

The interpretation of contracts and the impact of *Chartbrook v Persimmon*

Interpretation of contracts

Contracts are entered into regularly and in so doing legal obligations assumed by parties, whether as regards work to be performed, payments to be made or the more intricate layers of respective obligations in a typical construction contract. Often, despite attempts at providing clarity in drafting, parties have differing views about the meaning of the contract and sometimes such differences must be settled by the courts. In settling such matters the courts provide guidance on how certain issues will be considered and the common law has been built up over time with the aim of providing some commercial certainty to business on how matters will be viewed. An area of law of significant interest to commerce is how courts will interpret the contracts entered into.

Investors Compensation Scheme

In this regard Lord Hoffman caused a stir in the late 1990's with his judgement in the House of Lords in *Investors Compensation Scheme v. West Bromwich Building Society* [1997] UKHL 28 ("ICS") where he summarised five principles by which contractual documents are construed by the courts. A decade or so on from that landmark judgement he has again caused a stir with his judgement in the House of Lords in *Chartbrook Ltd and another v Persimmon Homes Ltd and another* [2009] UKHL 38 ("Chartbrook").

In *ICS* Lord Hoffman summarised five principles:

1. The correct meaning is what the document would convey to a reasonable person with the relevant background knowledge;
2. The background includes everything in the "*matrix of fact*" (relevant background material);
3. The law excludes the prior negotiations of the parties;
4. The meaning of words in a document is not the same as the literal meaning of words, but the meaning one would reasonably understand against the relevant background;
5. The rule that words should be given their "*natural and ordinary meaning*" reflects the common sense proposition that it is not easily accepted that people have made linguistic mistakes, particularly in formal documents.

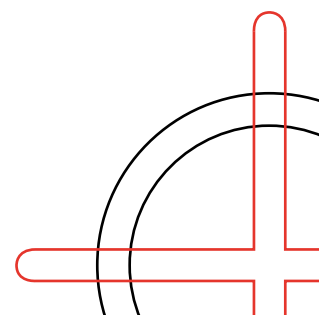
The five principles should be read as a whole.

The *ICS* judgement caused a stir not least because of the relevant background material referred to in the principles. What is the relevant background material against which to construe the contract? How far should this background material extend? Various sources expressed concern at an approach that perhaps hinted at the possibility of disregarding the obvious meaning of words used in a contract. In *National Bank of Sharjah v Dellborg* [1997] EWCA Civ 2070 Saville LJ said (perhaps prophetically) in this regard;

"where the words used have an unambiguous and sensible meaning as a matter of ordinary language, I see serious objections in an approach which would permit the surrounding circumstances to alter that meaning"

There were other sources supportive of Lord Hoffmann's principles, including those who believed he had simply expressed judicial consideration in a particular way and did not alter the previously employed principles of construction. Irrespective of debate the principles summarised in *ICS* have since constituted the starting point for consideration of interpretation of contracts.

In 2009 the debate was given fresh impetus by the *Chartbrook* case.



Chartbrook v Persimmon

The facts

Chartbrook and Persimmon entered into contract in 2001. The agreement was that Chartbrook would grant Persimmon license to enter the site (following planning permission) to build a mixed residential and commercial development in return for payment from Persimmon. The amount to be paid by Persimmon to Chartbrook was in two parts, the total land value (calculated using agreed rates) and a balancing payment defined as the 'additional residential payment' ("ARP"). The question to be decided in the House of Lords was how the ARP was to be calculated.

The ARP was calculated by reference to further contractually defined terms. Chartbrook contended that the meaning of the provisions was perfectly simple and clear and gave rise to an ARP payment to them of approximately £4.4m.

Persimmon disagreed and, in arguing for a different interpretation of the provisions, explained the purpose of the ARP; that it was a further payment over and above the minimum price for the land value if flats sold for more than expected: they calculated the ARP at approximately £897k. The documentation in relation to the negotiations leading up to the contract was supportive of Persimmon's case (who had a fallback case: rectification of the Contract). The commercial intent appeared to be that the total land value was a minimum payment and the ARP was an extra payment if the price achieved exceeded expectations. On the interpretation put forward by Chartbrook the ARP would be payable even if flats sold for as little as £55k (approximately) when negotiations indicated that expectations for the properties in London was £200k. Persimmon used this to seek to support its case for a contractual interpretation that was reflective of the commercial purpose of the agreement.

The Court of Appeal supported the Chartbrook position that there was nothing unclear or ambiguous in the wording. Persimmon appealed to the House of Lords who unanimously allowed the appeal, agreeing with the Persimmon interpretation. Lord Hoffmann's was the leading judgement. Whilst acknowledging that it "*requires a strong case to persuade the court that something must have gone wrong with the language*" it was found that the construction favoured by Persimmon was correct. Persimmon's commercial purpose prevailed over Chartbrook's literal interpretation. The judgement declined to review the rule that the prior negotiations of the parties are excluded in interpreting contracts.

The implications

Arising out of the judgement in *Chartbrook* is there greater potential for parties to contend that what the words say is not what the parties actually meant? It may be that parties seek to contend in certain scenarios that the 'bad bargain' entered into cannot reflect the commercial purpose intended. A concern is that a 'flood' of (sometimes dubious) arguments might be formulated in reliance on *Chartbrook* to try to support a construction of contractual provisions that the words will simply not bear, and in the process unnecessarily incur court time and substantial expense for litigants, not to mention all the time and money expended prior to that time.

Whilst the concern must be taken seriously that parties may cite *Chartbrook* to seek to avoid the effect of contractual provisions not in their favour an example of the difficulty in succeeding with such an argument is the recent Court of Appeal case of *William Hare Ltd v Shepherd Construction Ltd [2010] EWCA CIV 283*. Shepherd argued that *Chartbrook* was authority to demonstrate "*that the principle [of construction] can even lead to alteration of the words themselves, if the court is compelled to the view that the parties simply cannot have meant what the words say*". That line of argument failed and parties considering using *Chartbrook* as authority in this way would be well served to constantly remember that it will require "*a strong case to persuade the court that something must have gone wrong with the language*".

On a practical level parties should ensure that the commercial nature and purpose of the agreement is well understood by those drafting agreements in order to reduce the possibility of subsequent dispute on the interpretation of contract provisions.

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