Interpretation of contract

Ian Pease examines a case which has highlighted the limits of pre-contractual negotiations when it comes to interpreting an agreement

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There have been few more influential cases on contractual construction than the House of Lords' judgment in *Investors Compensation Scheme Ltd v West Bromwich Building Society* [1998]. (The box opposite sets out the basic rules for interpretation that emerged from the case.) The proper limits to the matrix of fact have recently been considered again before the Court of Appeal in *Chartbrook Ltd v Persimmon Homes Ltd* [2008].

Investors effectively rejuvenated the emphasis on the need to understand context in order to interpret contracts and not merely to reach for the dictionary. Of course, it was not the first to put forward these propositions – after all *Prenn v Simmonds* [1971] had talked about the factual background known to the parties at or before the date of the contract, including evidence of the 'genesis' and, objectively, the 'aim' of the transaction, but *Investors* brought into play, as Lord Hoffmann said:

> ... absolutely anything which would have affected the way in which the language of the document would have been understood by a reasonable man.

Lord Hoffmann's fourth point (see box) built upon previous judgments, such as that of Kerr J in *Partenreederei MS Karen Oltmann v Scarsdale Shipping Co Ltd* [1976], where he held:

> If a contract contains words which, in their context, are fairly capable of bearing more than one meaning, and if it is alleged that the parties have in effect negotiated on an agreed basis that the words bore only one of the two possible meanings, then it is permissible for the court to examine the extrinsic evidence relied upon to see whether the parties have in fact used the words in question in one sense only, so that they have in effect given their own dictionary meaning to the words as the result of their common intention. Such cases would not support a claim for rectification of the contract, because the choice of words in the contract would not result from any mistake. The words used in the contract would *ex hypothesi* reflect the meaning which both parties intended.

And this is where *Chartbrook Ltd v Persimmon Homes Ltd* comes in.

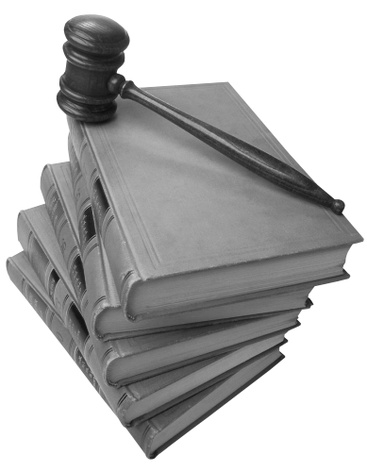
Chartbrook v Persimmon Homes

The case concerns the proper interpretation of an agreement to develop land. The judge rejected Persimmon's argument that pre-contractual material showed its interpretation to be correct, and upheld Chartbrook's interpretation of the agreement, finding that the ordinary meaning of the clause pointed clearly towards Chartbrook's rather than Persimmon's construction.

On appeal, Persimmon argued that the judge had failed to construe the contract correctly in both failing to have regard to the background correspondence and also in reaching a conclusion that, it said, flew in the face of commercial common sense.

Chartbrook, on the other hand, contended that its reading was the natural and obvious one and that Persimmon's approach required the reading of extra words into the clause.

In short, the key question was whether, even if the meaning of the words on the page appears to be clear, a judge can ignore the relevant 'background'. And furthermore, what is relevant background anyway if it does not include any of the 'previous negotiations'?



Lord Hoffmann in *Investors*

(1) Interpretation is the ascertainment of the meaning which the document would convey to a reasonable person having all the background knowledge which would reasonably have been available to the parties in the situation in which they were at the time of the contract.

(2) Subject to the requirement that [the background or matrix of fact] should have been reasonably available to the parties and to the exception to be mentioned next, it includes absolutely anything which would have affected the way in which the language of the document would have been understood by a reasonable man.

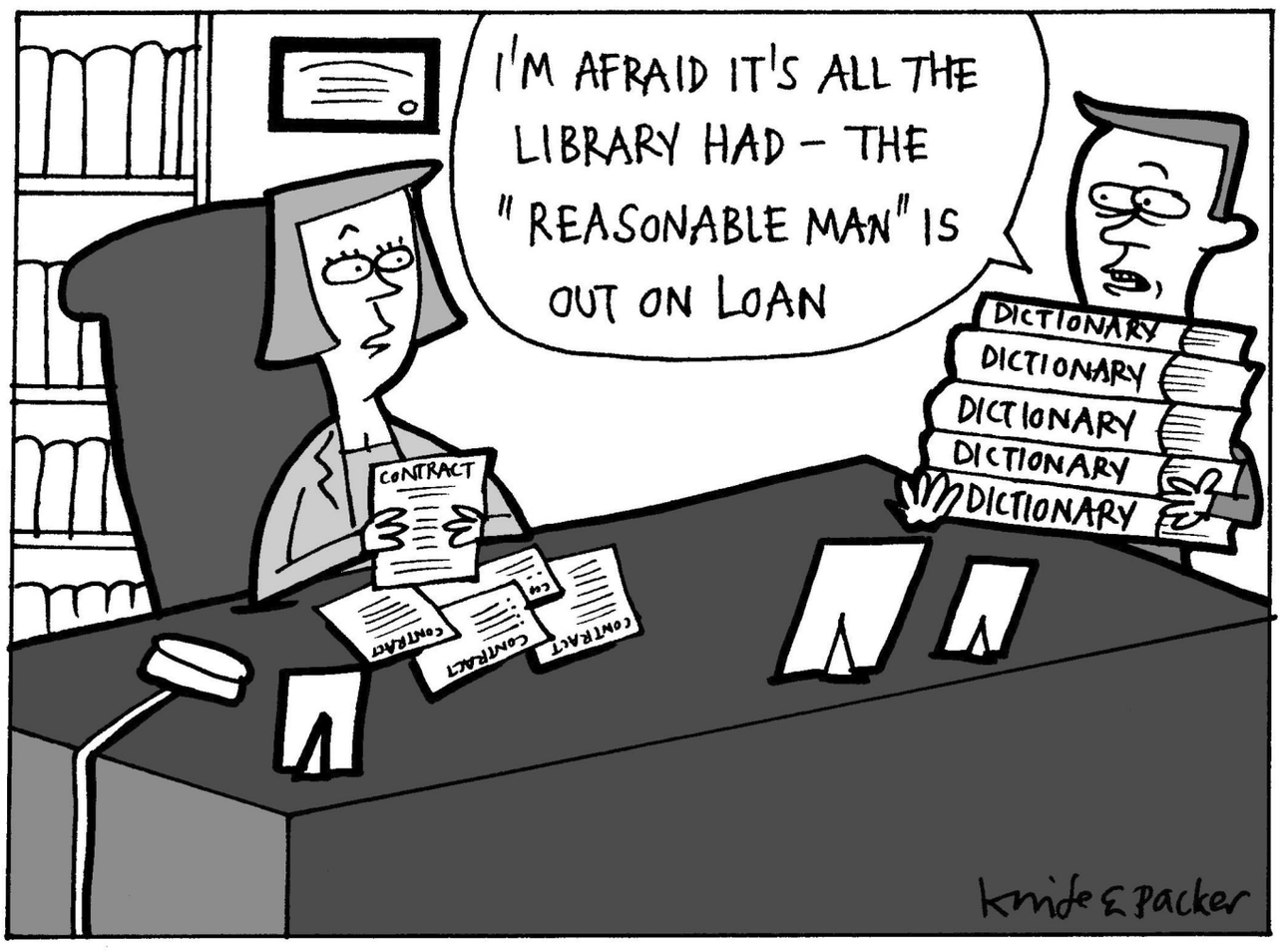
(3) The law excludes from the admissible background the previous negotiations of the parties and their declarations of subjective intent. They are admissible only in an action for rectification. The law makes this distinction for reasons of practical policy and, in this respect only, legal interpretation differs from the way we would interpret utterances in ordinary life. The boundaries of this exception are in some respects unclear.

(4) 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. The background may not merely enable the reasonable man to choose between the possible meanings of words which are ambiguous but even (as occasionally happens in ordinary life) to conclude that the parties must, for whatever reason, have used the wrong words or syntax.

(5) The 'rule' that words should be given their 'natural and ordinary meaning' reflects the common sense proposition that we do not easily accept that people have made linguistic mistakes, particularly in formal documents. On the other hand, if one would nevertheless conclude from the background that something must have gone wrong with the language, the law does not require judges to attribute to the parties an intention which they plainly could not have had.

Patently, the courts are still struggling with this because the Court of Appeal was split on those questions even with the benefit of cases dating back 35 years as guidance. Lawrence Collins LJ would have overturned the first instance judge but was out-voted. He argued that the judge was wrong to decide that background was not relevant because the words in question appeared in a definition clause of the contract. That did not affect the process of interpretation. Perhaps most importantly, he said that it was impossible to discern the commercial sense behind Chartbrook's construction. He said:

> ... this is a case in which, if one puts aside the drafts of the agreement, every contemporary document prior to the conclusion of the agreement, and every



> piece of paper which throws light on the commercial purpose of the provision, supports Persimmon's case...

Clearly he felt that a full review of the 'contemporary document[ation]' was essential in order to first establish the commercial purpose, and only when that is established to look at the words used on the page.

So why was he in the minority? Lawrence Collins LJ was forced to accept the 'exclusionary rule' (Lord Hoffmann's paragraph 3 in the box) as the starting point. However, he found that he was not bound to accept a strict application of that rule because, as Lord Hoffmann admitted, the boundaries of the exception are unclear. Lawrence Collins LJ found that the 'policy reasons' that previous cases have set out were 'not compelling'. He was therefore able to escape the rule and admit into his consideration of the words on the page what he considered the commercial purpose of the agreement ascertained from the pre-contract documentation.

Lawrence Collins LJ was forced to accept the 'exclusionary rule' as the starting point, but was not bound to accept a strict application of that rule because, as Lord Hoffmann admitted, the boundaries of the exception are unclear.

For the other judges (Rimer and Tuckey LJJ) the determining factors appear to have been both a greater emphasis on the exclusionary rule's pervasive nature, combined with a view that recourse to the 'background' was starting to encroach upon the principle that the courts were not there to rewrite the parties' agreement. Rimer LJ indicated:

> I can see no basis for rewriting the agreement as invited by Persimmon... There is nothing unclear, uncertain or ambiguous about [the clause]. It is clear, certain and unambiguous... I would reject any suggestion that this is a case in which it is legitimate, as part of the construction exercise, to have recourse to the pre-contract negotiations... Persimmon's purpose in going into the archaeology of the transaction is not to derive assistance in the interpretation of [the clause], for which there is no need. It is to seduce the court into accepting that the parties' subjective intentions with regard to [the clause] were different from what [the clause] actually provides, and then to invite the interpretation of that definition in a way that is in line with the alleged intentions.

The problem that this highlights is the continuing disagreement amongst judges as to whether the history of contractual negotiations are only to be used for the purpose of contractual rectification (as Rimer LJ explicitly indicates) or whether they can also be used as part of the relevant background to found the court's view as to the commercial purpose of the transaction, and hence to contextualise and interpret the words used in the contract. Indeed, as we saw Lord Hoffmann himself say at paragraph 4:

> The background may not merely enable the reasonable man to choose between the possible meanings of words which are ambiguous but even (as occasionally happens in ordinary life) to conclude that the parties must, for whatever reason, have used the wrong words or syntax.

And that comes perilously close to rectification.

This question of the proper use of pre-contract negotiations is a recurring one at the moment. In June last year, in commenting on *Great Hill Equity Partners II LP v Novator One LP & ors* [2007], I remarked that the judge may have kept the lid on the argument (the pre-contract negotiations argument failed) for the moment, but that one senses that the old certainties are no longer so certain. *Chartbrook Ltd* was not the breakthrough case, but it will come. ■

Chartbrook Ltd v Persimmon Homes Ltd [2008] EWCA Civ 183

Emmott v Michael Wilson & Partners Ltd [2008] All ER (D) 162 (Mar); [2008] EWCA Civ 184

Great Hill Equity Partners II LP v Novator One LP & ors [2007] EWHC 1210 (Comm)

Investors Compensation Scheme Ltd v West Bromwich Building Society [1998] 1 WLR 896

Partenreederei MS Karen Oltmann v Scarsdale Shipping Co Ltd [1976] 2 Lloyd's Rep 708

Prenn v Simmonds [1971] 1 WLR 1381

Keep it quiet – the limits of confidentiality in arbitration

It is one of the touted advantages of arbitration that it is a private and therefore a discreet method of dispute resolution. However, there are limits and *Emmott v Michael Wilson & Partners Ltd* [2008] explores one in particular.

The dispute between the parties eventually involved arbitration in London and allied court proceedings abroad in various jurisdictions. Hence documents were generated in the London arbitration that the claimant wanted to use in those allied foreign proceedings. But could he? At first instance the judge held disclosure to be in the public interest. Otherwise it was possible that foreign courts would be misled if there was not a parity of knowledge. The Court of Appeal set out the four circumstances where disclosure was justified, namely where:

(1) there was express or implied consent;

(2) there was an order, or leave of the court;

(3) it was reasonably necessary for the protection of the legitimate interests of an arbitrating party; or

(4) the interests of justice required disclosure.

It went on to find that it was in the interests of justice to allow disclosure. Furthermore, the interests of justice were not confined to the interests of justice in England but could range more widely to foreign jurisdictions also.