CONTRACTUAL CONSTRUCTION: THE TENSION

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When the courts are faced with questions of contractual construction there remains a tension in the approach they should take. As Sir Lewison said in his 7th Edition of The Interpretation of Contracts, there is a tension between *"a decision of the Supreme Court which had emphasised the primacy of the contractual language over background facts on the one hand, and the repeated statements that contractual interpretation is an iterative exercise which requires consideration of the commercial consequences of rival interpretations"*[1] ("the Tension").

This article serves to highlight the existence of the Tension in the court's approach to contractual construction in light of the recent case of *Solutions 4 North Tyneside Limited v Galliford Try Building 2014 Limited*[2].

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1 Lewison, The Interpretation of Contracts, 7th Edition, page
2 [2022] EWHC 2372 (TCC)

What is the Tension?

In order to understand what the Tension is, readers must understand the history of the series of judgments on contractual construction. So, in short it goes like this:

Starting in **1998** – Lord Hoffman gave his leading judgment in *Investors Compensation Scheme v West Bromwich Building Society*[3] (page 912H); this was cited for many years as the leading judgment for the interpretation of contracts.

In his judgment, Lord Hoffman formulated five principles for contractual construction, which he said replaced the *"old baggage of 'legal' interpretation"*[4]. Principles four and five are discussed below:

(1) The fourth principle distinguished the meaning of a document and the meaning of its words. He said:

   a. Language is a matter of dictionaries and grammar.

   b. Meaning is what a reasonable person would have understood the words to mean against the relevant background.

   c. The relevant background "may not merely enable the reasonable man to choose between the possible meanings of words which are ambiguous but even … to conclude that the parties must, for whatever reason, have used the wrong words or syntax".

(2) Hoffman's fifth principle builds upon the fourth. He said:

   a. The natural and ordinary meaning of the language is no more than a reflection of the commonsense proposition that people mean what they say in formal documents.

   b. However, if the background suggests something went wrong with the words or syntax, then the law may attribute a different intention to them.

There has been various academic comment on Lord Hoffman's judgment in ICS, arguably the most relevant to explaining the Tension was that of Lord Sumption in a lecture made to Keble College, Oxford. He said:

"What did Lord Hoffmann mean by suggesting that something might have gone wrong with the words? He clearly did not have in mind a case where the text got garbled in the word processor or the verb had been accidentally omitted. Looking through his seductive prose, what he actually appears to have meant is that the background may be used to show that the parties cannot as reasonable people have meant what they said, so that the court is entitled to substitute something else. Lord Hoffmann does not spell out how we are to discover what else they meant if it was not what they said. But the only plausible answer to that question is that the parties are taken to have intended whatever reasonable people would have intended even if it is not a possible meaning of the words"[5].

Moving on to between **2009 to 2011** - there was a series of case-law refining and developing Lord Hoffman's *ICS* judgment. Drawing on *Rainy Sky SA v Kookmin Bank*[6]; the discrepancies between its Court of Appeal and Supreme Court judgments are key to highlighting the Tension.

(1) Beginning with the dispute itself, this concerned the scope of a bank guarantee given in connection with a shipbuilding contract. The guarantee covered the repayment of **certain** advance instalments of the contract price should the ship fail to be delivered. The question for the court to decide was: which kinds of advance instalments were covered?

(2) The Defendant argued **not** all of the advances were covered. The language of the provision, on its face, supported this view and the Court of Appeal agreed. In the judgment Patten LJ said that any other view was *"in real danger of substituting our own judgment of the commerciality of the transaction for that of those who were actually party to it"* (paragraph 51).

(3) Despite this, the Supreme Court reversed the decision on the ground that it was not necessary to show that the apparent meaning of the contract was absurd or irrational. It was enough that there was no plausible reason

3 [1998] 1 W.L.R 896

4 Investors Compensation Scheme v West Bromwich Building Society, page 912G

5 Lord Sumption, A Question of Taste: The Supreme Court and the Interpretation of Contracts, page 7

6 [2011] 1 W.L.R. 2900

why the guarantee should have been for less than the full amount of the advances.

(4) Lord Clarke, in his leading judgment for the Supreme Court, said:

> *"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"* (paragraph 21).

As with *ICS*, Lord Sumption commented on *Rainy Sky* in the same Keble College, Oxford lecture referenced above. He said:

"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. Because, in the absence of an explanation, the court thought it objectively more reasonable that there should be full guarantee than a partial one, it followed that the words which pointed to a partial one did not really represent the parties' intentions"[7].

Moving to **2015** – it was in this year that the Supreme Court handed down judgment in the case of *Arnold v Britton*[8]. In this case, despite the natural meaning of a clause producing, what was deemed a *"grotesque result"*,[9] due to a different economic climate to the one the contract was produced in, the Supreme Court declined to depart from the natural and ordinary meaning of the words. This was the case Lewison says the Supreme Court, specifically, Lord Neuberger *"stressed the importance of the words of the contract, and what appeared to be their primacy over surrounding circumstances or business common sense. This led to the widespread perception in lower courts that Arnold v Britton heralded a return to more conventional principles of interpretation"*[10].

However, in **2017**, despite the widespread perception of the effect of *Arnold v Britton*, the leading case of *Wood v Capita* was realised, in which the Supreme Court failed to accept that Arnold represented any kind of retreat from the approach to interpretation described in *ICS*, or even, *Rainy Sky*.

In a nutshell, the Tension is the question of which approach to contractual construction the courts should adopt. Should the courts:

(1) Give primacy to the contractual language of a provision over the surrounding circumstances or business common sense (Arnold v Britton); or

(2) Give primacy to the repeated statements that contractual interpretation is an iterative exercise which requires consideration of the commercial consequences of rival interpretations (Rainy Sky; Wood v Capita)?

The approach to contractual construction according to *Solutions 4 North Tyneside Limited v Galliford Try Building 2014?*

Despite the Supreme Court's objections to the existence of the Tension; I consider the recent case of *Solutions 4 North Tyneside Limited v Galliford Try Building 2014 Limited* as exemplary to identifying that there is a debate about the most appropriate approach to adopt when faced with a question of contractual construction.

In this case, the parties sought a series of declarations from the court in relation to the interpretation of various contractual provisions. The outcome in relation to the declarations is not important for the purposes of this article; it is Eyre J's remarks on contractual construction which are interesting. He said:

1. Following *Wood v Capita*[11], the approach to be taken in general terms to questions of contractual construction is to seek to ascertain the intention of the parties by reference to the language used when seen in context (paragraph 74).

7 Lord Sumption, A Question of Taste: The Supreme Court and the Interpretation of Contracts, page 8

8 [2015] A.C. 1619

9 Lord Sumption, A Question of Taste: The Supreme Court and the Interpretation of Contracts, page 13

10 Lewison, The Interpretation of Contracts, Ch. 1

11 [2017] UKSC 24

2. However, when a party seeks a declaration as to the proper construction of a contractual provision in the abstract of the commercial consequence of a particular alleged breach, the Court should adopt a cautious approach on whether to grant the declarations by:

    a. Exercising care in what it regards as commercial sense and to the consequences envisaged. Specifically, it must not re-write the contract to protect one side from having made a bad bargain or entered a commercially foolish arrangement (paragraph 76).

    b. Recognising that in the absence of breach, there is a risk that in choosing competing interpretations, the Court will end up re-writing the contract. This is because, in these circumstances there is a heightened risk that the Court will be making the contract different from that which was agreed (paragraph 76).

Does *Solutions 4 North Tyneside Limited v Galliford Try Building 2014 Limited* illustrate the existence of the Tension?

As to point (1) above; Eyre J's reliance on *Wood v Capita*, where the Supreme Court confidently denied the existence of any tension, might to some readers suggest there is no tension in the approach to be taken to contractual construction.

However, I consider point (2) above to expel that thought. Eyre J adopts the position that contractual language, when clear, should be adopted even if it leads to the contract being a *"bad bargain or a commercially foolish arrangement"* (paragraph 76). As such, whilst not denying the importance of commercial sense and context, Eyre J certainly re-highlights the importance of the *Arnold v Britton* approach to contractual construction in that care should be taken not to re-write a contract even if the consequences seem commercially foolish or a bad bargain. However, unlike in *Arnold v Britton*, where the clause equating to a commercially nonsensical result was expressed in clear language; in this case, the Claimant's interpretation as to the meaning of the provisions at issue, equated to an unusual and wasteful arrangement and Eyre J said that if *"such were the parties' intention one would have expected it set out in clear terms"* (paragraph 88).

In light of this, going forward, it will be interesting to see what approach the courts take to contractual construction, when faced with circumstances where, unlike this decision, the commercial consequences of a particular construction of a contractual provision are not so obvious. However, in the meantime, Eyre J has made clear that the Tension does exist, despite the Supreme Court's objections.