Commercial / Contract

The edifice begins to crack

Ian Pease identifies the cracks in *Chartbrook*

IN BRIEF

- Superficially an endorsement of previous House of Lords decisions on the interpretation of contracts.
- Hence pre-contractual negotiations between the parties are ruled out.
- However reading between the lines this rule may be on the way out.

Chartbrook Ltd v Persimmon Homes Ltd & Others [2009] UKHL 38, [2009] All ER (D) 12 (Jul) concerns the proper construction of the terms of a contract. It represents the most important case in this area since *Bank of Credit and Commerce International SA v Ali and Others* [2002] 1 AC 251 which itself built upon *Investors Compensation Scheme Ltd (ICS) v West Bromwich Building Society* [1998] 1 All ER 98, Lord Hoffmann having given judgments in both. Superficially *Chartbrook* appears to be "business as usual" and a fairly conventional endorsement of the line on contractual construction that the House of Lords had taken in those former cases. However, this may be a misconception, for the case contains some obiter remarks from three of the judges that tend to indicate that a change is in the offing.

The most important aspect of the case is the extent of the context and background that the court can legitimately take into account when construing contract terms and, in particular, whether it is ever right to have recourse to the pre-contractual negotiations between the parties ("the exclusionary rule").

The five basic rules

In many ways it was Lord Hoffmann himself who ignited this debate by his judgment in *ICS*. Remember he started his judgment by remarking about the "fundamental change which has overtaken this branch of the law" and continued: "The result has been, subject to one important exception, to assimilate the way in which such documents are interpreted by judges to the common sense principles by which any serious utterance would be interpreted in ordinary life. Almost all the old intellectual baggage of 'legal' interpretation has been discarded."

He went on to set down the five principles of modern contractual construction.

"(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.

> **"The meaning which a document would convey to a reasonable man is not the same thing as the meaning of its words"**

(2) **The background**…Subject to the requirement that it should have been reasonably available to the parties and to the exception to be mentioned next, 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...The boundaries of this exception are in some respects unclear…

(4) **The meaning** which a document... 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…enable the reasonable man…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."

Further scrutiny was perhaps foreseeable but Lord Hoffmann's later attempt in *Ali* to flesh out the principle merely served to open the door still further: "I did not think it necessary to emphasise that I meant anything which a reasonable man would have regarded as relevant. I was merely saying that there is no conceptual limit to what can be regarded as background. It is not, for example, confined to the factual background but can include…proved common assumptions which were in fact quite mistaken."

Hence Lord Hoffmann seems to sanction a consideration of the parties' actions pre-contract to the extent that they show "common assumptions which were in fact quite mistaken". This no doubt was a crack in the door that gave further

sustenance to those who felt that it was wrong to exclude from the start a type of evidence that, whilst it may on occasions be irrelevant or unhelpful, at other times may prove part of the jigsaw of evidence. This "crack in the door" was apparently assisted by Lord Bingham's comment in *Ali* that: "To ascertain the intention of the parties the court reads the terms of the contract as a whole, giving the words used their natural and ordinary meaning in the context of the agreement, the parties' relationship and all the relevant facts surrounding the transaction so far as known to the parties."

Could the reference to "the parties' relationship" be taken as a reference to their communications leading up to the bargain?

Fresh thinking in New Zealand

Looking more widely, internationally the exclusionary principle is not held to, an example of this is the recent New Zealand Supreme Court decision in *Wholesale Distributors Ltd v Gibbons Holdings Ltd* [2007] NZSC 37. The case is useful because of the extensive discussion of the admissibility of pre-contract negotiations.

Tipping J is perhaps the most restricted in his endorsement, holding: "As a matter of principle, the court should not deprive itself of any material which may be helpful in ascertaining the parties' jointly intended meaning, unless there are sufficiently strong policy reasons for the court to limit itself in that way…"(emphasis added).

Note in limiting the use of this type of evidence to showing some proved common meaning he comes quite close to Lord Hoffmann's "proved common assumptions" which of course Lord Hoffmann would rule into his factual matrix.

A rather less restrictive line comes from Thomas J (again in *Wholesale Distributors)* who would prefer to leave it to the Court's discretion as to whether the evidence is helpful in explaining the context of the words used. Evidently a variety of views exist and some would still put some restrictions on admissibility.

A fifth column in the ranks

In his judgment Thomas J cites the "seminal article" of Lord Nicholls, *My Kingdom for a Horse: The Meaning of Words* [2005] 121 LQR 577 which could be regarded as a blow to the heart of the doctrine from a very senior insider (and Lord Hoffmann's fellow panel member on the *Ali* case). In the article itself Lord Nicholls sets out number of cogent arguments against this exclusion including:

(1) **Justice**: "…the exclusion of relevant evidence means that at times justice may not be done."
(2) **Best evidence:** "[T]here will be occasions…when the parties in their pre-contract exchanges made clear the meaning they intended by language they subsequently incorporated into the contract."
(3) **Certainty:** In such cases "admission of the evidence can hardly promote uncertainty".
(4) **Transparency:** "[I]n practice, despite the exclusionary rule, in one form or another evidence of the actual intentions of the parties often does come to the attention of the judge."
(5) **Comparative law:** The exclusions are inconsistent with most other legal systems and international restatements of contract law.
(6) **Decided cases**: Evidence of previous negotiations is admissible to resolve:

(a) ambiguity in written documents (*The Karen Oltmann* [1976]);
(b) questions about the formation of contracts which are at least partly oral;
(c) claims for misrepresentation or rectification;
(d) questions as to the nature and object of the contract.

Perfect justice is no justice

One must, however, acknowledge the counter-argument against doing away with the exclusion. This was propounded by a solicitor called Alan Berg in *Thrashing Through the Undergrowth* [2006] 122 LQR 354 and it is one that may resonate in these cash-strapped times.

Berg concentrates on the practical difficulties a lawyer faces in giving a client advice as to the meaning of contractual clauses. He correctly states that a client who asks a lawyer to advise on the meaning of a particular clause is asking how a court would be likely to interpret it. This means, he argues, that the lawyer would first need to obtain all the relevant background knowledge which was reasonably available to the parties in the situation in which they were at the time of the contract and that he concludes would either be too expensive or impossible to do.

This argument is cited by Lord Hoffmann in *Chartbrook* but he also notes the counter that: "…evidence of the pre-contractual negotiations is almost invariably tendered in support of an alternative claim for rectification…or an argument based on estoppel by convention or some alleged exception to the exclusionary rule. Even if such an alternative claim does not succeed, the judge will have read and possibly been influenced by the evidence. The rule therefore achieves little in saving costs…"

The presage of things to come?

As to *Chartbrook* itself, Lord Hoffmann restated the principles that he had previously expounded in *ICS* and *Ali* and used them to decide the case, the rest of the panel fell into line behind him. Apparently the matter is settled, but the case contains an extraordinary sub-plot that starts with Lord Hoffmann himself.

Having concluded that "there is no clearly established case for departing from the exclusionary rule" despite it being not "inconsistent with the English objective theory of contractual interpretation to admit evidence", he goes on to muse: "It is possible that empirical study (for example, by the Law Commission) may show that the alleged disadvantages of admissibility are not in practice very significant or that they are outweighed by the advantages of doing more precise justice in exceptional cases or falling into line with international conventions."

This appears to be a plea that the Law Commission step in and get the House off the hook of its own precedent and is then followed by Lord Rodger who, after stating that the rule is "firmly embedded in our law" says: "So, if there is to be a change, it should be on the basis of a fully informed debate in a forum where the competing policies can be properly investigated and evaluated."

Finally Baroness Hale, after finding on the facts with the other judges, says: "I have to confess that I would not have found it quite so easy to reach this conclusion had we not been made aware of the agreement which the parties had reached on this aspect of their bargain during the negotiations which led up to the formal contract. On any objective view, that made the matter crystal clear…"

The debate will no doubt continue but the intellectual tide appears to be with the forces of abolition. The principal question may be more when and how rather than whether abolition of this long-standing rule takes place. NLJ

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