THE IMPACT OF PRE-AND POST-CONTRACTUAL CONDUCT ON CONTRACTUAL INTERPRETATION

1. Where there is a dispute as to the meaning of a provision in a contract, the role of the court is to determine the meaning as a matter of law, by reference to what I believe in the United Kingdom are well established principles. The aim of this brief talk is to explain and justify those principles, while accepting that they may of course have to be reconsidered one day.

2. The purpose of interpreting a provision in a written contract is to identify what the parties intended, and this is to be assessed by "determin[ing] what the parties meant by the language used, which involves ascertaining what a reasonable person would have understood the parties to have meant" – per Lord Clarke in the *Rainy Sky* case[1].

3. Where there is a written contract, the one thing over which the parties have control is the words they have used in the contract, and when they agree those words they are intentionally doing so with a view to setting out definitively their contractual rights and obligations for good. Therefore a judge, when asked to determine the parties' contractual rights and obligations should never forget how important the wording of the contract is.

[1] *Rainy Sky SA v Kookmin Bank* [2011] UKSC 50 [2011] 1 WLR 2900, para 14

4. However, no contractual provision can exist without a context. As Lord Hoffmann, whose contributions in the field of contractual interpretation have been extraordinary, has said: "No one has ever made an acontextual statement"[2]. And the particular context inevitably colours what the provision means. There are several contexts which have to be taken into account when interpreting a contract. In almost every case there are at least three contexts which are relevant – (i) the documentary context, namely the other provisions of the contract; (ii) the factual context which includes the facts known to both parties; (iii) the commercial context, which includes commercial common sense. Thus in one Supreme Court case[3], it was said that "[t]he resolution of an issue of interpretation in a case like the present is an iterative process, involving checking the rival meanings against other provisions of the document and investigating the commercial consequences" – and, in a case where they are relied on by either side, the surrounding circumstances.

5. In English law, the following cannot be taken into account when interpreting a contract: (i) what either party says that they meant, (ii) what either party believe that they intended; (iii) facts known to one party but not to the other; (iv) what was stated in negotiations, including earlier drafts of the contract; (v) what the parties did or said after the contract was entered into. The exclusion of items (i), (ii) and (iii) are clearly consistent with the notion that, when interpreting a written contract, the court is concerned with the objective

[2] *Kirin-Amgen Inc v Hoechst Marion Roussel Ltd* [2004] UKHL 46, [2005] 1 All ER 667, para 64
[3] *Re Sigma Finance Corp* [2009] UKSC 2, [2012] 1 All ER 571

question of what it would mean to a hypothetical reasonable person in the position of the parties. The exclusion of items (iv) and (v) is rather different, but justified on grounds of established law, practicality and principle.

6. In this connection, the speech of Lord Hoffmann (with which Lord Goff and Lord Jauncey agreed) in the *Carmichael* case[4] repays attention. He explained, citing an extra-judicial speech by Lord Devlin in support, that the origin of the common law rule, that the interpretation of written contracts is a matter of law depending on legal principles, is based on pragmatism. It originates from the fact that disputes over the meaning of contracts were originally tried by a judge with a jury, rather than a judge alone (as happens now). Under that system, judges decided points of law and juries decided points of fact. It was better for judges to interpret written contracts as (i) juries were often unable to read, and (ii) as many contracts had standard terms, it was desirable for their interpretation to be consistent. Therefore the interpretation of written contracts had to be a matter of law.

7. However, where a contract arose from oral statements, even if it also included written material (ie if the contract was not purely in writing), its interpretation, explained Lord Hoffmann was a matter of fact. As that was the position in the *Carmichael* case, it meant that the evidence of the parties as to what they had understood or intended their contract to mean was

[4] *Carmichael v National Power plc* [1999] UKHL 47, [1999] 1 WLR 2042

admissible as an aid to its interpretation. Similarly, said Lord Hoffmann, the subsequent actions of the parties, while inadmissible as an aid to interpretation of a wholly written contract, could be taken into account when interpreting a contract which is not wholly in writing.

8. It's a pretty strange situation some might think, at least at first sight. First it's odd that there should be completely different rules for interpreting wholly written contracts, on the one hand, and, on the other hand, partly written contracts. Secondly, it's odd that the difference should be based on legal procedures which ended much more than a century ago. As to the latter point, we should not be surprised if a common law principle is based upon old cases and procedures: that is inherent in a system built on precedent. We should not be slaves to the past but we should be careful to depart from established practices unless there are good reasons for doing so.

9. And, I would suggest, on examination, there are good contemporary reasons for maintaining the current distinction between the approach to the interpretation of wholly written contracts and contracts which are partly or wholly oral. As I said in one case[5] "If the contract is solely in writing, the parties rarely give evidence as to the terms of the contract, so it is cost-effective and practical to exclude evidence of their understanding as to its effect. On the other hand, if the contract was made orally, the parties will

[5] *Thorner v Major* [2009] UKHL 18, [2009] 1 WLR 776, para 83

inevitably be giving evidence as to what was said and done at the relevant discussions or meetings, and it could be rather artificial to exclude evidence as to their contemporary understanding. Secondly, and perhaps more importantly, memory is often unreliable and self-serving, so it is better to exclude evidence of actual understanding when there is no doubt as to the terms of the contract, as when it is in writing. However, it is very often positively helpful to have such evidence to assist in the interpretation of an oral contract, as the parties will rarely, if ever, be able to recollect all the details and circumstances of the relevant conversations".

10. Furthermore, quite separately from the court's power to interpret a contract, there is its power to rectify a written contract – ie to correct the contract so that it complies with the parties' common intention. This normally involves showing that the contract, as interpreted by the court, does not reflect the common intention of the parties as communicated between them: if the court is satisfied that this is the position, it will rectify the contract so that it reflects the parties' common intention unless for some reason it would be inequitable to do so. In order to see what the parties' intentions were, the court can look at those categories of evidence which are excluded when the court is concerned with interpretation. Rectification is only available in respect of documents, so there is a further pragmatic justification for the principle described by Lord Hoffmann in *Carmichael*.

11. However, in addition to all this, there are good practical reasons for not allowing into evidence, when interpreting a written contract, the pre-contractual negotiations, the subsequent acts and statements of the parties (as well as evidence from the parties as to what they intended). In a nutshell, those reasons are four fold. First, it is more trouble than it is worth to admit these matters into evidence – the game's not worth the candle. Secondly, they will distract from the centrally important matter of the words the parties have used. Thirdly, there are third party interests to consider. Let me take those three points in turn. Fourthly, is a judge a reliable assessor of commercial common sense?

12. First, the game's not worth the candle. Particularly in these days of long contracts, protracted negotiations, multiple drafts, and electronic and telephonic communications, there will very often be an absolute mountain of documentary and oral evidence which one or both parties will want to put in evidence. The cost in terms of discovery and inspection, preparation for trial, and length of the hearing will often be enormous. When the parties are relying on what one party said to another in pre- or post-contractual discussions, there will very often be disagreement as to what was said, and, while the judge will have to make a finding, it will frequently be knife-edge.

13. And so often the evidence, whether oral or written, will be equivocal anyway. Party A may triumphantly point out that a provision which would have

precisely the effect the Party B is arguing for was included in an earlier draft and then deleted. But, while Party A may be right in saying that this shows that the parties intended the contract should not have the effect argued for by Party B, Party B may surely equally well be right in saying that it could well have been deleted because the parties thought that it was unnecessary because the contract as drafted had that effect anyway. Or, when the contract was being negotiated, one party may have thought one thing at the time and the other party may have thought the other. Or, as so often happens, they may not have thought anything at all about the deletion.

14. As for post-contractual actions, they rarely will be clear, and they will often be the subject of contradictory evidence and detailed explanation, which will require cross-examination. And if it is known that post-contractual words and conduct are relevant, parties will incur effort time and cost in scurrying back to their lawyers to make sure that they can do or say what they are proposing without harming their interests. So, too, self-serving statements from the parties will be unlikely to cast much light on the issue of what the contract means, and will similarly risk leading to long cross-examinations.

15. I am not saying that such evidence will never be of any assistance. Of course it sometimes will be. But we have to look "across the piece" (sorry) at the general interests of parties, not just at a few individual cases, to decide what the law should be. Clarity and simplicity suggests that one should not let in

the shed loads of evidence which changing the law would involve. And, for the reasons I have tried to give, the cost, time and effort involved in permitting all such evidence to be adduced is simply not worth it for the benefit of a few cases where it might make a difference.

16. In the 2009 *Chartbrook* case[6], Lord Hoffmann considered whether the House of Lords should change the law on the issue whether it should be permissible to take into account prior negotiations in order to construe a contract. He concluded that an insufficiently strong case had been made out to justify the change. His main reason was that refusing parties the right to put all the negotiations in evidence was "in the more general interest of economy and predictability in obtaining advice and adjudicating disputes".

17. The other three reasons for not letting in all the evidence which would result from changing the law can be more briefly expressed. The second reason, is that it would distract everyone's attention from the words. I have already mentioned how important it is that a judge pays great attention to the words which the parties have used in their contract, because, after all, those words, at the end of the day, are how they chose to express and set out their bargain. The words have to be construed in context, but so long as it is an objective and limited context, we do not risk losing sight of the all-important fact of how the parties have expressed themselves in their contract. If we deluge the

[6] *Chartbrook Ltd v Persimmon Homes Ltd* [2009] UKHL 38, [2009] 1 AC 1101

court with a mound of further evidence, there is a real danger that the essential feature of how the parties have expressed themselves will be drowned out. In other words, there would be a wood and trees problem.

18. As for the third reason, it is that third parties are often highly affected by a contract. The most obvious examples are in cases of assignable contracts such as leases and contracts relating to land which are enforceable by or against successors to the original contracting parties. But there are plenty of other cases in the commercial world where third parties acquire an interest or a liability which is affected by a contract which they will read before they sign up to the interest or liability. If the contract's interpretation is to be affected by matters of which they cannot have, and cannot reasonably be expected to have, any knowledge, such as what the parties said in negotiation, or what they thought, then it could be terribly unfair, and, indeed, it could affect many markets adversely. This was a point which weighed with the first instance judge, Briggs J, now in the Court of Appeal, in the *Chartbrook* case.

19. 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 for 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.

20. The argument that we ought to change and let in evidence of pre-and post-contractual conduct risks resulting in the judge not deciding what the parties did agree: rather the judge will be deciding what he or she considers that the parties ought to have agreed. 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.

21. In civilian law jurisdictions where judges are used to rolling their sleeves up and getting involved, as *juges d'instruction*, and where the theory of contract is very different from that if the common law, imposing what the court thinks is a fair solution in a contractual dispute, may well be appropriate. But in a common law system, where the judge is a detached impartial umpire, and party autonomy is accorded great importance, we should be concentrating on the contractual provisions which the parties have agreed when deciding on

their rights and obligations. And the international commercial world votes with its feet, by opting for the common law when it comes to the resolution of their disputes. Long may this remain, and we should think long and hard before doing anything which undermines this.

22. Let me finally revert to the recent UK cases on interpretation, which are helpfully reviewed in *Rainy Sky*. I think that the best description of the English approach to interpretation may be that of Lord Wilberforce in the *Reardon Smith* case[7]; his earlier speech in *Prenn v Simmonds*[8] is more often cited, but I find it more opaque. Of course, the most oft-cited judicial view on the topic in our courts is that of Lord Hoffmann, who expressed the proper approach more fully in *Investors Compensation* case[9]. A view which has been expressed by some people is that, while the analysis is characteristically brilliant, he either said no more than Lord Wilberforce, in which case he was potentially confusing things, or (which I do not think) he went further than Lord Wilberforce, in which case he was wrong.

23. In the *Chartbrook* case Lord Hoffmann also considered the interpretation of contracts more generally. He said that there was no "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

[7] *Reardon Smith Line Ltd v Hansen-Tangen* [1976] 1 W.L.R. 989
[8] [1971] 1 WLR 1381
[9] *Investors Compensation* case *Scheme v. West Bromwich Building Society* [1997] UKHL 28, [1998] 1 WLR 896

the language and that it should be clear what a reasonable person would have understood the parties to have meant." In a later case[10], the Supreme Court has suggested that this 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".

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[10] see *Marley v Rawlings* [2014] UKSC 2, [2014] 2 WLR 213