

NEWS BRIEF

Contract interpretation: the Supreme Court's last word (for now)?

The Supreme Court in *Wood v Capita Insurance Services* has reasserted the importance of considering the wording of a contract in its context ([2017] UKSC 24). This marks a subtle but significant reassertion of the modern orthodoxy. Two recent decisions of the Supreme Court had suggested that there were some circumstances where the context could be marginalised, if not altogether ignored. *Wood* has now removed this uncertainty.

Literalism v contextualism

In interpreting a contract there is often a potential tension between the literal wording and the meaning which might be given to it in light of the background and context. An example of the difference between a literal interpretation and a contextual one is illustrated in *Smith v Wilson* ((1832) 110 ER 266). A tenant was required to leave ten thousand rabbits in a warren. Read literally, the number is clear. However, the court accepted that the relevant context, of describing rabbits in Suffolk, radically changed things as the term "thousand", as applied to rabbits, meant 100 dozen in that part of the country.

The move to literalism

In *ICS v West Bromwich Building Society*, Lord Hoffmann emphasised the importance of the context in interpreting any contract ([1998] 1 WLR 896). For over ten years after *ICS*, Lord Hoffmann's position was widely adopted.

However, in *Rainy Sky v Kookmin Bank*, the Supreme Court appeared to change direction ([2011] UKSC 50; see News brief "Contractual interpretation: let commercial common sense prevail", www.practicallaw.com/9-513-7588). The court held that where the parties have used unambiguous language the court must apply it. This appeared to introduce a two-step process: where the words of the contract are unambiguous, there is no need for the context to be used. However, where the words of the contract are ambiguous then, and only then, the context can be introduced as a tool in order to assist in interpretation. Although it was not billed as such, this amounted to a change in direction from *ICS*.

Tips for contractual interpretation

- The overall task of the court is to ascertain the objective meaning of the language which the parties have chosen to express their agreement.
- The relevant word or phrase should be read in light of the contract as a whole.
- Contractual interpretation is a unitary exercise, in which context is always relevant, but the court will put more or less emphasis on this in interpreting the contract, depending on the circumstances.
- Circumstances that will tend in favour of taking into account the context include: one or both of the parties were unsophisticated or not advised by lawyers; brevity; and where the contract was agreed in an informal setting or using informal words.
- Circumstances that will tend against taking into account the context include where the contract is one which involves or may involve many different parties, especially where it is a negotiable instrument designed to be traded, such as a bond. Industry standard documents such as the ISDA Master Agreement, which are widely used and commercially extremely important, are likely to be given more literal meanings because of the uncertainty that might otherwise result.
- If there are several rival interpretations in light of the context, the court can give weight to their implications by reaching a view as to which is more consistent with business common sense.
- Choosing from rival interpretations can be an "iterative process" in which the court considers a number of possible meanings and their consequences.
- The courts cannot rewrite the contract merely because one of the parties has made a bad bargain.
- The contra proferentem rule provides that any ambiguity in a clause excluding liability will be resolved against the party seeking to rely on it. However, this is of limited use in contracts negotiated by sophisticated counterparties.
- Pre-contractual negotiations are not admissible as evidence in interpreting the contract, although they can be evidence of the factual matrix which constitutes the contract's context.
- Rectification remains an option in circumstances where the wording of the contract does not reflect the mutual intention of the parties; that is, where there has been a mistake in recording what they agreed. This can be established by evidence of pre-contractual negotiations.

A difficulty with this two-step approach is that there is rarely, if ever, an unambiguous meaning of contractual words as many words and phrases are capable of multiple interpretations. Moreover, by not expressly departing from *ICS*, *Rainy Sky* created

uncertainty as to which approach was to be followed.

The Supreme Court was given another opportunity to address contractual interpretation in *Arnold v Britton* ([2015]

UKSC 36; www.practicallaw.com/9-616-5783). This was notable for two reasons. Firstly, a very literal, and commercially surprising, reading was arrived at on the facts. Secondly, *Arnold* did not even mention *ICS*, appearing to signal a distinct break from Lord Hoffmann's jurisprudence, although not explicitly overruling it. However, *Arnold* did not discuss the two-step approach in *Rainy Sky*, further contributing to the uncertainty.

The decisions in *Wood*

The dispute in *Wood* concerned the proper construction of an indemnity given by Mr Wood under the terms of a share purchase agreement under which Capita bought the entire issued share capital of Sureterm Direct Limited. The indemnity covered claims and complaints registered with the Financial Services Authority (FSA) in relation to mis-selling. The main issue was whether the language of the indemnity meant that it would be triggered only by a customer's claim or complaint, or whether it would apply where Sureterm self-reported findings of potential mis-selling to the FSA.

The High Court held that the indemnity applied even if there had been no claim or complaint by a customer ([2014] EWHC 3240). The Court of Appeal upheld Mr Wood's appeal, finding that the indemnity was not triggered on Sureterm's self-reporting as no liability could arise under it unless a mis-selling claim had been made against Sureterm or a complaint had been made

to the FSA ([2015] EWCA Civ 839; see *News brief "Contract interpretation: the end of the more liberal trend?"*, www.practicallaw.com/7-618-8691).

The Supreme Court dismissed Capita's appeal. In doing so, it laid down the following definitive test for the interpretation of contracts:

- The court must ascertain the objective meaning of the language which the parties have chosen to express their agreement.
- This is not a literalist exercise focused solely on analysing the wording of a particular clause.
- The court must consider the contract as a whole and, depending on the nature, formality and quality of the drafting of the contract, give more or less weight to elements of the wider context in reaching its view.

The court rejected the two-step process in *Rainy Sky*, ruling that contractual interpretation is a unitary exercise where context is always to be taken into account, even though the weight that should be put on it can vary depending on the circumstances (see box "*Tips for contractual interpretation*"). This qualifier is important in preserving the fundamental importance to be attached to the draftsmen's words so far as is possible.

Return to contextual approach

In *Wood*, Lord Hodge, giving the judgment of the court, took the opportunity to rehabilitate Lord Hoffmann's views, calling *ICS* a "celebrated judgment" in which Lord Hoffmann had "reformulated the principles of contractual interpretation". However, Lord Hodge did not overrule *Arnold* or *Rainy Sky*. In fact, he began his judgment by saying that it was not appropriate to reformulate the guidance given in *Rainy Sky* and *Arnold*.

Lord Hodge said in *Wood* that he was not changing the direction of the law, yet this is what he appears to have done. Why this careful judicial positioning? The reason may lie in the constitution of the panel. In addition to Lord Hodge, it included Lord Clarke, who gave the lead judgment in *Rainy Sky* and Lord Neuberger, who gave the lead judgment in *Arnold*.

Lord Hodge, as the youngest member of the Supreme Court bench, is not required to retire until 2024. His judgment in *Wood* has clarified the law and restored the most sensible approach. Seen in this context, one might expect that it could be the last word on the interpretation of contracts for some time.

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