THE CONSTRUCTION OF CONTRACTS

Lecture by Sir Rupert Jackson and Tim Chelmick at the 4 New Square conference on construction law on 1st May 2018

1. INTRODUCTION

1.1 The luckless lawyer. Any lawyer called upon to construe a complex commercial contract has an unenviable task. First, they must wade through the contractual provisions, which may fill several ring files. Secondly, they must pick their way through a thicket of inconsistent authorities in order to ascertain the legal principles of construction, or perhaps the latest appellate fashion in contractual interpretation.

1.2 The purpose of this lecture. The purpose of this lecture is (i) to examine where we have got to now and (ii) to suggest a constructive way out of the difficulties which judges are creating by constantly moving the goal posts. We will address five topics, namely, factual matrix, business common sense, implied terms, exclusion clauses and jumbled contracts. We make no complaint about the rules governing exclusion clauses (which have evolved in an orderly way to meet the changing needs of society) or about the approach to jumbled contracts. Our concern is about the way in which the rules about factual matrix, business common sense and implied terms are oscillating and (we are told) are likely to go on oscillating.

1.3 Sections 5 and 6. Sections 5 and 6 of this paper are the sole responsibility of Tim Chelmick, since those sections discuss cases in which Sir Rupert Jackson was involved.

2. FACTUAL MATRIX

2.1 *Prenn v Simmonds.* In *Prenn v Simmonds* [1971] 1 WLR 1381 Lord Wilberforce, with whom the other four law lords agreed, stated the orthodox position. Evidence of the pre-contract negotiations is absolutely barred as an aid to construction. Evidence of the factual matrix is admissible, but limited. At 1385E Lord Wilberforce said:
"evidence should be restricted to evidence of the factual background known to the parties at or before the date of the contract, including evidence of the "genesis" and objectively the "aim" of the transaction."

2.2 *Reardon-Smith.* Lord Wilberforce returned to the same theme in *Reardon-Smith v Hansen-Tangen* [1976] 1 WLR 989. At 996 he said:
"It is often said that, in order to be admissible in aid of construction, these extrinsic facts must be within the knowledge of both parties.to the contract, but this requirement should not be stated in too narrow a sense. When one speaks of the intention of the parties to the contract, one is speaking objectively – the parties cannot themselves give direct evidence of what their intention was – and what must be ascertained is what is to be taken as the intention which reasonable people would have had if placed in the situation of the parties. Similarly, when one is speaking of the aim, or object, or commercial purpose, one is speaking objectively of what reasonable persons would have had in mind in the situation of the parties."

2.3 *ICS.* In *Investors Compensation Scheme v West Bromwich Building Society* [1998] 1 WLR 896 ("*ICS*") Lord Hoffmann (with whom Lord Goff, Lord Hope and Lord Clyde agreed) stated five

principles governing the interpretation of contracts. Principles (2) and (3) are:
"(2) The background was famously referred to by Lord Wilberforce as the "matrix of fact," but this phrase is, if anything, an understated description of what the background may include. Subject to the requirement that it should have been reasonably available to the parties and to the exception to be mentioned next, it includes absolutely anything which would have affected the way in which the language of the document would have been understood by a reasonable man.
(3) The law excludes from the admissible background the previous negotiations of the parties and their declarations of subjective intent. They are admissible only in an action for rectification. The law makes this distinction for reasons of practical policy and, in this respect only, legal interpretation differs from the way we would interpret utterances in ordinary life. The boundaries of this exception are in some respects unclear. But this is not the occasion on which to explore them."
The language of principle (2) makes it clear that the scope of the admissible factual matrix evidence is being widened.

2.4 Retreat from *ICS*. In *Arnold v Britton* [2015] UKSC 36; [2015] AC 1619 Lord Neuberger gave the leading judgment, with which Lords Sumption and Hughes agreed. He downplayed the effect of surrounding circumstances, observing that these "should not be invoked to undervalue the importance of the language of the provision which is to be construed". He added that any surrounding facts taken into account must have been known to both parties at the time when the contract was made. See the fuller citation from of *Arnold* set out in para 3.9 below. In *Wood v Capita Insurance Services* [2017] UKSC 24; [2017] AC 1173 Lord Hodge, commenting on Lord Hoffmann's second principle in *ICS*, observed that "some saw his second principle, which allowed consideration of the whole relevant background available to the parties at the time of the contract, as signalling a break with past." Lord Hodge maintained that there was no such break.

2.5 Lord Sumption, in his Harris Lecture[1] delivered some six weeks after the judgment in *Wood*, commented:
"That brings me to the second major problem about the use of the surrounding circumstances to modify the effect of language. This is the difficulty of applying it fairly in a legal system like ours which rigorously excludes the use of precontractual negotiations as evidence of intention."
There is much force in this criticism. Courts must use the 'facts known to the parties' with caution, since they are obliged to leave out of account certain of those facts which the parties may regard as of critical importance.

2.6 The difficulty. No later authority has expressly disapproved ICS principle (2). So we are left with authorities at the highest level pointing in different directions and an extra-judicial dictum which is obviously right but does not have the force of law.

3. BUSINESS COMMON SENSE

3.1 *Antaios.* In *Antaios Compania Naviera SA v Salen Rederierna SA* [1985] AC 191 at 201 D-E, Lord Diplock (with whom the other four law lords agreed) famously stated the role of business common sense in contractual interpretation as follows:
"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."

[1] Harris Society Annual Lecture, 8th May 2017

3.2 Subsequent cases. A series of subsequent cases followed that approach, in particular *Charter Reinsurance Co Ltd v Fagan* [1997] AC 313 and *Mannai Investments Co Ltd v Eagle Star Life Assurance co Ltd* [1997] AC 749. The question therefore became when and how far the 'detailed and semantic analysis' should yield to business common sense.

3.3 *ICS.* *Investors Compensation Scheme v West Bromwich Building Society* [1998] 1 WLR 896 provided an answer to that question. There was complex litigation arising out of ill-advised equity release schemes. ICS paid compensation to investors and attempted to take an assignment of their claims against WBBS. Unfortunately, clause 3 (b) of the claim form which investors signed and sent to ICS defeated that intention. The House of Lords, by a majority reversing the decision of the Court of Appeal, whilst purporting to construe clause 3 (b) effectively rewrote the clause to achieve what ICS had wanted to do. Lord Hoffmann stated his fourth and fifth principles as follows:
"(4) The meaning which a document (or any other utterance) would convey to a reasonable man is not the same thing as the meaning of its words. The meaning of words is a matter of dictionaries and grammars; the meaning of the document is what the parties using those words against the relevant background would reasonably have been understood to mean. The background may not merely enable the reasonable man to choose between the possible meanings of words which are ambiguous but even (as occasionally happens in ordinary life) to conclude that the parties must, for whatever reason, have used the wrong words or syntax: see *Mannai Investments Co. Ltd. v. Eagle Star Life Assurance Co. Ltd* [1997] 2 WLR 945.
(5) The "rule" that words should be given their "natural and ordinary meaning" reflects the common sense proposition that we do not easily accept that people have made linguistic mistakes, particularly in formal documents. On the other hand, if one would nevertheless conclude from the background that something must have gone wrong with the language, the law does not require judges to attribute to the parties an intention which they plainly could not have had."

3.4 *Chartbrook.* The In *Chartbrook Ltd* v *Persimmon Homes Ltd* [2009] UKHL 38, [2009] 1 AC 1101 the court was called upon to construe a contract relating to the development of a building site in Wandsworth. The issue between the parties was the amount of a balancing payment which was owed by the developer to the landowner under schedule 6 to the contract. In construing the clause which defined this balancing payment, the House of Lords (reversing the majority decision of the Court of Appeal) departed from the literal interpretation of that clause. Lord Hoffmann formulated the correct approach at paragraph 14 of his speech as follows:
"14. There is no dispute that the principles on which a contract (or any other instrument or utterance) should be interpreted are those summarised by the House of Lords in *Investors Compensation Scheme Ltd v West Bromwich Building Society* [1998] 1 WLR 896, 912-913. They are well known and need not be repeated. It is agreed that the question is what a reasonable person having all the background knowledge which would have been available to the parties would have understood them to be using the language in the contract to mean. The House emphasised that "we do not easily accept that people have made linguistic mistakes, particularly in formal documents" ... but said that in some cases the context and background drove a court to the conclusion that "something must have gone wrong with the language". In such a case, the law did not require a court to attribute to the parties an intention which a reasonable person would not have understood them to have had."
At paragraphs 22 to 24 Lord Hoffmann reviewed two earlier Court of Appeal authorities before concluding at paragraph 25:
"What is clear from these cases is that there 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. In my opinion, both of

these requirements are satisfied."

3.5 Extra-judicial comments by senior judges. Sir Geoffrey Vos (who was counsel for ICS) now concedes that the case was wrongly decided. In his lecture on contractual interpretation, 'Do judges sometimes say one thing and mean another?',[2] he said "It would be surprising if *ICS* were to be decided the same way today".
Lord Sumption in his Harris Lecture stated, in effect, that *Chartbrook* was wrongly decided: "The result may well have been just, but I have some difficulty in recognising it [as] a process of construction."

3.6 *Rainy Sky.* *Rainy Sky SA v Kookmin Bank* [2011] UKSC 50; [2011] 1 WLR 2900 concerned the construction of a bank guarantee. Two different constructions were canvassed: a narrow interpretation which accorded with the natural meaning of the words and a broad interpretation which – to put it politely – required a great deal of stretching. The Court of Appeal upheld the narrow interpretation and found in favour of the bank. The Supreme Court allowed the claimants' appeal and accepted the broad interpretation. Lord Clarke delivered the leading judgment, with which the other members of the court agreed. He ascribed a more limited role to business common sense. At [21] he said:
"The language used by the parties will often have more than one potential meaning. 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 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."

3.7 Lord Clark added [22]:
"Where the parties have used unambiguous language, the court must apply it."

3.8 Lord Sumption's criticism of *Rainy Sky.* In a lecture last year,[3] Lord Sumption criticised the reasoning in *Rainy Sky*. He observed:
"Lord Clarke, in his leading judgment, emphasised that the object was to understand rather than override the language. But his reasoning points the other way."
Comment. There are two important points to be made here. First, Lord Clarke' statement of principle marks a significant retreat from *Antaios* and *ICS*. He is saying that the court can use business common sense as an aid to choosing between two possible meanings, not as a justification for re-writing the clause or ascribing to it an impossible meaning. Secondly, Lord Sumption says that the court applied that principle wrongly, in other words that *Rainy Sky* was wrongly decided.

3.9 *Arnold v Britton.* In *Arnold v Britton* [2015] UKSC 36; [2015] AC 1619 provisions governing service charges operated extremely harshly on the tenants. The Supreme Court, upholding the decision of the lower courts, held the parties to their bargain. Lord Neuberger (with whom Lord Sumption and Lord Hughes agreed) stated the principles of contractual interpretation as follows:

"17 First, the reliance placed in some cases on commercial common sense and surrounding circumstances (eg in *Chartbrook*, paras 16-26) should not be invoked to undervalue the importance of the language of the provision which is to be construed. The exercise of interpreting a provision

[2] At Canterbury University, Christchurch on 18th October 2017
[3] Harris Society Annual Lecture, 8th May 2017

involves identifying what the parties meant through the eyes of a reasonable reader, and, save perhaps in a very unusual case, that meaning is most obviously to be gleaned from the language of the provision. Unlike commercial common sense and the surrounding circumstances, the parties have control over the language they use in a contract. And, again save perhaps in a very unusual case, the parties must have been specifically focussing on the issue covered by the provision when agreeing the wording of that provision.

18 Secondly, when it comes to considering the centrally relevant words to be interpreted, I accept that the less clear they are, or, to put it another way, the worse their drafting, the more ready the court can properly be to depart from their natural meaning. That is simply the obverse of the sensible proposition that the clearer the natural meaning the more difficult it is to justify departing from it. However, that does not justify the court embarking on an exercise of searching for, let alone constructing,[4] drafting infelicities in order to facilitate a departure from the natural meaning. If there is a specific error in the drafting, it may often have no relevance to the issue of interpretation which the court has to resolve.

19 The third point I should mention is that commercial common sense is not to be invoked retrospectively. The mere fact that a contractual arrangement, if interpreted according to its natural language, has worked out badly, or even disastrously, for one of the parties is not a reason for departing from the natural language. Commercial common sense is only relevant to the extent of how matters would or could have been perceived by the parties, or by reasonable people in the position of the parties, as at the date that the contract was made. Judicial observations such as those of Lord Reid in *Wickman Machine Tools Sales Ltd v L Schuler AG* [1974] AC 235, 251 and Lord Diplock in *Antaios Cia Naviera SA v Salen Rederierna AB (The Antaios)* [1985] AC 191, 201, quoted by Lord Carnwath at para 110, have to be read and applied bearing that important point in mind.

20 Fourthly, while commercial common sense is a very important factor to take into account when interpreting a contract, a court should be very slow to reject the natural meaning of a provision as correct simply because it appears to be a very imprudent term for one of the parties to have agreed, even ignoring the benefit of wisdom of hindsight. The purpose of interpretation is to identify what the parties have agreed, not what the court thinks that they should have agreed. Experience shows that it is by no means unknown for people to enter into arrangements which are ill-advised, even ignoring the benefit of wisdom of hindsight, and it is not the function of a court when interpreting an agreement to relieve a party from the consequences of his imprudence or poor advice. Accordingly, when interpreting a contract a judge should avoid re-writing it in an attempt to assist an unwise party or to penalise an astute party.

21 The fifth point concerns the facts known to the parties. When interpreting a contractual provision, one can only take into account facts or circumstances which existed at the time that the contract was made, and which were known or reasonably available to both parties. Given that a contract is a bilateral, or synallagmatic, arrangement involving both parties, it cannot be right, when interpreting a contractual provision, to take into account a fact or circumstance known only to one of the parties.

22 Sixthly, in some cases, an event subsequently occurs which was plainly not intended or contemplated by the parties, judging from the language of their contract. In such a case, if it is clear what the parties would have intended, the court will give effect to that intention. An example of such a case is *Aberdeen City Council v Stewart Milne Group Ltd* [2011] UKSC 56, 2012 SCLR 114, where the court concluded that "any … approach" other than that which was adopted "would

[4] "constructing" looks a bit like a typo. Perhaps Lord Neuberger meant "correcting".

defeat the parties' clear objectives", but the conclusion was based on what the parties "had in mind when they entered into" the contract (see paras 17 and 22)."

3.10 A return to orthodoxy. The *Arnold* decision represents a return to orthodoxy after the adventures of *ICS*, *Chartbrook* and other cases of that period. The difficulty is that no-one has overruled *ICS* or *Chartbrook*. We simply have decisions which appear to be inconsistent with them and eminent judges giving lectures saying that they are wrong. Judges are still citing *ICS* or *Chartbrook*, when that suits their purposes.

4. IMPLIED TERMS

4.1 *Belize.* In *Attorney General of Belize v Belize Telecom Ltd* [2009] UKPC 10; [2009] 1 WLR 1988 the issue was whether a provision which was not spelt out in the articles of association of a company was implicit, in order to deal with an unforeseen situation which had arisen. The judge held that it was. The Court of Appeal of Belize held that it was not. The Privy Council restored the decision of the judge. Lord Hoffmann, delivering the judgment of the Board, said that the implication of a term was an exercise of construction. At [21] he said:
"It follows that in every case in which it is said that some provision ought to be implied in an instrument, the question for the court is whether such a provision would spell out in express words what the instrument, read against the relevant background, would reasonably be understood to mean. It will be noticed from Lord Pearson's speech that this question can be reformulated in various ways which a court may find helpful in providing an answer – the implied term must "go without saying", it must be "necessary to give business efficacy to the contract" and so on – but these are not in the Board's opinion to be treated as different or additional tests. There is only one question: is that what the instrument, read as a whole against the relevant background, would reasonably be understood to mean?"

4.2 *Marks and Spencer.* In *Marks and Spencer plc v BNP Paribas* [2015] UKSC 72; [2016] AC 742 a lease entitled the tenant to terminate on 24th January 2012. The tenant exercised that right and subsequently sought to reclaim rent which it had paid in advance, namely for the period between 24th January and the next quarter day. No express term permitted the tenant to recover that rent. The judge held that there was an implied term to that effect. The Court of Appeal and the Supreme Court held that there was no such implied term. Lord Neuberger (with whom Lords Sumption and Hodge agreed) rejected the suggestion that the implication of terms was an exercise of construction. At [26] he said:
"I accept that both (i) construing the words which the parties have used in their contract and (ii) implying terms into the contract, involve determining the scope and meaning of the contract. However, Lord Hoffmann's analysis in *Belize Telecom* could obscure the fact that construing the words used and implying additional words are different processes governed by different rules."

4.3 Lord Neuberger effectively reinstated the traditional rules governing implied terms. He cited with approval the following dictum of Lord Simon in *BP Refinery (Westernport) Pty Ltd v Shire of Hastings* (1977) 180 CLR 226 at 282-283:
"[F]or a term to be implied, the following conditions (which may overlap) must be satisfied: (1) it must be reasonable and equitable; (2) it must be necessary to give business efficacy to the contract, so that no term will be implied if the contract is effective without it; (3) it must be so obvious that 'it goes without saying'; (4) it must be capable of clear expression; (5) it must not contradict any express term of the contract."
At [21] Lord Neuberger added:
"In my judgment, the judicial observations so far considered represent a clear, consistent and principled approach. It could be dangerous to reformulate the principles, but I would add six

comments on the summary given by Lord Simon in *BP Refinery* as extended by Sir Thomas Bingham in *Philips* and exemplified in *The APJ Priti*. First, in *Equitable Life Assurance Society v Hyman* [2002] 1 AC 408, 459, Lord Steyn rightly observed that the implication of a term was "not critically dependent on proof of an actual intention of the parties" when negotiating the contract. If one approaches the question by reference to what the parties would have agreed, one is not strictly concerned with the hypothetical answer of the actual parties, but with that of notional reasonable people in the position of the parties at the time at which they were contracting. Secondly, a term should not be implied into a detailed commercial contract merely because it appears fair or merely because one considers that the parties would have agreed it if it had been suggested to them. Those are necessary but not sufficient grounds for including a term. However, and thirdly, it is questionable whether Lord Simon's first requirement, reasonableness and equitableness, will usually, if ever, add anything: if a term satisfies the other requirements, it is hard to think that it would not be reasonable and equitable. Fourthly, as Lord Hoffmann I think suggested in *Attorney General of Belize v Belize Telecom Ltd* [2009] 1 WLR 1988, para 27, although Lord Simon's requirements are otherwise cumulative, I would accept that business necessity and obviousness, his second and third requirements, can be alternatives in the sense that only one of them needs to be satisfied, although I suspect that in practice it would be a rare case where only one of those two requirements would be satisfied. Fifthly, if one approaches the issue by reference to the officious bystander, it is "vital to formulate the question to be posed by [him] with the utmost care", to quote from Lewison, *The Interpretation of Contracts* 5th ed (2011), para 6.09. Sixthly, necessity for business efficacy involves a value judgment. It is rightly common ground on this appeal that the test is not one of "absolute necessity", not least because the necessity is judged by reference to business efficacy. It may well be that a more helpful way of putting Lord Simon's second requirement is, as suggested by Lord Sumption in argument, that a term can only be implied if, without the term, the contract would lack commercial or practical coherence."

4.4 Where are now? It seems that the wheel has come full circle. The construction of contractual provisions and the implication of terms are separate exercises. The traditional principles, which were largely fashioned in the Victorian age, still govern implied terms. Curiously, the Supreme Court stopped short of expressly disapproving the reasoning in *Belize*. Instead, the court said that Lord Hoffmann's observations "should henceforth be treated as characteristically inspired discussion rather than authoritative guidance on the law of implied terms": see para 31.

5. EXCLUSION CLAUSES

5.1 Traditional approach. Traditionally courts have been hostile to exclusion clauses and construed them as restrictively as they reasonably could. There is a long line of authorities to that effect, starting with *Canada Steamship Lines Ltd v The King* [1952] AC 192. In that well known case the Privy Council was considering the construction of two separate clauses in a lease, one being an exemption clause and the other being an indemnity clause. At 208 Lord Morton, delivering the judgment of the court, said:

"Their Lordships think that the duty of a court in approaching the consideration of such clauses may be summarized as follows:-

(1) If the clause contains language which expressly exempts the person in whose favour it is made (hereafter called "the proferens") from the consequence of the negligence of his own servants, effect must be given to that provision. Any doubts which existed whether this was the law in the Province of Quebec were removed by the decision of the Supreme Court of Canada in *The Glengoil Steamship Company v. Pilkington*.

(2) If there is no express reference to negligence, the court must consider whether the words used are wide enough, in their ordinary meaning, to cover negligence on the part of the servants of the proferens. If a doubt arises at this point, it must be resolved against the proferens in accordance

with article 1019 of the Civil Code of Lower Canada: "In cases of doubt, the contract is interpreted against him who has stipulated and in favour of him who has contracted the obligation.
(3) If the words used are wide enough for the above purpose, the court must then consider whether "the head of damage may be based on some ground other than that of negligence", to quote again Lord Greene in the *Alderslade* case. The "other ground" must not be so fanciful or remote that the proferens cannot be supposed to have desired protection against it; but subject to this qualification, which is no doubt to be implied from Lord Greene's words, the existence of a possible head of damage other than that of negligence is fatal to the proferens even if the words used are prima facie wide enough to cover negligence on the part of his servants."

5.2 The debate post-*Canada Steamship*. In *Persimmon Homes Ltd v Ove Arup & Partners Ltd* [2017] EWCA Civ 373, Jackson LJ stated:
Over the last 67 years there has been a long running debate about the effect of that passage and the extent to which it is still good law. In hindsight we can see that it is not satisfactory to deal with exemption clauses and indemnity clauses in one single compendious passage. It is one thing to agree that A is not liable to B for the consequences of A's negligence. It is quite another thing to agree that B must compensate A for the consequences of A's own negligence.

In later years, and especially since the enactment of Unfair Contract Terms Act 1977, the courts have softened their approach to both indemnity clauses and exemption clauses: see Lictor Anstalt v MIR Steel UK [2012] EWCA Civ 1397; [2013] 2 All ER (Comm) 54 at [31] to [34]. Although the present judgment is not the place for a general review of the law of contract, my impression is that, at any rate in commercial contracts, the Canada Steamships guidelines (in so far as they survive) are now more relevant to indemnity clauses than to exemption clauses.

In major construction or other commercial contracts the parties commonly agree how they will allocate the risks between themselves and who will insure against what. Exemption clauses are part of the contractual apparatus for distributing risk. There is no need to approach such clauses with horror or with a mindset determined to cut them down. Contractors and consultants who accept large risks will charge for doing so and will no doubt take out appropriate insurance. Contractors and consultants who accept lesser degrees of risk will presumably reflect that in the fees which they agree."

5.3 A similar approach taken in *Transocean Drilling UK Ltd v Providence Resources plc* [2016] EWCA Civ 372.

5.4 A more consistent line of authority. The courts have gradually softened their hostility to exclusion clauses, thus developing the law in line with the needs and expectations of the commercial community. In a commercial context and, in particular, in construction, this approach makes sense. Far from being unusual or exceptional, exemption clauses are important parts of the risk sharing mechanism which are often the subject of careful negotiation. There is no need to treat such clauses differently for the purposes of contractual construction. Although there remains more scope for argument for indemnity clauses, again, as a matter of principle, it is difficult to see why such clauses should be treated differently in commercial contracts.

6. JUMBLED CONTRACTS

6.1 The final issue considered in this paper is whether there is a separate category of contracts where a different approach to construction is taken. Contracts falls into two categories:
(a) coherent contracts, which are usually the product of a small number of draftsmen or negotiators on each side;
(b) jumbled contracts, which are usually the product of many different minds, with lots of people contributing different sections or provisions.

6.2 Construction contracts often fall into the latter category. Here an iterative approach to construction is required, as explained by Lord Mance in *Re Sigma* [2009] UKSC 2 at [12]. The reader must check each of the rival meanings of a provision against the other provisions of the contract.

6.3 Two specific issues have arisen recently in the construction context. First, in *MT Hojgaard A/S v E.ON Climate and Renewables* [2017] UKSC 59 the Courts had to construe a complex construction contract (for the construction of an offshore windfarm) where the contract documents were described as `"somewhat diffuse". The issue was that the prescribed design, if constructed literally, could not meet the prescribed performance criteria. The Supreme Court noted that such terms are not necessarily mutually inconsistent. Lord Neuberger stated:

While each case must turn on its own facts, the message from decisions and observations of judges in the United Kingdom and Canada is that the courts are generally inclined to give full effect to the requirement that the item as produced complies with the prescribed criteria, on the basis that, even if the customer or employer has specified or approved the design, it is the contractor who can be expected to take the risk if he agreed to work to a design which would render the item incapable of meeting the criteria to which he has agreed.

6.4 The other obvious area where contracts can be described as jumbled is in the context of PFI where the nature and complexity of the contractual arrangements makes inconsistencies and other infelicities inevitable. The Court of Appeal recently construed a complex PFI contract in *Amey Birmingham Highways Ltd v Birmingham City Council* [2018] EWCA Civ 264. At paragraph 93, the Court of Appeal stated:

"Any relational contract of this character is likely to be of massive length, containing many infelicities and oddities. Both parties should adopt a reasonable approach in accordance with what is obviously the long-term purpose of the contract. They should not be latching onto the infelicities and oddities, in order to disrupt the project and maximise their own gain"

6.5 Although on one view, this may be seen as controversial, placing relational contracts such as PFI contracts in a separate category, this can also be analysed as an application of the 5th and 6th limbs of construction recognised in *Arnold v Britton.* The Court has taken into account the nature of the contract and the fact that all parties intended this to be a long term relationship when construing contractual provisions where a literal construction of one clause in isolation produced an anomalous outcome. A similar outcome may be achieved by the imposition of a duty of good faith in such contracts, but the decision perhaps illustrates how a fair result can be achieved using conventional principles of contractual construction without imposition of a wide ranging duty of good faith which, traditionally, has formed no part of the English common law.

7. REVIEW

7.1 Judicial heroism. Lord Hodge in a heroic judgment (with which all other members of the court agreed) in *Wood v Capita Insurance Services Ltd* [2017] UKSC 24; [2017] AC 1173 maintained that there was no inconsistency between the authorities. He offered a synthesis at [10]–[14]. At [15] he said:
"The recent history of the common law of contractual interpretation is one of continuity rather than change. One of the attractions of English law as a legal system of choice in commercial matters is its stability and continuity, particularly in contractual interpretation."

7.2 Judicial realism. In his lecture entitled 'Contractual interpretation: Do judges sometimes say one thing and mean another?'[5] Sir Geoffrey Vos C argued that the recent cases on contractual

[5] 18th October 2017

interpretation and implied terms are far from consistent. He is devastating in his criticism of para 15 of *Wood*. He describes that paragraph as "remarkable" (lecture para 29). He also bluntly states: "what seems to have been a palpable change in the law has been repeatedly denied or at least played down."[6]

He states that there has been a "sea change" in this area of the law since the retirement of Lord Hoffmann. If one accepts that thesis (and I must confess to finding Sir Geoffrey's reasoning persuasive), then it may be unhelpful to pretend that this is not the case.

7.3 Why all this difficulty? Surely the law on contractual interpretation is clear by now? Well yes. The trouble is that every generation of judges, especially those on loftier perches, feel an irresistible urge to state or re-state the principles in their own words. Every time they do so, different aspects of those principles receive emphasis. Every formulation of the rules or principles is coloured by the case which is then before the court. The judge has a sense of what the right answer is in that case and tends to slant his/her general propositions towards reaching that answer. Both *ICS* and *Arnold v Britton* are examples of that phenomenon, although tending in opposite directions.

7.4 Is this multiplication of the authorities a good thing? On one view, it is a good thing to have so many brilliant jurists telling us how to interpret contracts. Indeed, the Court of Appeal has recently expressed its appreciation in *Royal Devon & Exeter NHS Foundation Trust v ATOS* [2017] EWCA Civ 2196 at [45]:

"We are lucky enough to live in an age when there is a galaxy of high appellate authority on how to interpret contracts. Each new pronouncement helpfully re-explains what the previous decisions meant."

An alternative view, however, is that this is not a good thing at all. Such a profusion of fluctuating statements of principle creates uncertainty, which is the last thing that anyone wants in the commercial sphere. Also, it takes long time for practitioners to plough through all the high appellate guidance, in order to identify where the law currently stands. Even that does not tell them where the law might be tomorrow.

7.5 Sir Geoffrey's final paragraph – the pendulum. In the final paragraph of his lecture, Sir Geoffrey Vos states that "we have just concluded one swing of the pendulum". He adds that "It will be interesting to see how matters develop as the composition of the UK Supreme Court changes." Interesting as it may be for learned judges and academic commentators, this is thoroughly unsatisfactory for practitioners and court users. How are commercial lawyers to advise their clients in contentious situations? As things stand, we have a heaving sea of inconsistent authorities, none expressly disapproved but several said to be wrong in extra-judicial lectures.

7.6 What about precedent? A pendulum swinging backwards and forwards between purposiveness and literalism is not a sensible way for the common law to develop. Any proper application of the doctrine of precedent means that we should have some clear statements of principle and stick to them.

7.7 Is *Wood v Capita* the answer? Not really, no. Paragraphs 10 to 14 are a wise and insightful analysis of what the Supreme Court was saying in *Rainy sky*, *Arnold v Britton* and *In Re Sigma*. But the passage does not purport to be a complete statement of all the principles governing the interpretation of contracts.

7.8 What is the answer then? The answer is most definitely not to have another deluge of decisions restating the principles, with copious references back to earlier cases in order to squeeze them into some new mould. What we need is something like a US style re-statement or a civil law code. This

[6] Lecture para 3

would be a comprehensive statement of the principles governing the interpretation of contracts. Although drawing inspiration from all the jurisprudence of earlier years, the document should be self-sufficient and make no reference to a single previous decided case. The document needs to be authoritative. It should be one which judges at all levels can apply, without any need to "re-state" the principles in their own words.

7.9 Does any such document currently exist? No. We have looked at the various contract law textbooks, articles 5:101 – 5:102 of European Contract Law and articles 1188 – 1192 of the French Civil Code. None of these would suffice. Articles 200 to 223 of the US Second Restatement of Contracts are nearer to the mark, but they are not directly based on the principles emerging from recent English case law.

7.10 Who should prepare such a document and how can we be confident that judges would sign up to it? We throw this question out for discussion. It merits debate, because the commercial world needs more certainty about the courts' approach to contractual interpretation than currently exists. Our suggestion would be a committee comprising a Commercial Court judge, a lord justice, two Supreme Court justices and two distinguished academic lawyers. Once that committee has prepared a draft, there should be a period of consultation and public debate. After that the same committee should finalise its comprehensive statement of the principles of contractual interpretation.[7] There should then be some robust Court of Appeal and Supreme Court decisions telling judges to apply those principles without constantly changing them and without adding glosses.[8]

7.11 Why should judges give up precious time to doing this? First, this exercise would be hugely valuable for court users. Secondly, judges have created the present highly unsatisfactory situation. The judiciary should take the initiative in putting it right.

7.12 Are you advocating a codification of the law of contract? No, we are simply suggesting a solution to a situation which has got out of hand. But if the project is successful, it could be a first step towards codifying the law of contract.

7.13 In the meantime what should we all be doing? Rely upon the most recent Supreme Court decisions and treat earlier cases (even though not expressly overruled) with a pinch of salt.

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[7] Scotland did attempt an exercise along those lines, but that exercise came to nothing. See https://www.scotlawcom.gov.uk/files/1512/7989/6878/rep160.pdf. This report by the Scottish Law Commission was never implemented.

[8] There is precedent for appellate courts giving effect to sensible reform proposals and thereafter intervening firmly when judges step out of line: *Simmons v Castle* [2012] EWCA Civ 1039 and 1288; [2013] 1 WLR 1239; *Summers v Bundy* [2016] Civ 126.