

# Wide-angle lens

Courts continue to wrestle with the thorny issue of contract construction, as **Ian Pease** reports

## IN BRIEF

- Where the contractual wording is ambiguous, it should be construed to give effect to that commercial goal of both parties.
- In complex multi-party transactions the courts have to be prepared to look still wider in construing the individual contract terms.

Construing the meaning of contractual wording is the bread and butter of the civil courts. Nevertheless, it has given the courts difficulties over the years, particularly in relation to which documents can be looked at to set the words used in their correct context.

In 2009 there was a major re-affirmation of the state of play, by Lord Hoffmann in *Chartbrook Ltd v Persimmon Homes Ltd* [2009] 3 WLR 267, a judgment that I commented upon in “The edifice begins to crack” (159 NLJ 7389, p 1435). Lord Hoffmann drew as widely as possible the ambit of the “matrix of fact”. Even the rule of construction that rendered inadmissible evidence of pre-contractual negotiations appeared to be on the wane. Nevertheless, given that the aim of the exercise is to assess the objective common intent of the parties, looking for a matrix or goal that is wider than the particular contract under consideration has been completely out of the question. However, even that sacred cow arguably now needs careful reconsideration.

Traditional analysis works well in a bi-partisan simple contract but it has severe difficulties in producing a just result where there is a network of interrelated contracts. The network of contracts in *Ibrahim v Barclays and others* [2011] EWHC 1897 (Ch); [2012] EWCA Civ 640 is not unusual in a complicated commercial deal. In this case, the crux of the construction involved words in a letter of credit (between a guaranteeing bank and a UK government department) and an agreement between that same department and a different bank as to how funds would be

“realised” if the target company should fall into liquidation.

The overall deal is illustrated in Diagram 1 below.

Although the claims revolved around equitable subrogation of the owner to the government’s rights under the Realisation Agreement, for present purposes they are not relevant as the *sine qua non* to such rights was the continued existence of that Realisation Agreement. The owner, standing in the shoes of the government, could have no better rights than the government had, and it was said that those rights had ceased to exist as soon as the guaranteeing bank had paid the government under the letter of credit.

In short, the question was whether the words used in the letter of credit showed that the intention of the parties (a guaranteeing bank and government

department) was that the target company’s debt to the government under the counter-indemnity was paid off by the payment under the letter of credit.

The words in the letter of credit were, of course, ambiguous. The letter said that the demand by the government “represents and covers” the unpaid sums due from the target company.

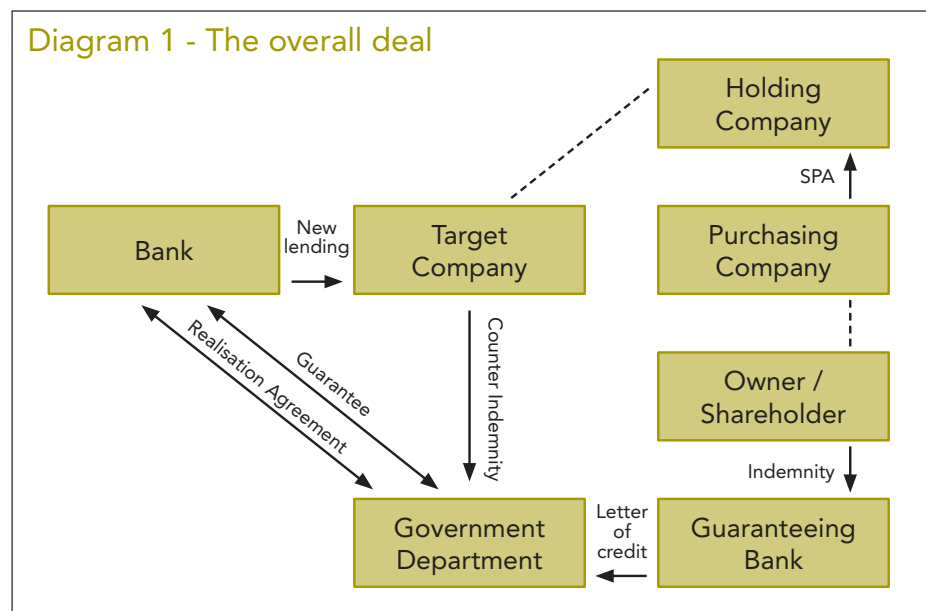
### The intention problem

The starting point of Vos J’s analysis, at first instance, was this: “It seems to me that what is important, as in any case of the alleged discharge of a debt, is the intention of the parties. In this case, the intentions of two parties are primarily engaged: the [government] as the party to whom the debt under the counter-indemnity was due, and [the target company] as the obligor under the counter-indemnity.”

It could be argued that this is the wrong starting point. If the question is how does one construe the words in the letter of credit, then perhaps the only legitimate starting point is what was the intention of the parties to that document (ie, the government and the guaranteeing bank). However if it was a slip, it is useful to my argument that innately the judge was having to look beyond the knowledge and intentions of the parties to the letter of credit.

It was evident what problem faced Vos J. As he said: “[The guaranteeing bank] was a party to an autonomous instrument, namely the letter of credit. Its intentions may not be strictly relevant to this issue, but it was undoubtedly bound by the terms of the letter of credit and

Diagram 1 - The overall deal



there has been no other evidence as to its intentions or expectations”, and, “In relation to the crucial question about the discharge of the [target company] debt under the counter-indemnity, Mr Birch [one of the government witnesses] said that he did not consider whether, when [the guaranteeing bank] paid up, there would be nothing more owed by [the target] to the government, and therefore nothing in which or in respect of which the government could share under the [Realisation Agreement].”

So neither of the parties had any intention in relation to the wording in the letter of credit.

Nevertheless, the first step, as with every contractual construction, was to get out the dictionary, to scope out the range of possible meanings. This Vos J did: “The question is what the words ‘represent and cover’ mean in the context in which they are used in the letter of credit... the most relevant definition of the word ‘cover’ is as follows:

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- (i) to be sufficient to defray (a charge, or expense), or to meet (a liability or risk of loss);
- (ii) to counterbalance or compensate (a loss or risk) so as to do away with its incidence, to be or make an adequate provision against (a liability); to protect by insurance or the like.”

Vos J continued: “Therefore, the wording is either saying that the [government] must certify that the amount demanded ‘is sufficient to discharge’ or ‘discharges’ the unpaid sums due from [target company] to the [government]”. Rightly Vos J described this as a “quite stark choice”.

Furthermore, as indicated above there was no relevant common intention in the actual parties to the letter of credit itself.

#### Traditional analysis fails

This is where traditional construction begins to break down. What does the judge do? He looked around at the other circumstantial documents and concluded “none of them seems to me, however, to take the matter much further”. I think it fair to conclude that the judge found no relevant context for

the admittedly ambiguous words and in the end concluded: “It seems to me that the common or garden usage of the word ‘cover’ in this context is indeed ‘discharge’, rather than ‘is sufficient to discharge’. If there were any extraneous material to suggest that the wording was required for another reason that might have been significant. But I can only rely on the evidence that is available.”

With respect to the judge that is a wholly inadequate analysis of the admittedly ambiguous wording. He had himself established that, according to his dictionary definition, there were two equally valid and diametrically opposed meanings for the wording, there was no “common or garden” usage therefore.

There is a significant passage in the judgment where the judge reviews the common expectation of the government and the owner (the ultimate indemnifier standing behind the guaranteeing bank, but of course not a party of the letter of credit): “It is true that [the government] argued

the case for [the owner’s] subrogation. But they never expressly turned their minds to whether [the guaranteeing bank’s] payment would discharge [the target’s] debt under the counter-indemnity.”

This was undoubtedly a difficult exercise in construction for the court but it selected the definition which destroyed the Realisation Agreement and thereby went against the contemporaneous expectations of both the government and the owner that the Realisation Agreement would survive the payment. In doing so it failed to do justice between the parties which is surely the prime directive.

#### The wide-angle lens

From the judgment it is evident that the court felt there was no relevant context that it could rely upon and this comes primarily from the concentration, in traditional construction analysis, upon the contractual matrix of a single transaction. What is needed is a wide-angle lens not a microscope. If such an analysis had been undertaken it would have been evident that:

- (i) The target was going to go into liquidation unless a white knight

was found, it desperately needed the purchasing company;

- (ii) The government wanted the deal to go through for political and economic reasons but it could not fund the due diligence exercise itself, however, it expected that the owner would be subrogated to its rights in the Realisation Agreement and told the purchasing company/owner as much before it entered into the agreement;
- (iii) The purchasing company was not sufficiently asset-rich to indemnify the government so the letter of credit eventually came from its owner. Neither the owner nor the purchasing company would have entered into the deal without the assurance that they would, via the subrogation route, get their money back.
- (iv) The target’s bank, which was to advance the further funds, also knew of the arrangement, with one of its personnel noting that if the target went under the purchasing company would “get first money in admin”.

Hence, standing back, one of the business drivers of the whole matrix of agreements above was that the Realisation Agreement would survive the payment.

The letter of credit’s wording should have been construed so as to give effect to that wider commercial goal even though, from a subjective point of view, neither party to the letter of credit appears to have contemplated the meaning of the words it contained.

The strange thing is that Vos J almost does this but then (perhaps through instinct) recoils: “In this case, as is demonstrated by the events that I have set out in the above chronology, the terms of the letter of credit were negotiated between [the government] and [the guaranteeing bank], and approved by [the purchasing company/its owner]. Those terms reflect the deal that these parties were doing. Whilst the negotiations are not admissible to construe the meaning of the letter of credit itself, they are admissible to the question of whether or not the parties intended any payment by [the guaranteeing bank] to discharge the debt due from [the target company] under the counter-indemnity.”

Doing justice sometimes needs a wide-angle lens and not a microscope. NLJ

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