

# The lingering confusion and uncertainty in the law of contract interpretation

*David McLauchlan\**

*The judgments of English courts regularly state that the principles governing contract interpretation are well established. On the surface this seems correct, particularly in view of the frequent endorsement of Lord Hoffmann's restatement of the fundamental principles of interpretation in the Investors Compensation case. However, this article argues that closer scrutiny reveals a different picture. The principles are now being questioned, or not applied as Lord Hoffmann intended, and in other respects the law is uncertain. Recent developments suggest that what Lord Steyn once described as the "shift towards commercial interpretation" has been halted, or at least curtailed. In other words, they are indicative of a desire to return to a more conservative approach to contract interpretation under which disputes should be resolved primarily on the basis of textual analysis with limited resort to external context, including considerations of commercial common sense. The author concludes by suggesting a principled way out of some of the current confusion and uncertainty that does not entail abandoning Lord Hoffmann's principles and turning the clock back to a plain meaning rule under which ordinarily the only escape from a finding that the language of the contract is unambiguous is a ruling that absurd consequences will result.*

## **1. Introduction**

Contract interpretation disputes continue to take up more judicial time than all other areas of the law of contract put together. A perusal every few weeks of the main English, Australian and New Zealand databases will reveal scores of new cases. Of course, they are mostly decisions on their own facts with no new law involved. In addition, the facts are usually so complex or extremely dry that attempting to read and master them all would require one to expend, often unproductively, considerable time and mental energy. However, I am encouraged to persevere, albeit with a degree of selectivity, when it is discovered that on many occasions the outcome of a dispute involving very large sums of money<sup>1</sup> will hinge on the finest of points that might reasonably be resolved either way and that do in fact give rise to divided judicial opinions. Sometimes these disputes even seem to border on the unjustifiable. Little wonder, therefore, that questions of interpretation are often described as "matters of impression" or intuition<sup>2</sup> and that disagreements arise over such elementary questions as whether particular words have an "ordinary" or "plain" meaning or which

\* Professor of Law, Victoria University of Wellington; Professorial Fellow, The University of Melbourne; Honorary Professor, The University of Queensland. Thanks to Richard Calnan for his helpful comments on a draft of this article.

1. See, eg, *Blueco Ltd v BWAT Retail Nominee (1) Ltd* [2014] EWCA Civ 154 (£120 million).

of the rival views is the “commonsense” or “more commercially sensible” interpretation. Interestingly, it has recently been said that “commercial absurdity tends to lie in the eye of the beholder” and that “[a]ssessments of commercial purpose or commercially absurd consequences will be influenced by factors such as the background and experience of the court”.<sup>3</sup>

The recent decision of the English Court of Appeal in *Napier Park European Credit Opportunities Fund Ltd v Harbourmaster Pro-Rata Clo 2 BV*<sup>4</sup> provides one of a number of possible illustrations of the first type of disagreement over plain meaning. In brief, the question whether the holder of a certain class of securities was entitled to be paid a substantial sum depended on whether a reinvestment criterion requiring that the credit ratings of the securities “have not been downgraded below their Initial Ratings” was not satisfied. Did the quoted words mean that the criterion would not be satisfied if at any point during the relevant period the securities were downgraded from their initial AAA rating to AA despite the fact that the former rating was later reinstated, or was the historical downgrade irrelevant if the initial rating was in force at the time for the potential reinvestment? The Chancellor of the High Court adopted the former view, holding that the words were clear and unambiguous, but the Court of Appeal<sup>5</sup> disagreed. The words were capable of being read as simply requiring the original rating to be the same at the time for application of the various reinvestment criteria and this was their true meaning once the overall structure of the transaction and the consequences of the rival interpretations were taken into account.<sup>6</sup>

A recent example of the former type of disagreement over the “commercially sensible” interpretation is provided by the decision of the same, albeit differently constituted, court some two weeks earlier in *Tidal Energy Ltd v Bank of Scotland Plc.*<sup>7</sup> The appellant had

2. See *Deutsche Genossenschaftsbank v Burnhope* [1996] 1 Lloyd’s Rep 113, 122, *per* Lord Steyn: “Often a question of construction can only be solved as a matter of first impression.” See also Johan Steyn, “The Intractable Problem of the Interpretation of Legal Texts” (2003) 25 Sydney L Rev 5, 8 (“Educated intuition may play a larger role than an examination of niceties of textual analysis”) and Sir Kim Lewison, *The Interpretation of Contracts*, 5th edn (Sweet and Maxwell, London, 2011), [2.12] and the cases cited therein. As Richard Calnan has astutely observed (*Principles of Contractual Interpretation* (OUP, Oxford, 2013), 2): “[H]owever far we try to create a body of law which explains how to interpret contracts, the interpretation of any particular contract will ultimately involve a question of judgement. You can get a long way with principled reasoning, but the final step is a leap of faith. It is important to understand the limits of logic, and where intuition takes over.”

3. *Firm PI 1 Ltd v Zurich Australian Insurance Ltd* [2014] NZSC 147, [90] (McGrath, Glazebrook and Arnold JJ), citing Lord Hoffmann’s observation in *Chartbrook Ltd v Persimmon Homes Ltd* [2009] UKHL 38; [2009] 1 AC 1101, [15] that it is “not unusual that an interpretation which does not strike one person as sufficiently irrational to justify a conclusion that there has been a linguistic mistake will seem commercially absurd to another”.

4. [2014] EWCA Civ 984; *rvsg* [2014] EWHC 1083 (Ch). Another recent example is *Firm PI 1 Ltd v Zurich Australian Insurance Ltd* [2014] NZSC 147, where the two dissenting judges, Elias CJ and William Young J, regarded the majority’s interpretation as rewriting the parties’ bargain without adequate basis for doing so.

5. Lewison LJ (Floyd and Longmore LJJ concurring).

6. The reasoning of the court is discussed further *post*, text to fn.149.

7. [2014] EWCA Civ 1107; [2014] 2 Lloyd’s Rep 549 (Lord Dyson MR, Tomlinson and Floyd LJJ). See also *Sugarman v CJS Investments LLP* [2014] EWCA Civ 1239, where the court overturned the decision of the trial judge that the literal interpretation of articles of association produced a “commercial absurdity”, albeit in the view of Briggs LJ “on a narrow balance” (at [50]). His Lordship observed (at [44]): “There can unfortunately be a fine dividing line between that which appears commercially unattractive and even unreasonable and that which appears nonsensical or absurd. It causes continuing difficulty in the application of English law to problems of construction, not least because it is not unusual for apparently reasonable judicial minds to disagree on the

instructed the respondent bank to pay one of its creditors through the clearing houses automated payment system known as CHAPS. The instructions included the correct name of the creditor but, due to the fraud of a third party, the incorrect account details. In accordance with banking practice, the receiving bank credited the payment to the fraudster's account without checking whether the name on the account corresponded with that of the appellant's creditor. Unsurprisingly, the funds were withdrawn and could not be recovered. The question before the court was whether the appellant's instruction authorised the respondent to debit its account when money has been paid into an account having the specified numerical data, but in the name of someone other than the designated payee. The majority (Lord Dyson MR and Tomlinson LJ) upheld the trial judge's affirmative answer. Lord Dyson ruled, *inter alia*, that, even if the banking practice could not be considered part of the factual background because its existence would not have been known to a reasonable person in the position of the appellant, the latter's interpretation "produce[d] a result which is not reasonable and not commercially sensible".<sup>8</sup> Similarly, Tomlinson LJ foresaw "grave difficulties arising"<sup>9</sup> if a payment could be made only when all identifiers of the payee in the customer's instructions corresponded. By contrast, the dissenting judge, Floyd LJ, regarded the respondent's interpretation as giving rise to "a most improbable and uncommercial result".<sup>10</sup> His Lordship could see "no rational criterion"<sup>11</sup> for concluding that the creditor's name could be disregarded when carrying out the customer's instructions and he was not prepared to accept that a decision against the bank "would undermine the CHAPS system".<sup>12</sup>

Despite such all too common judicial disagreements, court judgments frequently state that the principles governing contract interpretation are well established (or at least that they were not disputed by opposing counsel).<sup>13</sup> On the surface this seems correct, particularly in view of the frequent citation and endorsement of Lord Hoffmann's restatement of the fundamental principles of interpretation in *Investors Compensation Scheme Ltd v West Bromwich Building Society* ("ICS").<sup>14</sup> However, closer scrutiny reveals a different picture. The truth is that in some respects the principles are now being questioned or not applied

question whether a particular contractual or other documentary provision has crossed it, as Lord Hoffmann ruefully observed in the *Chartbrook* case at paragraph 15." (Lord Hoffmann's observation is cited *supra*, fn.3.)

8. [2014] EWCA Civ 1107; [2014] 2 Lloyd's Rep 549, [62].

9. *Ibid*, [44].

10. *Ibid*, [29].

11. *Ibid*, [34].

12. *Ibid*, [37]. For a comprehensive and helpful discussion of this case, including other respects in which the judges were divided, see Gerard McMeel, "Fraud and Electronic Funds Transfers" [2015] LMCLQ 1.

13. For recent examples see, eg, *Tael One Partners Ltd v Morgan Stanley & Co International Plc* [2015] UKSC 12; [2015] Bus LR 278, [1]; *AL Challis Ltd v British Gas Trading Ltd* [2015] EWHC 141 (Comm), [8]; *BG Global Energy Ltd v Talisman Sinopec Energy UK Ltd* [2015] EWHC 110 (Comm), [24]; *Reinhard v Ondra LLP* [2015] EWHC 26 (Ch), [305]; *Morris v Blackpool Borough Council* [2014] EWCA Civ 1384, [24]; *Globe Motors, Inc v TRW Lucas Varity Electric Steering Ltd (Rev 1)* [2014] EWHC 3718 (Comm), [180]; *UBS AG (London Branch) v Kommunale Wasserwerke Leipzig GmbH* [2014] EWHC 3615 (Comm), [817]; *Carewatch Care Services Ltd v Focus Caring Services Ltd* [2014] EWHC 2313 (Ch), [89]; *Starbev Gp Ltd v Interbrew Central European Holdings BV* [2014] EWHC 1311 (Comm), [58]; *BMA Special Opportunity Hub Fund Ltd v African Minerals Finance Ltd* [2013] EWCA Civ 416, [24]; *Amlin Corporate Member Ltd v Oriental Assurance Corp* [2014] EWCA Civ 1135, [44]; *Barclays Bank Plc v Landgraf* [2014] EWHC 503 (Comm), [27]; *Burntcooper Ltd (t/a Contemporary Design Unit) v International Travel Catering Association Ltd* [2014] EWHC 148 (Comm), [24]; *Ardagh Group SA v Pillar Property Group Ltd* [2013] EWCA Civ 900; [2014] STC 26, [50].

14. [1998] 1 WLR 896, 912–913.

by the courts as Lord Hoffmann intended. The primary purpose of this article is to discuss these developments, but a brief consideration of other respects in which the principles remain contentious or give rise to difficulties may assist in putting that discussion into context.

## 2. Objectivity and actual intention

Lord Hoffmann's well-known first principle is that "[i]nterpretation 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".<sup>15</sup> Thus, it is commonly said that it is a basic principle that the law is concerned only with the intention of the parties as *objectively ascertained*, not their actual or "subjective" intention. As Lord Clarke said in *Rainy Sky SA v Kookmin Bank* ("*Rainy Sky*"),<sup>16</sup> "the ultimate aim of interpreting a provision in a contract, especially a commercial contract, is to determine what the parties meant by the language used, which involves ascertaining what a reasonable person would have understood the parties to have meant". But who is this reasonable person and from what perspective does he judge what the parties meant? It is widely thought that the common law depersonalises contracting parties and asks what a detached or outside observer would have taken their intention to be.<sup>17</sup> On one view, this observer "is informed with business common sense, the knowledge of the parties, including of course of the other provisions of the contract, and the experience and expertise enjoyed by the parties, at the time of the contract",<sup>18</sup> but apparently he is unaware of, or wholly unconcerned with, their actual intention, even if it is held in common and communicated between them. This seems counter-intuitive.<sup>19</sup> Perhaps this is why the Court of Appeal observed in a recent case<sup>20</sup> that "an argument that the court should interpret a contractual provision in a way not actually intended by either party to it is not the most promising starting point". Be that as it may, it is equally common to refer to the objective test as requiring a determination of what the reasonable person *in the position of the parties* would have inferred. As Lord Steyn once said, "the question is what reasonable persons, circumstanced as the actual parties were, would have had in mind".<sup>21</sup> On this version of objectivity, the question arises: would not such a reasonable person, who is asked to determine what the parties meant by the language used, give decisive weight to either a manifested actual mutual understanding of

15. *Ibid.*, 912.

16. [2011] UKSC 50; [2011] 1 WLR 2900, [14].

17. See, eg, *Chartbrook Ltd v Persimmon Homes Ltd* [2009] UKHL 38; [2009] 1 AC 1101, [39].

18. *Pink Floyd Music Ltd v EMI Records Ltd* [2010] EWCA Civ 1429, [18] *per* Lord Neuberger MR.

19. See generally D McLauchlan, "The Contract that Neither Party Intends" (2012) 29 JCL 26.

20. *Blueco Ltd v BWAT Retail Nominee (1) Ltd* [2014] EWCA Civ 154, [55], *per* Sir Terence Etherton C, with whom Briggs LJ and Proudman J agreed.

21. *Mannai Investment Co Ltd v Eagle Star Life Assurance Co Ltd* [1997] AC 749, 768. See also *Toll (FCGT) Pty Ltd v Alphapharm Pty Ltd* (2004) 219 CLR 165, [40]: "It is not the subjective beliefs or understandings of the parties about their rights and liabilities that govern their contractual relations. What matters is what each party by words and conduct would have led a reasonable person in the position of the other party to believe."

22. [2009] UKHL 38; [2009] 1 AC 1101.

the meaning of the language or the understanding of one party where that party was led reasonably to believe that that understanding was shared by the other party?

Lord Hoffmann's third principle in *ICS*, that "[t]he law excludes from the admissible background the previous negotiations of the parties", is even more contentious. Although the rule was reaffirmed by the House of Lords in *Chartbrook Ltd v Persimmon Homes Ltd* ("*Chartbrook*")<sup>22</sup> and it is unlikely to be revisited in the foreseeable future,<sup>23</sup> it is now subject to so many qualifications and exceptions that it is questionable whether much of substance remains. There are, for example, various legal mechanisms that might be invoked to give effect to a clearly proven actual mutual intention of the parties.

First, it was accepted in *Prenn v Simmonds*<sup>24</sup> that "evidence of mutually known facts may be admitted to identify the meaning of a descriptive term", as in *Macdonald v Longbottom*,<sup>25</sup> where a conversation between the parties showed that a contract for the sale of "your wool" was intended to include both wool produced on the seller's farm and wool that the seller had bought in from other farms. One is driven to ask why the position should be different if the dispute relates to some other important term in respect of which there is reliable evidence as to the parties' intended meaning.

Secondly, in *Chartbrook*<sup>26</sup> Lord Hoffmann stated the latter exception more broadly when he said that the rule does not exclude the use of evidence of prior negotiations "to establish that a fact which may be relevant as background was known to the parties". Although his Lordship would not have countenanced this, it can certainly be argued that an exchange between the parties irrefutably establishing an actual mutual intention as to the meaning of a term is an objective background fact and therefore admissible.<sup>27</sup>

Thirdly, there is the so-called "private dictionary" exception stated by Kerr J in *The Karen Oltmann*<sup>28</sup> (allowing evidence that the parties negotiated on the basis of a common understanding that words bore a particular meaning), which was widely accepted until Lord Hoffmann dubiously confined it in *Chartbrook* to situations where evidence is sought to be adduced "that the parties habitually used words in an unconventional sense in order to support an argument that words in a contract should bear a similar unconventional meaning".<sup>29</sup> The distinction drawn here is difficult to sustain. What rational explanation can there be for admitting evidence that, say, the parties always, or for a particular transaction,

23. It is often said, somewhat misleadingly, that Lord Hoffmann held that the exclusionary rule was justified on pragmatic grounds. In fact, his Lordship said that the rule *may* be justified on such grounds. In essence, he held that the case for departing from the exclusionary rule had not been "clearly established" (at [41]). He was not convinced that the often raised pragmatic objections to doing so, which he was careful not to endorse unreservedly, were outweighed by the advantages. He acknowledged that an empirical study might find otherwise, but concluded that in the meantime the only appropriate course, given that the rule was long-standing and had been affirmed several times by the House of Lords, was to preserve the status quo.

24. [1971] 1 WLR 1381, 1384, *per* Lord Wilberforce.

25. (1859) 1 E & E 977; 120 ER 1177.

26. [2009] UKHL 38; [2009] 1 AC 1101, [42].

27. The argument is developed in D McLauchlan, "Contract Interpretation: What Is It About?" (2009) 31 Sydney L Rev 5, 25–29.

28. *Partenreederei MS Karen Oltmann v Scarsdale Shipping Co Ltd (The Karen Oltmann)* [1976] 2 Lloyd's Rep 708, 712.

29. *Chartbrook* [2009] UKHL 38; [2009] 1 AC 1101, [45]; followed in *Retirement Services Australia (RSA) Pty Ltd v 3143 Victoria St Doncaster Pty Ltd* [2012] VSCA 134; 37 VR 486, [103].

used “apples” to mean “pears”, but not evidence that they used a word, such as “after” in *The Karen Oltmann*, in one of two conventional senses?

Fourthly, and most importantly, although Lord Hoffmann was not prepared to endorse the wider version of the “private dictionary” principle because it “would destroy the exclusionary rule and any practical advantages which it may have”,<sup>30</sup> he did accept that the “two legitimate safety devices” of rectification and estoppel by convention are alternative means of enforcing an agreed meaning reached in the course of negotiations and thus “will in most cases prevent the exclusionary rule from causing injustice”.<sup>31</sup> These “remedies” were said to “lie outside the exclusionary rule, since they start from the premise that, as a matter of construction, the agreement does not have the meaning for which the party seeking rectification or raising an estoppel contends”.<sup>32</sup> Nevertheless, estoppel by convention in this context is essentially the private dictionary principle dressed up under a new legal label because, as Lord Hoffmann said, “[i]f the parties have negotiated an agreement upon some common assumption, which may include an assumption that certain words will bear a certain meaning, they may be estopped from contending that the words should be given a different meaning”.<sup>33</sup>

### 3. The demise of *ICS*?

Returning to the main focus of this article, analysis of recent cases reveals some dissatisfaction with or departures from the *ICS* principles in important respects. Indeed, on one view, these cases reflect a return to the traditional approach to interpretation, an approach that was thought to have been discarded as a result of the decisions of the House of Lords in *Mannai Investment Co Ltd v Eagle Star Life Assurance Co Ltd* (“*Mannai Investment*”),<sup>34</sup> *ICS* and *Chartbrook*. Under that approach, (a) the terms of a written contract must ordinarily be given their plain meaning unless that would result in an absurdity or commercial nonsense; (b) if it is alleged that the parties chose the wrong words to give effect to their intention, the appropriate course is to seek rectification; and (c) only where the words of a contract are ambiguous, or their application to the facts uncertain, is it appropriate to engage in the task of determining which of the competing interpretations is the more “commercial” in the light of the factual matrix. A return to this approach would mean, for example, that a preliminary finding of ambiguity has assumed renewed importance, and the claims by commentators that the modern approach to interpretation of contracts has usurped much of the function of the equitable remedy of rectification<sup>35</sup>

30. *Ibid.*, [47].

31. *Ibid.*

32. *Ibid.*

33. *Ibid.* As I have discussed elsewhere (“Common Intention and Contract Interpretation” [2011] LMCLQ 30, 45), surely a more principled approach would be that, where it is proven that the parties to a proposed contract negotiated on the basis of a common understanding or assumption that a particular term has a certain meaning, the latter is the meaning of the term. The current law in effect says to the party who attempts to depart from the understanding: “You are right. The contract does not mean what both parties intended it to mean. But, because both proceeded on the basis that it did mean what it was intended to mean, you are precluded from denying that meaning; it is unconscionable for you to invoke or enforce the true meaning when the other party relied to its detriment on the existence of a different meaning when it entered into the contract.”

34. [1997] AC 749.

35. See, eg, G McMeel, *The Construction of Contracts*, 2nd edn (OUP, Oxford, 2011), [17.63].

would need to be revised. Nevertheless, the picture remains uncertain in several respects. For example, it is difficult to see how the old plain meaning rule has been reinstated, given that to my knowledge no judge has doubted Lord Hoffmann's first principle in *ICS* that interpretation involves ascertaining the meaning that the document would convey to a reasonable person with knowledge of the background. It would certainly be inconsistent with that principle, and indeed the whole tenor of his Lordship's judgment, to insist on a preliminary finding of ambiguity before it is permissible to have regard to evidence of the factual background.<sup>36</sup> Such evidence must *always* be admissible as an aid to interpretation. However, it may be, although we cannot yet be sure, that, when it is said, as in *Rainy Sky*<sup>37</sup> and in numerous cases thereafter, that the court must give effect to unambiguous language, it was not intended that the existence of ambiguity be judged solely on the basis of internal linguistic considerations but rather *after* consideration of the factual background to the contract. It is convenient to begin a discussion of this and related issues with the important *dicta* in the judgment of Lord Neuberger (with whom Lords Clarke, Sumption, Carnwath and Hodge agreed) in the recent case of *Marley v Rawlings*.<sup>38</sup>

#### 4. Interpretation and rectification

According to Lord Hoffmann's fourth and fifth principles in *ICS*:<sup>39</sup>

"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: see *Mannai Investment Co Ltd v Eagle Star Life Assurance Co Ltd* [1997] AC 749.

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. Lord Diplock made this point more vigorously when he said in *Antaios Compania Naviera SA v Salen Rederierna AB* [1985]

36. As Lord Hoffmann pointed out in *Chartbrook* [2009] UKHL 38; [2009] 1 AC 1101, [37], *ICS* decided two main points: "first, that it was not necessary to find an 'ambiguity' before one could have any regard to background and, secondly, that the meaning which the parties would reasonably be taken to have intended could be given effect despite the fact that it was not, according to conventional usage, an 'available' meaning of the words or syntax which they had actually used". See also *Westminster City Council v National Asylum Support Service* [2002] UKHL 38; [2002] 1 WLR 2956, [5], *per* Lord Steyn: "The starting point is that language in all legal texts conveys meaning according to the circumstances in which it was used. It follows that the context must always be identified and considered before the process of construction or during it. It is therefore wrong to say that the court may only resort to evidence of the contextual scene when an ambiguity has arisen ... [I]n his important judgment in *Investors Compensation Scheme Ltd v West Bromwich Building Society* [1998] 1 WLR 896, 912–913, Lord Hoffmann made crystal clear that an ambiguity need not be established before the surrounding circumstances may be taken into account."

37. [2011] UKSC 50; [2011] 1 WLR 2900, [23].

38. [2014] UKSC 2; [2015] 1 AC 129, [37].

39. [1998] 1 WLR 896, 913.

AC 191, 201: ‘if detailed semantic and syntactical analysis of words in a commercial contract is going to lead to a conclusion that flouts business commonsense, it must be made to yield to business commonsense’.”

The second sentence of the fifth principle, under which mistaken language may be corrected as a matter of interpretation, was described as “controversial” by Lord Neuberger in *Marley v Rawlings*.<sup>40</sup> His Lordship noted that the approach was taken “a little further”<sup>41</sup> in *Chartbrook* when Lord Hoffmann said:<sup>42</sup>

“[T]here is not, so to speak, a limit to the amount of red ink or verbal rearrangement or correction which the court is allowed. All that is required is that it should be clear that something has gone wrong with the language and that it should be clear what a reasonable person would have understood the parties to have meant.”

Lord Neuberger then continued:<sup>43</sup>

“In a forcefully expressed article, “‘Construction” and Rectification after *Chartbrook*’ [2010] CLJ 253, Sir Richard Buxton has suggested that Lord Hoffmann’s approach to interpretation in [*ICS* and *Chartbrook*] is inconsistent with previously established principles. Lewison on *The Interpretation of Contracts*, 5th edn, (2011), para.9.03, footnote 67, in an illuminating chapter dealing with mistakes, suggests that Sir Richard has made out ‘a powerful case for the conclusion that the difference between construction and rectification has reduced almost to vanishing point’, if Lord Hoffmann’s analysis is correct.

At first sight, it might seem to be a rather dry question whether a particular approach is one of interpretation or rectification. However, it is by no means simply an academic issue of categorisation. If it is a question of interpretation, then the document in question has, and has always had, the meaning and effect as determined by the court, and that is the end of the matter. On the other hand, if it is a question of rectification, then the document, as rectified, has a different meaning from that which it appears to have on its face, and the court would have jurisdiction to refuse rectification or to grant it on terms (eg if there had been delay, change of position, or third party reliance) ...”

Although his Lordship did not find it necessary to decide “this difficult point”,<sup>44</sup> he has, with the concurrence of all of their Lordships, clearly cast doubt on the validity of Lord Hoffmann’s fourth and fifth principles. That it was his intention to do so is confirmed in the course of a recent extrajudicial speech in which he said that “the Supreme Court has suggested that [the fifth principle] may go too far, not least because, as Sir Richard Buxton put it in a trenchant article, it reduces the ‘difference between construction and rectification almost to vanishing point’”.<sup>45</sup> Significantly, as we will see, acceptance of Buxton’s views would have the effect of reinstating the plain meaning rule, whereas Lord Neuberger appears to have regarded the presence of a “natural and ordinary meaning” as one factor to be considered by the court as it seeks “to identify the intention of the...

40. [2014] UKSC 2; [2015] 1 AC 129, [37]. His Lordship had earlier said (at [36]) that “[m]ost of the content of [the five principles] is unexceptionable”.

41. *Ibid.*, [38].

42. *Chartbrook* [2009] UKHL 38; [2009] 1 AC 1101, [25].

43. *Marley v Rawlings* [2014] UKSC 2; [2015] 1 AC 129, [39–40].

44. *Ibid.*, [41].

45. Lord Neuberger, “The impact of pre- and post-contractual conduct on contractual interpretation”, a speech delivered at the Banking Services and Finance Law Association Conference, Queenstown, New Zealand on 11 August 2014, para.23 (available at [supremecourt.uk/news/speeches.html](http://supremecourt.uk/news/speeches.html)).

parties to the document by interpreting the words used in their documentary, factual and commercial context".<sup>46</sup>

If it is indeed true that Lord Hoffmann went too far, so that *there is* "a limit to the amount of red ink or verbal rearrangement or correction which the court is allowed", this has major implications for the survival of his restatement as a whole. One cannot simply excise the whole or part of the fifth principle and leave the remainder of the restatement intact, because his Lordship plainly regarded that principle, as well as his closely-related fourth principle, as a natural extrapolation from his first principle that interpretation involves ascertaining the meaning that the document would convey to a reasonable person with knowledge of the background. If he went too far, does this mean that sometimes words will be just too clear to admit of correction by interpretation, so that the proper remedy, if any, is rectification? Must there be ambiguity or difficulty in applying the words to the facts that have arisen before some rewriting is permissible? If not, where is the line to be drawn? Several points need to be made here.

First, presumably it would not be suggested that courts can never correct mistakes in expression as a matter of interpretation. Even under the traditional approach to interpretation centred around the plain meaning rule, the courts would rewrite contracts where it was obvious that the wrong words were used because the literal meaning gave rise to a manifest absurdity.<sup>47</sup>

Secondly, as already indicated, acceptance of the view that Lord Hoffmann's fourth and fifth principles went too far undermines the whole theory on which his restatement was based. His starting point was that contracts are generally to be interpreted in the same commonsense manner that "any serious utterance would be interpreted in ordinary life".<sup>48</sup> He had in mind here the point, later reflected in his fourth principle, that it is an everyday occurrence for people to use the wrong words or syntax yet at the same time succeed in communicating their meaning, often without ambiguity.

A fuller explanation of this point is to be found in his Lordship's instructive speech, delivered less than a month earlier, in *Mannai Investment*:<sup>49</sup>

"It is a matter of constant experience that people can convey their meaning unambiguously although they have used the wrong words. We start with an assumption that people will use words and grammar in a conventional way but quite often it becomes obvious that, for one reason or another, they are not doing so and we adjust our interpretation of what they are saying accordingly. We do so in order to make sense of their utterance: so that the different parts of the sentence fit together

46. [2014] UKSC 2; [2015] 1 AC 129, [20]. His Lordship said (at [19]): "When interpreting a contract, the court is concerned to find the intention of the party or parties, and it does this by identifying the meaning of the relevant words, (a) in the light of (i) the natural and ordinary meaning of those words, (ii) the overall purpose of the document, (iii) any other provisions of the document, (iv) the facts known or assumed by the parties at the time that the document was executed, and (v) common sense, but (b) ignoring subjective evidence of any party's intentions."

47. See, eg, *Watson v Phipps* (1985) 60 ALJR 1 (PC) and *Fitzgerald v Masters* (1956) 95 CLR 420. In the latter case a written contract of sale provided that "the usual conditions of sale in use or approved of by the Real Estate Institute of New South Wales relating to sales by private contract of lands held under the Crown Lands Act shall so far as they are inconsistent herewith be deemed to be embodied herein". The word "inconsistent" was an obvious mistake and the High Court of Australia had no difficulty in finding that it meant "consistent" or "not inconsistent".

48. [1998] 1 WLR 896, 912.

49. [1997] AC 749, 774–775.

in a coherent way and also to enable the sentence to fit the background of facts which plays an indispensable part in the way we interpret what anyone is saying...

It is of course true that the law is not concerned with the speaker's subjective intentions. But the notion that the law's concern is therefore with the 'meaning of his words' conceals an important ambiguity. The ambiguity lies in a failure to distinguish between the meanings of words and the question of what would be understood as the meaning of a person who uses words. The meaning of words, as they would appear in a dictionary, and the effect of their syntactical arrangement, as it would appear in a grammar, is part of the material which we use to understand a speaker's utterance. But it is only a part; another part is our knowledge of the background against which the utterance was made. It is that background which enables us, not only to choose the intended meaning when a word has more than one dictionary meaning but also, in the ways I have explained, to understand a speaker's meaning, often without ambiguity, when he has used the wrong words."

Later in his speech his Lordship reiterated that we must not "confuse the meaning of words with the question of what meaning the use of the words was intended to convey".<sup>50</sup> In order to displace an alleged plain meaning it is sufficient that the words would have conveyed a different meaning to a reasonable person with knowledge of the background. Lord Hoffmann essentially rejects the notion of plain meaning. Language is fallible and does not define itself. As he also pointed out in *Mannai Investment*,<sup>51</sup> "words do not in themselves refer to anything; it is people who *use* words to refer to things".

Thirdly, having said all that, Lord Hoffmann was by no means suggesting that the words used by the parties are unimportant. On the contrary, he accepted that most issues of interpretation can be solved by a reading of the words in the context of the document as a whole. There will usually be no answer to the solution derived from giving the words their ordinary or conventional meaning. His Lordship stressed in his fourth principle in *ICS* that "we do not easily accept that people have made linguistic mistakes, particularly in formal documents".<sup>52</sup> Indeed, earlier, in *Mannai Investment*,<sup>53</sup> he said that "[w]e start with an assumption that people will use words and grammar in a conventional way"; and later, in *Bank of Credit and Commerce International SA v Ali*,<sup>54</sup> he emphasised that "the primary source for understanding what the parties meant is their language interpreted in accordance with conventional usage" and that in the *ICS* case he "was certainly not encouraging a trawl through 'background' which could not have made a reasonable person think that the parties must have departed from conventional usage". Furthermore, in *Chartbrook*<sup>55</sup> he cautioned that "the fact that a contract may appear to be unduly favourable to one of the parties is not a sufficient reason for supposing that it does not mean what it says".

50. *Ibid.*, 779.

51. *Ibid.*, 778. In the same case Lord Steyn said (at 771): "In determining the meaning of the language of a commercial contract... the law... generally favours a commercially sensible construction. The reason for this approach is that a commercial construction is more likely to give effect to the intention of the parties. Words are therefore interpreted in the way in which a reasonable commercial person would construe them. And the standard of the reasonable commercial person is hostile to technical interpretations and undue emphasis on the niceties of language." See also his Lordship's observations to like effect in *Sirius International Insurance Co v FAI General Insurance* [2004] UKHL 54; [2004] 1 WLR 3251, 3258–3259.

52. [1998] 1 WLR 896, 913.

53. [1997] AC 749, 774–775.

54. [2001] UKHL 8; [2002] 1 AC 251, [39].

55. [2009] UKHL 38; [2009] 1 AC 1101, [20].

Fourthly, if it were now the law that judicial rewriting is permissible only in cases where the plain meaning of the words used would result in an absurdity or make the contract a “commercial nonsense”, the *ICS* case itself would have to be considered wrongly decided. In that case Lord Hoffmann, speaking for the majority of the House of Lords, did not dispute the view of the dissenting judge, Lord Lloyd of Berwick, that the consequences of the literal interpretation of the words in question fell short of being “extraordinary” or “ridiculous” and hence did not “prompt the comment ‘whatever else the parties may have had in mind, they cannot have meant *that*’”.<sup>56</sup> In rejecting Lord Lloyd’s interpretation and reversing the decision of the Court of Appeal, Lord Hoffmann relied primarily on the strange wording of the clause and various anomalies that would result from that interpretation. There does not seem to have been any question of the appellant’s having to pass the absurdity or “commercial nonsense” threshold before its interpretation of the words could be upheld. It sufficed that this interpretation was “what the parties using those words against the relevant background would reasonably have been understood to mean”.<sup>57</sup> It is true that in *Chartbrook* Lord Hoffmann justified his decision to depart from the literal meaning in that case on the basis that interpreting the disputed clause “in accordance with ordinary rules of syntax [made] no commercial sense”<sup>58</sup> and that Lord Walker referred to the consequences of the alleged plain meaning as “totally incredible”<sup>59</sup> and a “commercial nonsense”.<sup>60</sup> However, those statements were made as part of the explanation why a reasonable person with knowledge of the background would have given the clause a different meaning. Absence of commercial sense was not itself *the test* for departing from the ordinary rules of syntax.<sup>61</sup>

Fifthly, it is significant that Lord Neuberger in *Marley v Rawlings* and in his extrajudicial comments cited with apparent approval Sir Richard Buxton’s *Cambridge Law Journal* article.<sup>62</sup> In that article the author, while acknowledging that the first three of the *ICS* principles were “a statement of the orthodox approach to construction”<sup>63</sup> and that his own views might be considered “heretical”,<sup>64</sup> took strong exception to the fourth and fifth *ICS* principles, concluding that “[r]ectification should in future occupy the whole of the field when it is necessary to correct errors in the formal expression of a contractual

56. *ICS* [1998] 1 WLR 896, 905.

57. *Ibid.*, 913.

58. *Chartbrook* [2009] UKHL 38; [2009] 1 AC 1101, [16].

59. *Ibid.*, [88].

60. *Ibid.*, [89].

61. Compare the inference by Briggs LJ in *Sugarman v CJS Investments LLP* [2014] EWCA Civ 1239, [43] that *ICS* is an example of a case where “the apparently unambiguous meaning of the words used produces such a nonsensical result that it cannot be treated as expressing the meaning of the document”.

62. “‘Construction’ and Rectification after *Chartbrook*” [2010] CLJ 253. See *ante*, text following fn.43. Buxton’s views were also endorsed by the Supreme Court in *Oceanbulk Shipping and Trading SA v TMT Asia Ltd* [2010] UKSC 44; [2011] 1 AC 662, [43–45] but only insofar as he argued that “the principles enshrined in the *ICS* case, especially the fifth principle, point to the close relationship between interpretation and rectification” (at [44]) and hence this supported the Court’s conclusion (at [45]) that “evidence of what was said or written in the course of without prejudice negotiations should in principle be admissible, both when the court is considering a plea of rectification based on an alleged common understanding during the negotiations and when the court is considering a submission that the factual matrix relevant to the true construction of a settlement agreement includes evidence of an objective fact communicated in the course of such negotiations”.

63. [2010] CLJ 253, 254.

64. *Ibid.*, 257.

consensus”.<sup>65</sup> He was comfortable with the use of the factual matrix by the House of Lords in *Prenn v Simmonds*<sup>66</sup> and *Reardon Smith Line Ltd v Yngar Hansen-Tangen (The Diana Prosperity)*<sup>67</sup> to show respectively that “profits” meant “the consolidated profits of the group, and not just the profits of the parent company” and that the reference to “Yard 354” in a shipbuilding contract “was merely a means of identifying the vessel in question, and not part of the description of the goods”,<sup>68</sup> but was strongly critical of “the new approach”<sup>69</sup> introduced by the fourth and fifth *ICS* principles:<sup>70</sup>

“Whatever the nature of the process in *ICS*, it is clear that it is not one of construing the meaning of the document. Take the two leading examples of the process referred to in paragraph 21 of *Chartbrook*. ‘13th January’ does not mean 12th January [*Mannai Investment v Eagle Star*]; and, however roughly its analysis was subsequently handled by the House of Lords, the Court of Appeal was, with respect, clearly right in *ICS* itself to say that ‘any claim (whether sounding in rescission for undue influence or otherwise)’ does not mean any claim sounding in rescission (whether for undue influence or otherwise). That objection is sought to be met by saying, at the start of *ICS* principle 4, that the meaning of a document is not the meaning of its words, but what the parties using those words would reasonably have been understood to mean. But that is plainly not so. The whole point of drawing up a document, and in particular a contractual agreement, is so that the legally binding obligation of the parties can be found in that document; which being a document can only speak through the words used in it. When something has gone wrong with the language used in the document, that shows that the parties did not succeed in giving the document the meaning that they intended. That meaning may be found elsewhere but, precisely because the language of the document that purports to express that meaning has gone wrong, it cannot be found in the document.”

The views expressed in the above passage will perhaps be welcomed by those who regard the likes of *ICS* and *Chartbrook* as extreme cases<sup>71</sup> or who see “judicial rewriting” as no part of the task of contract interpretation. However, Lord Hoffmann would no doubt take strong exception because the passage represents a rejection of the central plank of his reasoning that “people can convey their meaning unambiguously although they have used the wrong words”.<sup>72</sup> It is also, in effect, a return to the plain meaning rule: a rule, as the great Professor Corbin explained, based on “a great illusion ... that words, either singly or in combination, have a ‘meaning’ that is independent of the persons who use them” and under which “[i]t is crudely supposed that words have a ‘true’, or ‘legal’, meaning (described as ‘objective’), whereas in truth “[w]ords, oral or written, are merely a medium by which one person attempts to convey his thoughts to another person” and “[i]t is individual men who have ‘meanings’ which they try to convey to others by the use

65. *Ibid.*, 262. In the 2013 TECBAR Annual Lecture entitled “Does Rectification Require Rectifying?” (available at [www.supremecourt.uk/docs/speech-131031.pdf](http://www.supremecourt.uk/docs/speech-131031.pdf)) Lord Toulson said (at 22) that he saw “merit” in this argument.

66. [1971] 1 WLR 1381.

67. [1976] 1 WLR 989.

68. [2010] CLJ 253, 254.

69. *Ibid.*, 254.

70. *Ibid.*, 255–256.

71. See Richard Calnan, *Principles of Contractual Interpretation* (OUP, Oxford, 2013), [7.95–7.120].

72. *Mannai Investment* [1997] AC 749, 774.

of words; and it is individual men who receive 'meanings' by reason of words used by others".<sup>73</sup>

Immediately after the above quoted passage, Buxton elaborated on his view as follows:<sup>74</sup>

"Principle 5 was thus revolutionary because it overrode the previous understanding that, rectification apart, the court could not depart from the words of the document to find an agreement different from that stated in the document. That understanding was shortly expressed by Lord Simon of Glaisdale in *L Schuler AG v Wickman Machine Tools* [1974] AC 235, 263]:

'[The general principle of law] has been frequently stated, but it is most pungently expressed in *Norton on Deeds* (1906), p.43, though it applies to all written instruments':

"... the question to be answered always is, 'What is the meaning of what the parties have said?' not 'What did the parties mean to say?'... it being a presumption juris et de jure... that the parties intended to say that which they have said."

It is, of course, always open to a party to claim rectification of an instrument which has failed to express the common intention of the parties; but, so long as the instrument remains unrectified, the rule of construction is as stated by *Norton*. It is, indeed, the only workable rule.'

"Principle 5 in *ICS* starkly departs from that guidance, by confusing the meaning of what the parties said in their document with what they meant to say but did not say; and substitutes for the meaning of the document an intention of the parties that was not manifested in or by the document. Accordingly, when principle 5 of *ICS* is applied the necessary albeit unstated assumption is that the parties had reached a consensus which they then, either out of choice or because the law requires them to do so, expressed in a written document. It is that document that was and was intended to be 'the agreement' between them; but, because something has gone wrong with the language of the document the agreement that it contains does not reflect the parties' consensus. *ICS* addresses that difficulty by reading the agreement so that it does reflect the consensus, but with the agreement as so construed remaining the instrument that binds the parties. But in reality, even though not in form, what is thereafter enforced is the original consensus, and not the written agreement that purported, wrongly, to set out that consensus."

There are three main difficulties here. First, as already mentioned,<sup>75</sup> the courts have long insisted on a jurisdiction to correct obvious drafting mistakes as a matter of interpretation. Secondly, the "rewriting" permitted by *ICS* does not necessarily rest on the finding of a prior consensus. Certainly, there was no such consensus on the facts of *ICS* itself.

73. AL Corbin, *Corbin on Contracts*, rev edn (West Publishing Co, St Paul, 1960), vol.1, § 106 (p.474). See also vol.3, 1971 Pocket Part, § 536 ("[I]t can hardly be insisted on too often or too vigorously that language at its best is always a defective and uncertain instrument, that words do not define themselves, that terms and sentences in a contract, a deed, or a will do not apply themselves to external objects and performances, that the meaning of such terms and sentences consists of the ideas that they induce in the mind of some individual person who uses or hears or reads them, and that seldom in a litigated case do the words of a contract convey one identical meaning to the two contracting parties or to third persons.") and § 543A ("Words, in themselves alone, have no 'meaning'; it is always some *person* who has a 'meaning', a person who uses them to convey his thoughts (*his* 'meaning'), or a person who hears or reads the words and thereby receives a 'meaning' and understanding (a 'meaning' and thoughts that are *his own*). This latter person may be one who is a party to the agreement, the judge, or any other third person.")

74. [2010] CLJ 253, 256–257.

75. See text at fn.47.

Of course, that was a test case and as a result there was no question of rectification. Furthermore, in the great majority of interpretation cases that come before the courts, there will be no suggestion that at the time of formation the parties addressed the issue that later arose, let alone gave any thought to the effect of the relevant words. There will be no question, therefore, of their having formed any consensus as to the meaning of the words. Accordingly, the court can only seek to resolve the dispute by reference to the parties' presumed intention. As the New Zealand judge, Thomas J, pointed out prior to *ICS*:<sup>76</sup>

"[T]he doctrine of presumed intent is the law's method of giving some meaning to any number of contracts where the events giving rise to the dispute were not anticipated at the time the contract was made. In this way the doctrine of presumed intent provides the community with a universal law of contract which could otherwise founder on the impossible task of ascertaining the parties' intention when in reality they had none."

Thirdly, the view expressed in the passage from *Norton on Deeds* that interpretation involves ascertaining the *meaning* of what the parties have said as opposed to what they *meant* (intended) by what they have said, although endorsed by Lord Simon in *Schuler* and in a sprinkling of earlier cases,<sup>77</sup> has always been problematic,<sup>78</sup> but it is actually itself meaningless in the context of the modern approach to interpretation embodied in the first *ICS* principle and consequently it is rarely cited nowadays. The statement wrongly assumes that words may have a settled meaning without regard to the users of them or the surrounding circumstances. Rather, as Lord Nicholls of Birkenhead, writing extrajudicially, has observed, echoing the view of Professor Corbin referred to earlier, "[w]ords used as a medium of communication do not have a 'meaning' of their own. They do not have a meaning independently of the person who utters them or the person who hears them".<sup>79</sup> Although in *ICS* Lord Hoffmann did not use terms such as "intended meaning" or "the parties' intention", there can be little doubt that his Lordship accepted that the fundamental task of a court in an interpretation dispute is to seek and give effect to the objective intention of the parties. His Lordship would have perceived no difference between saying that the task is to determine *the meaning that the document would convey to a reasonable person with knowledge of the background*, and saying that the task is to determine *what a reasonable person aware of all the relevant background would consider*

76. *Attorney-General v Dreux Holdings Ltd* (1996) 7 TCLR 617 (NZCA), 632. In the more recent case of *Gibbons Holdings Ltd v Wholesale Distributors Ltd* [2007] NZSC 37; [2008] 1 NZLR 277, [96] his Honour said, inter alia: "The doctrine [of presumed intent] has necessarily had an impact on the way judges and lawyers approach contractual interpretation in general. Aware that in many, if not most, cases the parties did not, because of unforeseen events, have an actual intention in respect of the particular clause in issue, the doctrine permits judges and lawyers to arrive at an interpretation without compromising the basic premise that the contract must not be interpreted subjectively. The presumed intent is imputed to the parties. Inevitably, and understandably, judges and lawyers come to impute an intention to the parties without questioning the process. The imputation becomes a habit of thought or attitude of mind."

77. See, eg, *Great Western Railway and Midland Railway v Bristol Corp* (1918) 87 LJ Ch 414, 430; *Blakeley and Anderson v De Lambert* [1959] NZLR 356, 367; *Eastmond v Bowis* [1962] NZLR 954, 959.

78. See Sir Christopher Staughton, "How do the Courts Interpret Commercial Contracts?" (1999) 58 CLJ 303, 304: "Rule One [of contract interpretation] is that the task of the judge when interpreting a written contract is to find the intention of the parties. In so far as one can be sure of anything these days, that proposition is unchallenged."

79. Donald Nicholls, "My Kingdom for a Horse: The Meaning of Words" (2005) 121 LQR 577, 578–579.

*the parties to have intended the document to mean.*<sup>80</sup> Further, as mentioned earlier, Lord Clarke said in *Rainy Sky*<sup>81</sup> that “the ultimate aim of interpreting a provision in a contract, especially a commercial contract, is to determine what the parties meant by the language used, which involves ascertaining what a reasonable person would have understood the parties to have meant.”

## 5. Other decisions of the Law Lords

It might be objected that too much significance has been attached to the *dicta* in *Marley v Rawlings* because the case concerned the principles governing interpretation and rectification of wills. However, the observations by Lord Neuberger that were highlighted in the previous part of this article were made, with the concurrence of all of their Lordships, in the course of a carefully considered explanation of why the approach to the interpretation of contracts is “just as appropriate for wills as it is for other unilateral documents”.<sup>82</sup> More significantly for the purposes of this article, the *dicta* in question are important because they continue a trend since the retirement of Lord Hoffmann of conservative pronouncements by the Law Lords concerning the principles of contract interpretation that are at odds with the principles expounded by his Lordship in *Mannai Investment, ICS* and *Chartbrook*. Indeed, his legacy in this area, which began with his assertion in *ICS* that a “fundamental change... has overtaken this branch of the law”,<sup>83</sup> appears in danger of being rather more short-lived than I, and no doubt others, would have imagined.

### (a) *The Multi-Link case*

The trend began in late 2010 in *Multi-Link Leisure Developments Ltd v North Lanarkshire Council*,<sup>84</sup> where Lord Hope said:<sup>85</sup>

“The court’s task [in resolving a contract interpretation dispute] is to ascertain the intention of the parties by examining the words they used and giving them their ordinary meaning in their contractual context. It must start with what it is given by the parties themselves when it is conducting this exercise. Effect is to be given to every word, so far as possible, in the order in which they appear in the clause in question. Words should not be added which are not there, and words which are there should not be changed, taken out or moved from the place in the clause where they have been put by the parties. It may be necessary to do some of these things at a later stage to make sense of the

80. His Lordship’s speech in *Chartbrook* contains numerous references to what the parties intended and what they *must have* intended or *cannot have* intended, as well as “the meaning which the parties would reasonably be taken to have intended”, the meaning “a reasonable observer would not have taken them to have intended”, and other words or phrases to like effect: see [2009] 1 AC 1101, [14], [17], [19], [23], [37], [39], [41].

81. [2011] UKSC 50; [2011] 1 WLR 2900, [14].

82. [2014] UKSC 2; [2015] 1 AC 129, [23].

83. [1998] 1 WLR 896, 912.

84. [2010] UKSC 47; [2011] 1 All ER 175. See generally D McLauchlan, “A Construction Conundrum?” [2011] LMCLQ 428. Ironically, if the main arguments in that article are accepted, Lord Hope and the other members of the Supreme Court wrongly failed to give the clause in question its ordinary meaning and did not give effect to “every word, so far as possible, in the order in which they appear in the clause”.

85. *Ibid.*, [11].

language. But this should not be done until it has become clear that the language the parties actually used creates an ambiguity which cannot be solved otherwise.”

It is not entirely clear what Lord Hope meant by the phrase “contractual context” when he said that words must be given “their ordinary meaning in their contractual context”. It could mean the background to the contract (the external context or so-called “matrix of facts”<sup>86</sup>) or the document as a whole (the internal context). The former would be more consistent with his Lordship’s agreement in *Chartbrook* with “all [Lord Hoffmann’s] reasoning”<sup>87</sup> and the latter would reflect his reiteration of the plain meaning rule when delivering the opinion of the Privy Council in a case decided shortly before *Mannai Investment* and *ICS*.<sup>88</sup> Be that as it may, the rest of the passage quoted above is plainly inconsistent with Lord Hoffmann’s principles, particularly insofar as it states that it is impermissible to add words or vary their syntactical arrangement unless it is necessary to do so “at a later stage to make sense of the language”, although that later stage is reached only when it is decided that the actual words or syntax give rise to an ambiguity. In *ICS* itself his Lordship varied the syntactical arrangement of words that made perfectly good sense and that were not ambiguous. He did so on the basis that, particularly in view of the anomalous consequences, a reasonable person with knowledge of the background would have given them a different meaning. In his view, the whole of the document, its context and the commerciality of the rival contentions are not only indispensable but *inseparable* components of the interpretation process. As his Lordship pointed out in *Chartbrook*,<sup>89</sup> there is a “single task of interpretation”. Contrary to what Lord Hope says in *Multi-Link*, one does not first determine the meaning of the document on its face and then address, as a separate question, whether, in the light of the factual matrix, there is a mistake in expression

86. *Prenn v Simmonds* [1971] 1 WLR 1381, 1384, *per* Lord Wilberforce.

87. [2009] UKHL 38; [2009] AC 1101, [1]. It would also be consistent with his agreement with the speech of Lord Hoffmann in *ICS* itself (see [1998] 1 WLR 896, 918) and that of Lord Mance, endorsing the *ICS* principles, in *Re Sigma Finance Corp* [2009] UKSC 2; [2010] 1 All ER 571.

88. *Melanesian Mission Trust Board v AMP Society* [1997] 1 NZLR 391, 394–395. His Lordship summarised the law as follows: “The approach which must be taken to the construction of a clause in a formal document... is well settled. The intention of the parties is to be discovered from the words used in the document. Where ordinary words have been used they must be taken to have been used according to the ordinary meaning of these words. If their meaning is clear and unambiguous, effect must be given to them because that is what the parties are taken to have agreed to by their contract. Various rules may be invoked to assist interpretation in the event that there is an ambiguity. But it is not the function of the Court, when construing a document, to search for an ambiguity. Nor should rules which exist to resolve ambiguities be invoked in order to create an ambiguity which, according to the ordinary meaning of the words, is not there. So the starting point is to examine the words used in order to see whether they are clear and unambiguous. It is of course legitimate to look at the document as a whole and to examine the context in which these words have been used, as the context may affect the meaning of the words. But unless the context shows that the ordinary meaning cannot be given to them or that there is an ambiguity, the ordinary meaning of the words which have been used in the document must prevail.” Interestingly, the Board included Lord Hoffmann. His Lordship was thus party to a decision based on principles that he was to repudiate a mere six months later. Surprisingly, Lord Hope’s statement was endorsed by Lewison LJ in *Cherry Tree Investments Ltd v Landmain Ltd* [2012] EWCA Civ 736; [2013] Ch 305, [124], despite his earlier apparent acceptance (at [100]) of the *ICS* principles.

89. [2009] UKHL 38; [2009] 1 AC 1101, [24]. See also *Ray Brooks Pty Ltd v NSW Grains Board* [2002] NSWSC 1049, [47], where Palmer J said that Lord Hoffmann “did not make a consideration of the text stage one of the process, to be followed, as stage two, by reference to extrinsic evidence”.

that it is possible to correct as a matter of interpretation.<sup>90</sup> It follows too that a finding of ambiguity could not be a precondition to a consideration of the factual background and consequently to entertaining the need for some rearrangement of the words or syntax. The task of the court is to determine what a reasonable person would have understood the parties to have meant and “[t]he fact that the court might have to express that meaning in language quite different from that used by the parties ... is no reason for not giving effect to what they appear to have meant”.<sup>91</sup>

Nevertheless, on at least two occasions Lord Hope’s statement has been cited alongside the *ICS* approach as if the two are consistent<sup>92</sup> and, more importantly, the Supreme Court in a recent judgment delivered by Lord Carnwath (with whom Lord Hope, Lord Walker, Baroness Hale and Lord Sumption agreed) described it as representing “ordinary principles of construction”.<sup>93</sup>

(b) *The Goblin Hill Hotels case*

Less than four months after *Multi-Link*, the Privy Council held in *Thompson v Goblin Hill Hotels Ltd*<sup>94</sup> that, where the words of a contract have “a plain and ordinary meaning”, the onus is on the party seeking to displace that meaning to show that it produces a commercial absurdity and, unless such absurdity “is patent and clear on the face of the instrument that has to be construed”, it will have to be proved “by an explanation of the relevant background facts”.<sup>95</sup> This approach also represents a departure from the *ICS* principles. Indeed, it is identical to the traditional approach, under which, in the absence of a proven technical meaning, trade usage or custom, the words of the contract must be given their plain meaning unless that would lead to manifest absurdity or inconvenience. It is an approach that formed part of “the old intellectual baggage of ‘legal’ interpretation” that, according to Lord Hoffmann in *ICS*,<sup>96</sup> had been discarded in favour of a unitary approach requiring the court to determine the meaning that the document would convey to a reasonable person who has knowledge of the background. Of course, as we have seen, his Lordship envisaged that, where the words in issue do have an ordinary or conventional meaning, that is likely to be the meaning that the document will convey to a reasonable person, but he clearly did not require a finding of absurdity in order to justify departure from the former meaning.

90. His Lordship endorsed (at [23]) the following statement by Carnwath LJ in *KPMG LLP v Network Rail Infrastructure Ltd* [2007] EWCA Civ 363; [2007] Bus LR 1336, [50]: “Both in the judgment [under appeal], and in the arguments before us, there was a tendency to deal separately with correction of mistakes and construing the paragraph ‘as it stands’, as though they were distinct exercises. In my view, they are simply aspects of the single task of interpreting the agreement in its context, in order to get as close as possible to the meaning which the parties intended.”

91. *Chartbrook* [2009] UKHL 38; [2009] 1 AC 1101, [21] *per* Lord Hoffmann.

92. *Morris v Blackpool Borough Council* [2014] EWCA Civ 1384, [25–26] and *Kayani v University Hospitals Birmingham NHS Foundation Trust* [2013] UKEAT 0369\_13\_1212, [34–35].

93. *Barts and the London NHS Trust v Verma* [2013] UKSC 20; [2013] ICR 727, [26].

94. [2011] UKPC 8; [2011] 1 BCLC 587.

95. *Ibid*, [24].

96. [1998] 1 WLR 896, 912.

*(c) The Rainy Sky case*

The Supreme Court's decision in late 2011 in *Rainy Sky SA v Kookmin Bank*<sup>97</sup> is now cited by the English courts at least as frequently as *ICS* as the leading authority on the principles of contract interpretation. It has even been described, somewhat surprisingly, as "herald[ing] an even more liberal approach than the earlier cases".<sup>98</sup> However, as discussed at length elsewhere,<sup>99</sup> the judgment, delivered by Lord Clarke,<sup>100</sup> gives rise to several difficulties. For example, although his Lordship thought that it was "clear" that the principle of contract interpretation applied in the Court of Appeal in the majority judgment of Patten LJ was different from that applied by the dissenting judge, Sir Simon Tuckey,<sup>101</sup> close analysis of the judgments reveals that the judges actually stated substantially *similar* principles. The reasons for their disagreement had more to do with different views as to the merits of the textual arguments and different perceptions of what a reasonable person with knowledge of the background would have understood the parties to mean. However, the most notable feature of Lord Clarke's judgment for the purposes of this article is the uncertainty it creates concerning the question whether a preliminary finding of ambiguity is necessary before attempting to give the contract its so-called commercial construction.

On the one hand, the *ICS* principles are endorsed and apparently applied throughout the *Rainy Sky* judgment. Thus, at the beginning of his analysis of the principles of interpretation Lord Clarke said:<sup>102</sup>

"[T]he ultimate aim of interpreting a provision in a contract, especially a commercial contract, is to determine what the parties meant by the language used, which involves ascertaining what a reasonable person would have understood the parties to have meant. As Lord Hoffmann made clear in the first of the principles he summarised in the *Investors Compensation Scheme* case [1998] 1 WLR 896, 912H, the relevant reasonable person is one who has 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."

And later he said:<sup>103</sup>

"I would accept the submission made on behalf of the appellants that the exercise of construction is essentially one unitary exercise in which the court must consider the language used and ascertain what a reasonable person, that is a person who has all the background knowledge which would

97. [2011] UKSC 50; [2011] 1 WLR 2900.

98. *Reinhard v Ondra LLP* [2015] EWHC 26 (Ch), [307], *per* Warren J.

99. See D McLauchlan and M Lees, "More Construction Controversy" (2012) 29 JCL 97. Some parts of the following discussion draw on the analysis therein.

100. With whom Lord Phillips, Lord Mance, Lord Kerr and Lord Wilson agreed.

101. [2011] UKSC 50; [2011] 1 WLR 2900, [20]. Indeed, he later said (at [30]) that the two approaches were "significantly different".

102. *Ibid.*, [14].

103. *Ibid.*, [21]. See also his Lordship's approval (at [25]) of Lord Steyn's observation in *Society of Lloyd's v Robinson* [1999] 1 WLR 756, 763 (emphasis added): "Loyalty to the text of a commercial contract, instrument, or document read in its contextual setting is the paramount principle of interpretation. But in the process of interpreting the meaning of the language of a commercial document the court ought generally to favour a commercially sensible construction. The reason for this approach is that a commercial construction is likely to give effect to the intention of the parties. *Words ought therefore to be interpreted in the way in which a reasonable commercial person would construe them. And the reasonable commercial person can safely be assumed to be unimpressed with technical interpretations and undue emphasis on niceties of language.*"

reasonably have been available to the parties in the situation in which they were at the time of the contract, would have understood the parties to have meant. In doing so, the court must have regard to all the relevant surrounding circumstances. If there are two possible constructions, the court is entitled to prefer the construction which is consistent with business common sense and to reject the other.”

The judgment also includes several citations from authorities that are wholly consistent with acceptance of the *ICS* principles, including *Re Sigma Finance Corp*,<sup>104</sup> where Lord Mance said that interpretation of the document in that case, a security trust deed that applied to a variety of creditors holding different types of security, involved “an iterative process” which, in the words of Lord Neuberger in the Court of Appeal, required “checking each of the rival meanings against other provisions of the document *and investigating its commercial consequences*”.<sup>105</sup>

On the other hand, Lord Clarke said that “[w]here the parties have used unambiguous language, the court must apply it”,<sup>106</sup> citing in support the pre-*ICS* decision of the Court of Appeal in *Co-operative Wholesale Society Ltd v National Westminster Bank Plc*,<sup>107</sup> where it was held, inter alia, that a court must give effect to unambiguous language even though it has an improbable commercial result. Interestingly, he quoted the statement in the judgment of Hoffmann LJ (as he then was) that one cannot “rewrite the language which the parties have used in order to make the contract conform to business common sense”,<sup>108</sup> which is exactly what his Lordship was later to do in *Chartbrook*! Furthermore, Lord Clarke expressly approved<sup>109</sup> the approach of Sir Simon Tuckey (who dissented in the Court of Appeal), including the following statement:<sup>110</sup>

“If the language of the [contract] leads clearly to a conclusion that one or other of the constructions contended for is the correct one, the court must give effect to it, however surprising or unreasonable the result might be. But if there are two possible constructions, the court is entitled to reject the one which is unreasonable and, in a commercial context, the one which flouts business common sense.”

These statements appear inconsistent with the *ICS* principles and the notion of interpretation being a unitary exercise.<sup>111</sup> They seem to require a preliminary determination of whether the words of the contract are ambiguous. If not, the words must be given their plain meaning, no matter how surprising or unreasonable the result (although presumably

104. [2009] UKSC 2; [2010] 1 All ER 571.

105. *Ibid.*, [12] (emphasis added).

106. [2011] UKSC 50; [2011] 1 WLR 2900, [23].

107. [1995] 1 EGLR 97.

108. *Ibid.*, 99.

109. [2011] UKSC 50; [2011] 1 WLR 2900, [22] and [30].

110. [2010] EWCA Civ 582; [2010] 1 CLC 829, [19].

111. The statement that contract interpretation is a “unitary exercise” is sometimes misunderstood. It means that one does *not* ask whether the words in dispute have a particular meaning *and then* ask whether that meaning is *displaced* by the context. As Lord Hoffmann said in *Charter Reinsurance Co Ltd v Fagan* [1997] AC 313, 392, “[i]t is artificial to start with an acontextual preconception about the meaning of the words and then see whether that meaning is somehow displaced”. The statement does not, of course, preclude the court’s beginning its analysis of the issue with a consideration of whether the words have an ordinary meaning.

that would not be so if the absurdity threshold were passed<sup>112</sup>). Thus, only where the words are capable of two interpretations does the court embark on the task of commercial construction.<sup>113</sup>

Although the above statements appear inconsistent with *ICS*, it is by no means clear that Lord Clarke intended to embrace the old plain meaning rule. Most of his Lordship's judgment focused on the principle to be applied when, as was common ground in the case, the words in dispute are capable, or *reasonably*<sup>114</sup> capable, of two meanings. He accepted that "[t]he language used by the parties will often have more than one potential meaning"<sup>115</sup> and that "[o]ften there is no obvious or ordinary meaning of the language under consideration",<sup>116</sup> but we are not told how that initial determination is to be made. Is the existence of ambiguity to be judged solely on the basis of internal linguistic considerations or against the factual background to the contract? The former is unlikely to have been intended, because that would mean that his Lordship was merely paying lip service to the *ICS* approach and the notion that "the exercise of construction is essentially one unitary exercise". Further, it would be surprising if he were unmindful that, as Lord Hoffmann confirmed in *Chartbrook*,<sup>117</sup> *ICS* decided not only that "it was not necessary to find an 'ambiguity' before one could have any regard to background" but also that "the meaning which the parties would reasonably be taken to have intended could be given effect despite the fact that it was not, according to conventional usage, an 'available' meaning of the words or syntax which they had actually used".

The lack of clarity is not helped by the variety of confusing terminology employed by Lord Clarke and the authorities he cited. Thus, we read at various points, for example, that language may have "ordinary", "obvious", "more obvious", "unambiguous", "natural", "no very natural", "most natural", "natural and ordinary", "natural and obvious" and "more than one potential" meaning. The term "natural meaning" and its variants are particularly troublesome.<sup>118</sup> Sometimes the term is used as a synonym for the "plain meaning" of

112. See *Pink Floyd Music Ltd v EMI Records Ltd* [2010] EWCA Civ 1429; [2011] 1 WLR 770, [18–22], where Lord Neuberger MR said that, in order to justify departure from a plain meaning, and thus attribute to the words in question "a meaning which they simply cannot have as a matter of ordinary linguistic analysis", "[o]ne is normally looking for an outcome which is 'arbitrary' or 'irrational'" or, in the words of Chadwick LJ in *City Alliance Ltd v Oxford Forecasting Services Ltd* [2000] EWCA Civ 510; [2001] 1 All ER Comm 233, [13], "a result which is so commercially nonsensical that the parties could not have intended it". See also *Sugarman v CJS Investments LLP* [2014] EWCA Civ 1239, [43] where Briggs LJ said that, "[n]otwithstanding Lord Clarke's dictum in the *Rainy Sky* case that the court must apply unambiguous language, I do not understand him to have disapproved, as an exception to that healthy principle, the earlier dicta... to the effect that, sometimes, the apparently unambiguous meaning of the words used produces such a nonsensical result that it cannot be treated as expressing the meaning of the document".

113. The inconsistency is often overlooked. Thus, in the recent case of *HBC Hamburg Bulk Carriers GmbH & Co KG v Huyton Inc (The Glory Sanye)* [2014] EWHC 4176 (Comm); [2015] 1 Lloyd's Rep 310, [12], Teare J said that "[t]here was no dispute between the parties as to the settled principles by which contracts are to be construed, though counsel emphasised different aspects of those principles" but then noted that counsel for the claimant, relying on para.23 of *Rainy Sky*, submitted that the court must apply unambiguous language, whereas counsel for the respondent, relying on para.21 of *Rainy Sky*, invoked the first *ICS* principle.

114. [2011] UKSC 50; [2011] 1 WLR 2900, [26].

115. *Ibid*, [21].

116. *Ibid*, [25].

117. [2009] UKHL 38; [2009] 1 AC 1101, [37].

118. See generally JW Carter and E Peden, "The 'Natural Meaning' of Contracts" (2005) 21 JCL 277.

words within the four corners of the document. Indeed, Lord Hoffmann himself used it in this sense in the fifth *ICS* principle:<sup>119</sup>

“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...”

So too, it seems, did Lord Neuberger when he said in *Marley v Rawlings*:<sup>120</sup>

“When interpreting a contract, the court is concerned to find the intention of the party or parties, and it does this by identifying the meaning of the relevant words, (a) *in the light of (i) the natural and ordinary meaning of those words, (ii) the overall purpose of the document, (iii) any other provisions of the document, (iv) the facts known or assumed by the parties at the time that the document was executed, and (v) common sense, but (b) ignoring subjective evidence of any party’s intentions.*”

However, more often nowadays the term is used to describe the meaning, or most likely meaning, best supported by consideration of the document as a whole *and* admissible background evidence. In other words, it is the contextual meaning, the meaning that a reasonable person with knowledge of the background would give to the document. This was the sense in which Lord Wilberforce used the term in the well-known case of *Prenn v Simmonds*.<sup>121</sup> When his Lordship said that the court had to “try to ascertain the ‘natural’ meaning” of the word “profits”, he was referring to the natural meaning in light of “the factual background known to the parties at or before the date of the contract”.<sup>122</sup> This usage was even more explicit in the speech of Lord Bingham of Cornhill in *Bank of Credit and Commerce International SA v Ali*<sup>123</sup> when he said that “[t]o 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*”. It is perhaps unfortunate, however, that more attention has not been paid to Lord Hoffmann’s observation that “the notion of words having a natural meaning is not a very helpful one”.<sup>124</sup> As his Lordship went on to explain:<sup>125</sup>

“Because the meaning of words is so sensitive to syntax and context, the natural meaning of words in one sentence may be quite unnatural in another. Thus a statement that words have a particular natural meaning may mean no more than that in many contexts they will have that meaning. In other contexts their meaning will be different but no less natural.”

Further, if Lord Clarke’s concern in *Rainy Sky* was to stress the importance of the written word and the need for commercial certainty, this could have been achieved more consistently with the rest of his reasoning by affirming what Lord Hoffmann made abundantly clear—that ordinarily the reasonable person with knowledge of the background will understand

119. [1998] 1 WLR 896, 913.

120. [2014] UKSC 2; [2015] 1 AC 129, [19] (emphasis added).

121. [1971] 1 WLR 1381.

122. *Ibid.*, 1385.

123. [2001] UKHL 8; [2002] AC 251, [8] (emphasis added).

124. *Charter Reinsurance Co Ltd v Fagan* [1997] AC 313, 391. Compare, however, his reliance on the natural meaning of the words in *Deutsche Genossenschaftsbank v Burnhope* [1995] 1 WLR 1580, 1589.

125. [1997] AC 313, 391.

the parties to have meant what they said according to ordinary usage, and the court will not lightly accept that words or grammar have not been used in a conventional way, particularly in formal documents.<sup>126</sup> Such a course would have avoided the conceptual inconsistency that results from trying to marry the *ICS* principles with a threshold requirement based on ambiguity.

## 6. The aftermath of *Rainy Sky*

Not surprisingly, later courts have reacted differently to Lord Clarke's statement in *Rainy Sky* that "[w]here the parties have used unambiguous language, the court must apply it". Several cases have simply taken the statement at face value and said that where the words in dispute have a plain meaning there is no scope for giving them a "commercial" or "businesslike" construction.<sup>127</sup> Others have suggested that a finding of plain meaning can only be made after consideration of the whole context<sup>128</sup> and/or that interpretation is always "an iterative process, involving checking each of the rival meanings against other provisions of the document and investigating its commercial consequences" and that "[i]t extends to placing the rival interpretations of a phrase within their commercial setting

126. See, eg, *Bank of Credit and Commerce International SA v Ali* [2001] UKHL 8; [2002] AC 251, [39], where Lord Hoffmann emphasised that "the primary source for understanding what the parties meant is their language interpreted in accordance with conventional usage" and said that in the *ICS* case he "was certainly not encouraging a trawl through 'background' which could not have made a reasonable person think that the parties must have departed from conventional usage". His Lordship was the dissenting judge in the *Bank of Credit and Commerce* case, but, in criticising the majority (at [37]) for giving "too little weight to the actual language and background" of the document in question, he was not backtracking from his principles. He was simply unconvinced that there was anything in the background that would lead a reasonable person to think that the parties must have departed from conventional usage of the words.

127. In *Cottonex Anstalt v Patriot Spinning Mills Ltd* [2014] EWHC 236 (Comm); [2014] 1 Lloyd's Rep 615, [55], Hamblen J said that, "[i]f the court concludes that the words are only capable of one meaning then that is their meaning regardless of considerations of business common sense". The judge repeated this view recently in *Edgeworth Capital (Luxembourg) SARL v Ramblas Investments BV* [2015] EWHC 150 (Comm), [34]. See also, eg, *BG Global Energy Ltd v Talisman Sinopec Energy UK Ltd* [2015] EWHC 110 (Comm), [24]; *Amlin Corporate Member Ltd v Oriental Assurance Corp* [2014] EWCA Civ 1135; [2014] 2 Lloyd's Rep 561, [44] ("where the parties have used unambiguous language, the court must apply it even though the results may be commercially improbable"); *Globe Motors, Inc v TRW Lucas Varity Electric Steering Ltd (Rev 1)* [2014] EWHC 3718 (Comm), [181]; *Francis v Phillips* [2014] EWCA Civ 1395, [72] (there must be "a real ambiguity" before the court is entitled to prefer the interpretation that is consistent with business common sense); *Polypearl Ltd v E.On Energy Solutions Ltd* [2014] EWHC 3045 (QB), [32]; *Northrop Grumman Mission Systems Europe Ltd v BAE Systems (Al Diriyah C4I) Ltd* [2014] EWHC 2955 (TCC), [28]; *Carewatch Care Services Ltd v Focus Caring Services Ltd* [2014] EWHC 2313 (Ch), [89]; *Gateway Plaza Ltd v White* [2014] EWCA Civ 555, [31]; *Starbev Gp Ltd v Interbrew Central European Holdings BV* [2014] EWHC 1311 (Comm), [58]; *MT Højgaard A/s v E.ON Climate And Renewables* [2014] EWHC 1088 (TCC), [76]; *Fujitsu Services Ltd v IBM United Kingdom Ltd* [2014] EWHC 752 (TCC), [24]; *Kudos Catering (UK) Ltd v Manchester Central Convention Complex Ltd* [2013] EWCA Civ 38; [2013] 2 Lloyd's Rep 270, [20]; *Greatship (India) Ltd v Oceanografia SA de CV* [2012] EWHC 3468 (Comm), [2013] 2 Lloyd's Rep 359, [17]; *Al Sanea v Saad Investments Co Ltd* [2012] EWCA Civ 313, [31].

128. *Fons Hf v Corporal Ltd* [2014] EWCA Civ 304, [14] ("the court will seek to give the words their natural and ordinary meaning derived from the context of the agreement and all other relevant facts indicating the nature and purpose of the transaction"); *Capita (Banstead 2011) Ltd v RFIB Group Ltd* [2014] EWHC 2197 (Comm), [14]; *Napier Park European Credit Opportunities Fund Ltd v Harbourmaster Pro-Rata Clo 2 BV* [2014] EWHC 1083 (Ch), [37]; *US Bank Trustees Ltd v Titan Europe 2007-1 (NHP) Ltd* [2014] EWHC 1189 (Ch), [25].

and investigating their commercial consequences".<sup>129</sup> Yet another view is that a plain meaning can be displaced only where the absurdity or "commercial nonsense" threshold is met.

The latter view was taken by the Court of Appeal in *Sugarman v CJS Investments LLP*.<sup>130</sup> The case concerned the interpretation of a voting provision contained in the articles of association of a company that managed a residential development consisting of 104 flats. The respondent company owned 66 of the flats, and hence a majority of the shares, but on the literal interpretation, unanimously upheld by the court, it was entitled to only one vote. This meant that it could be "routinely outvoted by the remaining flat owners".<sup>131</sup> Floyd LJ, with whom Macur LJ agreed, held that the language of the voting provision was "simply not flexible enough to admit of the respondents' construction"<sup>132</sup> and that the consequences of the literal interpretation fell "well short of commercial absurdity".<sup>133</sup> However, Briggs LJ was not so sure. He agreed that the relevant part of the provision was unambiguous but described it, "taken as a whole", as "riddled" with mistakes and, "in short, a drafting shambles".<sup>134</sup> Nevertheless, even though his first impression was that there was "real force" in the trial judge's view that "the literal meaning... produced a commercial absurdity which could not be its intended or real meaning"<sup>135</sup> and he accepted that the result of upholding that literal meaning may appear "unreasonable, un-commercial or even undemocratic, to many",<sup>136</sup> he was satisfied, "on a narrow balance",<sup>137</sup> that the appeal should be allowed.

The important point to be made here is that the approach of the judges is an exact replica of that adopted in countless pre-ICS cases. Let us take, for example the leading decisions of the High Court of Australia in *Australian Broadcasting Commission v Australasian Performing Right Association*<sup>138</sup> and *Codelfa Construction Pty Ltd v State Rail Authority of NSW*<sup>139</sup> and the New Zealand Court of Appeal in *Benjamin Developments Ltd v Robt Jones (Pacific) Ltd*.<sup>140</sup> These cases held, in reliance on well-known English precedents, that where the terms of a contract have a plain meaning the court must give effect to that meaning. In the absence of a successful claim for rectification of the contract, the chosen language had to be taken as representing the intention of the parties. Extrinsic evidence was not admissible in order to find a different meaning, for "that would amount to the Court holding that the parties really meant something different from what they chose to

129. *Richmond Pharmacology Ltd v Chester Overseas Ltd* [2014] EWHC 2692 (Ch), [44]. See also *US Bank Trustees Ltd v Titan Europe 2007-1 (NHP) Ltd* [2014] EWHC 1189 (Ch), [25]; *Osmium Shipping Corp v Cargill International SA* [2012] EWHC 571 (Comm); [2012] 2 Lloyd's Rep 46, [8].

130. [2014] EWCA Civ 1239. See also the earlier references to this case in fnn 7, 61 and 112.

131. *Ibid.*, [3].

132. *Ibid.*, [38].

133. *Ibid.*, [39].

134. *Ibid.*, [45].

135. *Ibid.*, [46].

136. *Ibid.*, [49].

137. *Ibid.*, [50].

138. (1973) 129 CLR 99.

139. (1982) 149 CLR 337.

140. [1994] 3 NZLR 189.

say”.<sup>141</sup> Lord Wilberforce’s famous statements in *Prenn v Simmonds*<sup>142</sup> about the need for the courts to consult the factual matrix background applied only where the language of the contract was ambiguous, “that is, where the words are susceptible of more than one meaning”.<sup>143</sup> It was not permissible to “allow the background to create the uncertainty of meaning and then use it again to resolve that uncertainty in a manner which is... contrary to the plain meaning of the words”.<sup>144</sup> The only exceptions were those mentioned earlier: a proven special technical meaning, trade usage or custom, or application of the plain meaning would lead to manifest absurdity or inconvenience—“an absurdity or inconvenience so great as to convince the Court that the intention could not have been to use [the words] in their ordinary signification”.<sup>145</sup> However, it was “not enough that its application produce[d] a result which one party or both may not have contemplated”.<sup>146</sup> It had to be truly “necessary to make commercial sense of the transaction”<sup>147</sup> or to prevent the whole transaction from being rendered “futile”.<sup>148</sup>

However, it is interesting to compare the approach of the Court of Appeal in *Sugarman* with that of the same, albeit differently constituted, court two months earlier in *Napier Park European Credit Opportunities Fund Ltd v Harbourmaster Pro-Rata Clo 2 BV*,<sup>149</sup> the facts of which were briefly outlined at the beginning of this article.<sup>150</sup> Lewison LJ<sup>151</sup> began his discussion of the law by stressing that the iterative process of interpretation, as described by Lord Mance in *Re Sigma Finance Corp*,<sup>152</sup> “is not confined to textual analysis and comparison” but “extends also to placing the rival interpretations within their commercial setting and investigating (or at any rate evaluating) their commercial consequences”.<sup>153</sup> Since the dispute involved a complex financial transaction contained in “a suite of interlocking documents”<sup>154</sup> that regulated the rights of various classes of noteholders, the case was seen as one where the “commercial intention” and the “commercial consequences” had to be discerned primarily from the terms of the contract,<sup>155</sup> which in turn fed into “the process of deciding whether a particular word or phrase is in reality clear and unambiguous”.<sup>156</sup> Importantly, it followed, in his Lordship’s view, that:<sup>157</sup>

141. *Ibid*, 203 *per* Hardie Boys J.

142. [1971] 1 WLR 1381, 1383–1385.

143. *Codelfa Construction Pty Ltd v State Rail Authority of NSW* (1982) 149 CLR 337, 350, *per* Mason J.

144. *Benjamin Developments* [1994] 3 NZLR 189, 203 *per* Hardie Boys J.

145. *River Wear Commissioners v Adamson* (1877) 2 App Cas 743, 764–765, *per* Lord Blackburn..

146. *Benjamin Developments* [1994] 3 NZLR 189, 199 *per* Casey J.

147. *Ibid*.

148. *Ibid*, 198 and 203.

149. [2014] EWCA Civ 984.

150. See *ante*, text to fn.4.

151. With whom Longmore and Floyd LJ agreed. Thus, Floyd LJ was the only judge to sit in both *Sugarman* and *Napier Park*.

152. [2009] UKSC 2; [2010] 1 All ER 571, [12].

153. [2014] EWCA Civ 984, [32].

154. *Ibid*, [3].

155. This restriction need not be seen as an exception to the *ICS* approach. As pointed out in *Firm PI 1 Ltd v Zurich Australian Insurance Ltd* [2014] NZSC 147, [62] (emphasis added), “[t]he fact that parties are aware their contract might be relied upon by a third party may justify a more restrictive approach to the use of background in some instances, *the parties’ awareness being itself part of the relevant background*.”

156. [2014] EWCA Civ 984, [33].

157. *Ibid*, (emphasis added).

“where possible, the court should test any interpretation against the commercial consequences. That is part of the iterative exercise of interpretation. It is *not merely a safety valve in cases of absurdity*. So much is... made clear by the decision of the Supreme Court in *Rainy Sky SA v Kookmin Bank* ...”.

Thus, his Lordship plainly did not regard *Rainy Sky* as having reinstated a plain meaning rule.

### 7. The role of “business common sense” in contract interpretation

In *Rainy Sky*,<sup>158</sup> Lord Clarke said that “[t]he issue between the parties in this appeal is the role to be played by considerations of business common sense in determining what the parties meant”. His Lordship seemingly had no qualms about judges adopting the role of arbiter of business common sense, because he held that the true principle is that, “where a term of a contract is open to more than one interpretation, it is generally appropriate to adopt the interpretation which is most consistent with business common sense”.<sup>159</sup> However, it is interesting that, both before and after *Rainy Sky*, some judges have expressed reservations about such an approach and even doubted their competence to evaluate considerations of business common sense.

A somewhat startling expression of such reservations and doubts is to be found in the recent extrajudicial speech by Lord Neuberger referred to earlier<sup>160</sup> in which, inter alia, he posed the question “is a judge a reliable assessor of commercial common sense?”<sup>161</sup> and gave a negative answer. His Lordship said:<sup>162</sup>

“As for business common sense, I would suggest that judges should be diffident before pontificating about the commercial realities of any particular interpretation. First, it does not seem obvious that a judge, who is normally fairly remote [from] business matters, would be particularly good at identifying the commercial common sense of any conclusion, let alone what a reasonable person might regard as commercially sensible. Secondly, there is a substantial danger that a judge will assess commercial common sense by reference to the particular circumstances which have occurred, which is a very unsafe basis for assessing what the parties would have thought when entering into the contract in question.”

And, in a similar vein, he later added:<sup>163</sup>

“We have to be very wary of relying on commercial common sense. First, a judge’s idea of commercial common sense may be thought by some to be about as reliable as a businessman’s idea of legal principle. Secondly, the judicial view of commercial common sense in a particular case is almost bound to be influenced by the facts as they have transpired since the contract, which should plainly be irrelevant to the exercise of interpretation.”

It is difficult to know what to make of the second observation in each of the above passages, given that the judge’s task in an interpretation dispute is obviously to determine the parties’ respective rights and obligations under the agreed terms in the circumstances, often wholly

158. [2011] UKSC 50; [2011] 1 WLR 2900, [15].

159. *Ibid.*, [30].

160. See *ante*, text to fn.45.

161. At [11].

162. At [19].

163. At [20].

unforeseen, that have arisen. Perhaps his Lordship had in mind that a countervailing good reason for allocating the risk in question existed at the time of the contract so that, for example, to depart from the apparent meaning of the disputed term will be to grant relief from a bad bargain. Even so, it surely cannot be correct that the events that have occurred since the contract and that are the cause of the litigation are “irrelevant” to a determination of what is the commercially sensible interpretation. Be that as it may, it is interesting that the concerns about judges ruling on commercial realities are reminiscent of a view he has expressed on the bench, albeit, not surprisingly, in much more measured terms. In *Skanska Rashleigh Weatherfoil Ltd v Somerfield Stores Ltd*<sup>164</sup> his Lordship said that “the court must be careful before departing from the natural meaning of the provision in the contract merely because it may conflict with its notions of commercial common sense of what the parties may must or should have thought or intended”. This is because “[j]udges are not always the most commercially-minded, let alone the most commercially experienced, of people, and should... avoid arrogating to themselves overconfidently the role of arbiter of commercial reasonableness or likelihood”.<sup>165</sup>

Similar sentiments have been expressed in several cases decided since *Rainy Sky*. It has been said that “parties should not be subjected to ‘the individual judge’s own notions of what might have been the sensible solution to the parties’ conundrum’”,<sup>166</sup> that “[i]t is often difficult for a court of law to make nice judgments as to where business common sense lies”,<sup>167</sup> that “[t]he Court must be wary of assuming it knows what is or is not

164. [2006] EWCA Civ 1732, [22].

165. *Ibid.* His Lordship did not, however, deny a role for considerations of commercial common sense. He said (at [21]) that “the interpretation of the provision in the commercial contract is not to be assessed purely by reference to the words the parties have used within the four corners of the contract, but must be construed also by reference to the factual circumstances of commercial common sense”, at the same time stressing that “the surrounding circumstances and commercial common sense do not represent a licence to the court to re-write a contract merely because its terms seem somewhat unexpected, a little unreasonable, or not commercially very wise”. And, after the passage quoted in the text, he continued (at [22]): “Of course, in many cases, the commercial common sense of a particular interpretation, either because of the peculiar circumstances of the case or because of more general considerations, is clear. Furthermore, sometimes it is plainly justified to depart from the primary meaning of words and give them what might, on the face of it, appear to be a strained meaning, for instance where the primary meaning of the words leads to a plainly ridiculous or unreasonable result.” Compare *Pink Floyd Music Ltd v EMI Records Ltd* [2010] EWCA Civ 1429; [2011] 1 WLR 770, [60] where his Lordship said that it was “quite permissible, indeed positively appropriate, to invoke commercial common sense to assist on the issue of clarifying a rather opaque provision”.

166. *BMA Special Opportunity Hub Fund Ltd v African Minerals Finance Ltd* [2013] EWCA Civ 416, [24], per Aikens LJ, citing the statement of Briggs J in *Jackson v Dear* [2012] EWHC 2060 (Ch), [40], which was in turn approved on appeal (*Dear v Jackson* [2013] EWCA Civ 89, [18]). See also *St Maximus Shipping Co Ltd v AP Moller-Maersk A/S* [2014] EWHC 1643 (Comm), [54]; *Fons Hf v Corporal Ltd* [2014] EWCA Civ 304, [16]; *Zhoushan Jinhaiwan Shipyard Co Ltd v Golden Exquisite Inc* [2014] EWHC 4050 (Comm), [22]; *Globe Motors, Inc v TRW Lucas Varity Electric Steering Ltd (Rev 1)* [2014] EWHC 3718 (Comm), [181].

167. *Cottonex Anstalt v Patriot Spinning Mills Ltd* [2014] EWHC 236 (Comm); [2014] 1 Lloyd’s Rep 615, [57], per Hamblen J. See also *Globe Motors, Inc v TRW Lucas Varity Electric Steering Ltd (Rev 1)* [2014] EWHC 3718 (Comm), [181].

commercially sensible”,<sup>168</sup> and that “a court must be *very* wary of assuming that it knows what is or is not commercially sensible”.<sup>169</sup>

Such statements are somewhat surprising, particularly since in so many other areas of the law judges are called upon to make determinations as to whether a variety of equally loose or broad standards have been met in situations with which they are unfamiliar or of which they have no practical experience.<sup>170</sup> In my view, the statements, along with some of the other developments described in this article, represent a desire to halt, or at least restrain, the “shift towards commercial interpretation”.<sup>171</sup> In other words, they are indicative of a desire to return to a more conservative approach to contract interpretation, under which disputes should be resolved primarily on the basis of textual analysis with limited resort to external context, including considerations of commercial common sense. In particular, a court should depart from what it considers to be the plain meaning of a contract only in exceptional circumstances.

A good illustration of a case exhibiting this more conservative approach is the decision of the Court of Appeal in *Fitzhugh v Fitzhugh*.<sup>172</sup> In essence, the case concerned the interpretation of a licence agreement whereby two brothers, A and B, who were the surviving administrators of their father’s estate, granted to B and his partner, C, a licence to occupy land forming part of the estate. The issue was as follows: “If A and B (described as ‘the Licensor’) grant a licence to occupy land to B and C (described as ‘the Licensee’), and the licence automatically terminates upon the failure of B and C to remedy any remediable breaches within the time specified by a notice given by ‘the Licensor’ to ‘the Licensee’, can such a notice validly be given by A alone?”<sup>173</sup> My immediate reaction was that this was a classical case where, although the term in question (cl.4(b)) had a plain meaning, something had gone wrong with the language. On what conceivable basis could the parties have intended that a notice of default could not be given unless the party in default consented to its being given? Surely a reasonable person would have understood it to mean that the licensor who was entitled to give notice included the persons named

168. *Richmond Pharmacology Ltd v Chester Overseas Ltd* [2014] EWHC 2692 (Ch), [44] *per* Stephen Jourdan QC, sitting as a deputy High Court judge.

169. *Napier Park European Credit Opportunities Fund Ltd v Harbourmaster Pro-Rata Clo 2 BV* [2014] EWCA Civ 984, [37] (emphasis added), *per* Lewison LJ). See also *Firm PI 1 Ltd v Zurich Australian Insurance Ltd* [2014] NZSC 147, [90–91], where a majority of the New Zealand Supreme Court endorsed the view of Neuberger LJ in *Skanska* and said (emphasis added): “In addition, those who negotiate commercial contracts will be influenced by a range of considerations in reaching their final bargains. The contracts that emerge from the process of negotiation will reflect accommodations of the parties’ varying interests, as they assess them at the time. *The reasons underlying the compromises that typically occur in commercial negotiations may not be easily perceived or understood by a court, even if they are exposed as part of the relevant background.*” After noting (at [92]) that “[d]espite his expression of caution in *Skanska*, Neuberger LJ did accept that commercial common sense still had a role to play” (see *ante*, fn.164), the majority concluded (at [93]): “All this means that where contractual language, viewed in the context of the whole contract, has an ordinary and natural meaning, a conclusion that it produces a commercially absurd result should be reached only in the most obvious and extreme of cases.”

170. For example, good faith, unconscionability, reasonable foreseeability, reasonable/legitimate expectations.

171. *Mannai* [1997] AC 749, 770, *per* Lord Steyn.

172. [2012] EWCA Civ 694; [2012] 2 P & C R 14.

173. *Ibid.*, [1], *per* Rimer LJ.

as licensor *except anyone who happened to be a licensee*. This was the view of the first instance judge, Morgan J, who said:<sup>174</sup>

“It seems to me that to hold that no notice can be given is an unsatisfactory contractual result which the parties cannot have intended. It also seems to me that a requirement... that A gets B removed or A gets an injunction requiring B to serve a notice on himself is equally a cumbersome, slow, expensive proceeding which I hesitate to think the parties intended. There is in my judgment a solution to these difficulties. The solution is to construe the reference to the licensor in Clause 4(b) as referring to all persons who together are the licensor apart from any person who is also the licensee. If that is the construction of the word licensor in Clause 4 (b) then the notice can be given by [A] alone, and this notice, being so given, was an effective notice.”

However, the Court of Appeal, in a judgment delivered by Rimer LJ (with which Longmore and Patten LJ concurred), disagreed. In doing so his Lordship rightly rejected the argument of counsel for the respondent that “this was a case where the meaning of ‘the Licensor’ in clause 4(b) had two possible constructions, it was therefore ambiguous, and accordingly the judge was right to prefer the construction that was consistent with business common sense and to reject the other”.<sup>175</sup> However, it was accepted that this was not the end of the matter. The “critical question” was the meaning that the defined term “the Licensor” in cl.4(b) “would convey to a reasonable person having all the background knowledge which would reasonably be available to the audience to whom the licence is addressed”.<sup>176</sup> The court’s answer was that the reasonable person would give it the same meaning as in the other clauses of the licence agreement so as to include a licensor who also happened to be a licensee. Accordingly, a valid notice could only be given in the wholly unlikely event that the licensee, B, joined in the giving of that notice to himself.

This seems, with respect, to be the kind of anomalous, arguably absurd, consequence that Lord Hoffmann took into account in *ICS* and *Chartbrook* when deciding that a reasonable person would not give the term in question its literal interpretation.<sup>177</sup> The practical difficulties resulting from that interpretation, including the necessity for “cumbersome” and “expensive” proceedings to have the licensee removed as trustee of the estate, and hence as licensor, provided a strong basis for concluding that “licensor” in cl.4(b) could not reasonably be understood as including anyone who was also a licensee. It is true that, as the court stressed, the licence was a “short, simple, professionally drawn document”,<sup>178</sup> but it was sloppily drafted in this and other respects.<sup>179</sup> Further, it is difficult to accept that there was “nothing to suggest... that something ha[d] gone wrong with [the] drafting”<sup>180</sup> and that “there was no basis for a conclusion that [the literal interpretation] would render the machinery of clause 4(b) unworkable”.<sup>181</sup> It is also difficult to see the relevance of the

174. *Fitzhugh v Fitzhugh* [2011] EWHC 3553 (Ch), [90].

175. [2012] EWCA Civ 694; [2012] 2 P & C.R 14, [18].

176. *Ibid*, [19].

177. It might be thought that the appropriate cause of action in this case was rectification. However, there was no evidence that the parties had turned their minds to the issue prior to the licence being executed.

178. [2012] EWCA Civ 694; [2012] 2 P & C R 14, [20].

179. For example, cl.4(a) provided that the licence would terminate upon “[t]he Licensee dying or becoming incapable by reason of mental or physical illness from discharging his obligations under this Agreement”. It thus failed to take into account that there were *two* licensees (B and his partner, C).

180. [2012] EWCA Civ 694; [2012] 2 P & C.R 14, [20].

181. *Ibid*, [21].

supporting reasoning that a reasonable person “might well consider that clause 4(b) could instead have been drafted in a way that would avoid any such difficulties arising in the future—for example, by providing for the relevant notice to be given by ‘the Licensors other than any who is for the time being a Licensee’”.<sup>182</sup> The reasonable person would surely have had the same reaction on the facts of *ICS* and *Chartbrook*!<sup>183</sup>

### 8. Conclusion: a way forward?

There is a principled way out of some of the current confusion and uncertainty highlighted above that does not entail turning the clock back to a plain meaning rule under which ordinarily the only escape from a finding that the language of the contract is unambiguous is a ruling that absurd consequences will result. It involves acceptance of four propositions that ought to be relatively uncontroversial.

First, as stated by Lord Hoffmann in his universally accepted first *ICS* principle, the task of interpretation involves the ascertainment of the meaning that the document would convey to a reasonable person with knowledge of the factual background. This principle is inconsistent with the existence of a plain meaning rule because, as we have seen, it not only allows but *requires* consideration of the background to the contract as part of the “unitary” or “single task of interpretation”,<sup>184</sup> regardless of whether there is any perceived ambiguity. The rule is relegated to a proposition that, where words do have a conventional or ordinary meaning, this is simply a strong indication that they were used in that sense.

Secondly, interpretation disputes, although they involve a question of law,<sup>185</sup> are of course heavily fact specific and as a result the meaning that will be conveyed to a reasonable person will depend on a wide variety of factors, including: the clarity of the language in dispute; the formality of the document and the quality of its drafting; the nature of the

182. *Ibid.*, [21].

183. It also seems that Rimer LJ misinterpreted Lord Hoffmann’s opinion in *Attorney-General of Belize v Belize Telecom Ltd* [2009] UKPC 10; [2009] 1 WLR 1988, when he said (at [21]) that “it is no part of the function of a court of construction to improve the document it is called upon to construe, nor does it have any power to do so”. In *Belize Telecom* Lord Hoffmann was addressing the question of implication of terms, a question that “arises when the instrument does not expressly provide for what is to happen when some event occurs” so that “[t]he most usual inference... is that nothing is to happen” (at [17]). It was in this context that he said (at [16]): “The court has no power to improve upon the instrument which it is called upon to construe, whether it be a contract, a statute or articles of association. It cannot introduce terms to make it fairer or more reasonable.” However, there is no reason to think that his Lordship was intending to qualify his view that the process of interpreting *the express terms* of a written contract can, at least in effect, involve the making of additions or alterations to the wording of the document. The task of the court is to determine what a reasonable person with knowledge of the background would have understood the parties to have meant and “[t]he fact that the court might have to express that meaning in language quite different from that used by the parties... is no reason for not giving effect to what they appear to have meant” (*Chartbrook*, [21]). In *Chartbrook*, as in *ICS*, their Lordships declined to give the term in question its ordinary or plain meaning and thus, in substance, they did resolve the case by redrafting the contract. Thus, in *Chartbrook* a formula providing for payment of “23.4% of the price achieved for each Residential Unit in excess of the Minimum Guaranteed Residential Unit Value less the Costs and Incentives” was held to mean “*the amount by which 23.4% of the price achieved for each Residential Unit (less the Costs and Incentives) is in excess of the Minimum Guaranteed Residential Unit Value*”.

184. *Chartbrook* [2009] UKHL 38; [2009] 1 AC 1101, [24], *per* Lord Hoffmann.

185. *But cf Capital Corp v Creston Moly Corp* 2014 SCC 53.

contract;<sup>186</sup> the genesis and purpose of the transaction; other admissible aspects of the factual background that were known, or ought to have been known, to the parties; and the consequences of the rival contentions. With regard to the latter factor, in *Wickman Machine Tool Sales Ltd v L Schuler AG*<sup>187</sup> Lord Reid said, in a passage endorsed by Lord Clarke in *Rainy Sky*<sup>188</sup> and cited on many other occasions:<sup>189</sup>

“The fact that a particular construction leads to a very unreasonable result must be a relevant consideration. The more unreasonable the result the more unlikely it is that the parties can have intended it, and if they do intend it the more necessary it is that they shall make their intention abundantly clear.”

Thus, the degree of required unreasonableness should be assessed with reference to the degree of clarity of the words in dispute.

Thirdly, a corollary of both the latter statement and the first *ICS* principle is that the interpretative task requires a careful balancing of internal textual considerations and external factors. The fact that the language of the text clearly supports the position of one of the parties will be important but cannot be conclusive of what the reasonable person would understand them to have meant. The language may contain an obvious typing mistake: for example, a “not” may have been omitted. Or, as in *ICS*, the drafting may be “slovenly” but “tolerably clear”<sup>190</sup> yet involve a choice “between competing unnatural meanings”<sup>191</sup>—and give rise to consequences which, although they “cannot be regarded as ‘ridiculous’ or ‘extraordinary’ or ‘very unreasonable’”,<sup>192</sup> are sufficiently anomalous or “uncommercial” to justify a conclusion that a reasonable person would not regard the language as meaning what it appears to say.<sup>193</sup> In other words, a mere unreasonable result may, when all circumstances are considered, suffice to displace a literal meaning. On the other hand, to take an extreme example, in the case of a formal and fully negotiated contract where the language in dispute, read in the context of the whole document, has only one meaning according to ordinary usage, it will usually be difficult to displace that meaning unless the consequence is so absurd or irrational that it cannot possibly have been

186. See the observations by Campbell JA in *Phoenix Commercial Enterprises Pty Ltd v City of Canada Bay Council* [2010] NSWCA 64, [151], endorsed by Lewison LJ in *Cherry Tree Investments Ltd v Landmain Ltd* [2012] EWCA Civ 736; [2013] Ch 305, [128]

187. [1974] AC 235, 251.

188. [2011] UKSC 50; [2011] 1 WLR 2900, [16].

189. Recent examples include *Marc Gilbard 2009 Settlement Trust v OD Developments and Projects Ltd* [2015] EWHC 70 (TCC), [7]; *Globe Motors, Inc v TRW Lucas Varity Electric Steering Ltd (Rev 1)* [2014] EWHC 3718 (Comm), [181]; *Starlight Shipping Co v Allianz Marine and Aviation Versicherungs AG* [2014] EWHC 3068 (Comm); [2014] 2 Lloyd’s Rep 579, [48]; *Francis v Phillips* [2014] EWCA Civ 1395, [72]; *Soufflet Negoce SA v Fedcominvest Europe Sarl* [2014] EWHC 2405 (Comm), [12]; *University of Brighton v Dovehouse Interiors Ltd* [2014] EWHC 940 (TCC), [31]; *Fujitsu Services Ltd v IBM United Kingdom Ltd* [2014] EWHC 752 (TCC), [24]; *Trafigura Beheer BV v Navigazione Montanari Spa* [2014] EWHC 129 (Comm), [9].

190. [1998] 1 WLR 896, 899, per Lord Lloyd.

191. *Ibid.*, 914, per Lord Hoffmann.

192. *Ibid.*, 905, per Lord Lloyd.

193. “[T]he poorer the quality of the drafting, the less willing the court should be to be driven by semantic niceties to attribute to the parties an improbable and unbusinesslike intention...”: *Mitsui Construction Co Ltd v Attorney General of Hong Kong* (1986) 33 BLR 14 (per Lord Bridge of Harwich), part of a passage endorsed by Mance LJ in *Gan Insurance Co Ltd v Tai Ping Insurance Co Ltd (No 2)* [2001] EWCA Civ 1047; [2001] CLC 1103, [13], which was in turn approved by Lord Clarke in *Rainy Sky* [2011] UKSC 50, [26].

intended. This is because, in the absence of such a consequence, it is the meaning that would be conveyed to a reasonable person with knowledge of the background.

Fourthly, even when the consequence of an interpretation based on textual considerations does appear absurd, it is important to bear in mind Lord Hoffmann's caution in *Chartbrook*<sup>194</sup> that "the fact that a contract may appear to be unduly favourable to one of the parties is not a sufficient reason for supposing that it does not mean what it says". His Lordship no doubt had in mind that sometimes even experienced commercial players make binding agreements that might be seen as making no commercial sense without there being any real question that the agreements do not mean what they appear to say. An excellent example is provided by the decision in *Board of Trustees of the National Provident Fund v Brierley Investments Ltd*,<sup>195</sup> where the Privy Council, in an opinion delivered by Lord Hoffmann, held that a term in an agreement to assign a lease that "the lease must not contain a ratchet clause" did not mean that the lease must not contain clauses having a ratchet effect, such as a clause providing for discretionary rent reviews, even though the consequence of this interpretation was to render the lease "hopelessly uneconomic".<sup>196</sup> The explanation for this conclusion is that the assignee's solicitor mistakenly assumed that, provided the lease did not contain a ratchet clause, the rent would go down as from the next review date. The solicitor was well aware what a ratchet clause was but it seems that he overlooked that its exclusion from the lease would not necessarily have the desired effect. The case serves as a reminder that interpretation is about working out what the parties agreed, actually or objectively, and that the fact that no person in the position of one of the parties acting rationally would have entered into the agreement if it had a particular meaning does not always provide a basis for arguing that something else must have been intended. Of course, distinguishing between an unduly favourable bargain and a commercially absurd bargain that was not intended is no easy task. However, it is important to note that in the leading House of Lords' cases of *Mannai*, *ICS* and *Chartbrook*, where an interpretation was accepted that appeared contrary to the conventional meaning of the words in question, their Lordships were satisfied that there had been a linguistic mistake and that a reasonable person with knowledge of the background would have given the words a different meaning. Thus, in *Chartbrook*<sup>197</sup> it was stressed that "the striking feature" of the case was not simply that the interpretation adopted by the lower courts was favourable to *Chartbrook* but that it made "the structure and language of the various provisions ... appear arbitrary and irrational, when it is possible for the concepts employed by the parties ... to be combined in a rational way". In their Lordships' view, it was "clear that something ha[d] gone wrong with the language" and "clear what a reasonable person would have understood the parties to have meant".<sup>198</sup>

Finally, although it was not a case where it could be said that the contract had a plain meaning, the general theme of the above propositions is borne out by the decision in *Rainy Sky*. Indeed, the points that the meaning a reasonable person will attribute to disputed language is dependent on how one balances internal textual considerations and external

194. [2009] UKHL 38; [2009] 1 AC 1101, [20].

195. [1997] 1 NZLR 1.

196. [1997] 1 NZLR 1, 5.

197. [2009] UKHL 38; [2009] 1 AC 1101, [20].

198. *Ibid.*, [25].

factors and that sometimes it may be necessary to categorise the consequences of the rejected interpretation as absurd, rather than merely unreasonable, due to the strength of the textual considerations, largely explain the different conclusions of the Court of Appeal and the Supreme Court. It will be recalled that, in broad terms, the question was whether advance payment bonds issued by the defendant bank to the buyers of ships from a Korean shipbuilder provided security upon the latter's insolvency. A majority of the Court of Appeal, in a judgment delivered by Patten LJ, answered in the negative,<sup>199</sup> but the buyers' appeal was allowed by a unanimous Supreme Court. Patten LJ was of the view that the competing interpretations, which were primarily based on the wording of the bonds and the shipbuilding contract, were not "in any way evenly balanced".<sup>200</sup> The buyer's interpretation was not "the meaning which the document would convey to a reasonable person reading it with knowledge of the terms of the shipbuilding contract".<sup>201</sup> Although security for repayment in the event of insolvency "was, objectively speaking, desirable", it was not "the natural and obvious construction of the bond".<sup>202</sup> Furthermore, that construction did not "produce an absurd or irrational result".<sup>203</sup> Importantly for present purposes, there is nothing in his Lordship's judgment to suggest that, if the competing interpretations had been seen as more evenly balanced, so that the bond was reasonably capable of either meaning, he would have thought it inappropriate to favour the more commercial interpretation. Having in effect found that there was an absence of "real ambiguity in the language of the bond",<sup>204</sup> his primary objection to the conclusion that the buyers should have the objectively desirable security for insolvency was that this would, on the basis of the evidence before the court, be to grant relief from a bad bargain. It would rewrite not the language, but the bargain itself. A court is not entitled to reformulate "relatively clear" contractual provisions "simply because" those provisions "balance the interests and obligations of the parties in a way which the judge considers to be one-sided or unfair".<sup>205</sup>

In the Supreme Court, however, Lord Clarke took a wholly different view of the merits of the parties' arguments. He disagreed that the bank's construction represented "the natural and obvious construction of the bond", saying "I do not regard the bank's construction as being the natural and ordinary meaning of the bonds".<sup>206</sup> In his view, the competing arguments were "much more finely balanced than suggested by Patten LJ and the bank".<sup>207</sup> Indeed, he said that, if the case were to be decided solely on the basis of textual analysis, he "would be inclined to prefer the buyers' construction to that of the bank".<sup>208</sup> However, since the relevant language was reasonably capable of two meanings, it was "appropriate for the court to have regard to considerations of commercial common sense in resolving

199. *Kookmin Bank v Rainy Sky SA* [2010] EWCA Civ 582; [2010] 1 CLC 829.

200. [2010] EWCA Civ 582; [2010] 1 CLC 829, [51].

201. *Ibid.*, [50].

202. *Ibid.*, [51].

203. *Ibid.*, [51].

204. *Ibid.*, [36].

205. *Ibid.*, [41].

206. [2011] UKSC 50; [2011] 1 WLR 2900, [34].

207. *Ibid.*, [35].

208. *Ibid.*, [40].

the question what a reasonable person would have understood the parties to have meant<sup>209</sup> and, as we have seen, his Lordship ruled in favour of the buyers because their interpretation was more consistent with business common sense than the bank's interpretation.

*Rainy Sky* was therefore a case where the judges asked essentially the same question—what meaning would the terms of the bonds convey to a reasonable person with knowledge of the background—but reached different conclusions stemming from different readings of the relevant terms. It is perhaps not unreasonable to speculate that, if Lord Hoffmann himself had been sitting in this case, he might have sympathised with the points made in both courts, depending on his view of the contractual language. If he shared Patten LJ's view as to the relative clarity of the language of the bond, he might have insisted on the need for the buyers to establish something akin to an absurd or irrational result of the bank's interpretation, because only then would a reasonable person reject that interpretation. On the other hand, if Lord Hoffmann shared Lord Clarke's view that the competing textual arguments were finely balanced, he might have agreed that it was entirely appropriate to uphold the buyers' interpretation on the basis that the reasonable person would have understood the parties to have meant what was more consistent with business common sense.<sup>210</sup>

209. *Ibid.*, [40].

210. While this article was in press, the Supreme Court delivered its decision in *Arnold v Britton* [2015] UKSC 36; [2015] 2 WLR 1593. The case provides yet another striking illustration of judicial disagreements over whether the term in question had a plain or "natural" meaning and the proper role of considerations of commercial common sense in contract interpretation. Thus, Lord Neuberger (with whom Lords Sumption, Hughes and Hodge agreed) concluded that the clause contained no ambiguity and that nothing had gone "significantly wrong" with its wording (at [34]). Furthermore, the fact that the consequences of the "natural" meaning for the appellants were "alarming" (at [30]) provided no basis for rewriting the clause and inserting words that were not there. By contrast, Lord Carnwath (dissenting) thought it was clear that "something [had] gone wrong with the drafting" and that there was "an inherent ambiguity" that should be resolved in the appellants' favour because the respondent's interpretation was "so commercially improbable that only the clearest words would justify the court in adopting it" (at [158]). However, more importantly for the purposes of this article, the case provides further support for the argument in the text that there is a trend towards a more conservative approach to contract interpretation, under which disputes should be resolved primarily on the basis of textual analysis, so that a court should depart from what it considers to be the plain meaning of a contract only in truly exceptional circumstances. Thus, Lord Neuberger stressed, for example, that the reliance in cases such as *Chartbrook* on considerations of commercial common sense "should not be invoked to undervalue the importance of the language of the provision which is to be construed" (at [17]), that what the parties meant, "save perhaps in a very unusual case, ... is most obviously to be gleaned from the language of the provision" (*ibid.*), and that "the mere fact that a court may be pretty confident that the subsequent effect or consequences of a particular interpretation was not intended by the parties does not justify rejecting that interpretation" (at [28]).