For an example of data analysis as a basis for research on the design of loan agreements, see Ganglmair & Wardlaw.

agreement. This is the model employed by parties in international or larger domestic financing transactions.

The use of definitions in contract drafting is a multi-faceted exercise, ideally striking a balance between detailed provisions and efficiently allocating control over future contingencies. It is our hope that this essay will provide some reflections on how to approach such challenges, be it as draftsman or as an adjudicator.