MILLS & REEVE

briefing

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Contractual terms: when an interpreter is required

Few commercial contracts are so clear that everyone would read them in exactly the same way. So what happens where contractual provisions are ambiguous and have more than one possible meaning?

Based on the Supreme Court decisions in *Investors Compensation Scheme Limited v West Bromwich Building Society (1997)* and *Chartbrook Limited v Persimmon Homes Limited (2009)*, and the cases which have followed, the courts' current approach can be summarised as follows:

- Where the language used in a contract can bear more than one meaning, the court will seek to ascertain what a reasonable person would have understood the contract to have meant at the time it was entered into in the light of the relevant background facts.
- Having looked at the relevant factual background, if there are two possible constructions the court is entitled to prefer the construction which is consistent with "business common-sense".
- The court will not impose on the parties its own view of what is sensible where the contract has a clear meaning even if that meaning does not make the most commercial sense. If the contract is clear then that will be taken to be the meaning that the parties intended.
- If it is obvious by looking at the contract as a whole that something has gone wrong with the language, and a reasonable person would understand the parties to have meant something different, then words can be rearranged, inserted or ignored, and poor grammar and punctuation overlooked, in order to resolve the ambiguity.
- If the mistake is not in the language, but in failing to anticipate the consequences of the contractual provision then the court will not intervene.
- The intentions of the parties are to be ascertained objectively. Evidence of their actual state of mind at the time of entering into the contract is largely irrelevant, and documentary evidence of their precise intentions, for example emails setting out the course of the pre-contract negotiations, will probably be inadmissible.
- Evidence of pre-contract negotiations may be admissible, however, to prove the commercial purpose of the transaction.
- Events after the contract was made are not relevant to issues of construction unless it is alleged that the contract terms have been varied.

The message from the courts is therefore this: draft with precision and clarity and your words will be given their unambiguous meaning, even if they do not reflect what the parties actually intended. Draft imprecisely, using confusing and equivocal language, and the courts will re-write your words to make “business common-sense”!

DRAFTING TIPS

- Where possible, use clear language that is capable of one (correct!) interpretation only
- Set out the background to the contract, and the parties’ intentions in entering into it, in the recitals
- If parties intend a contract to be one sided (perhaps in return for a beneficial arrangement elsewhere) then acknowledge this in the document itself
- Use clear and consistent definitions, particularly where you are using terms that have a particular meaning in a particular industry
- Where there is a conflict or tension between contractual provisions, spell out the order of precedence that needs to prevail
- Take particular care with termination provisions and the consequences that will follow from a failure to adhere to the terms of the contract
- Where possible, provide worked examples to show precisely how the contract is to work

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