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Contractual interpretation: continuity rather than change?

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To the casual observer, it may seem that the English courts' approach to interpreting contracts has been in something of a state of flux in recent years, with contrasting decisions at the highest levels.

Although the underlying aim of the exercise has remained constant – to determine the objective meaning of the contract, or the meaning it would convey to a reasonable person with the relevant background knowledge – there have, on the face of it, been two competing views as to how that aim should be achieved. One is seen as giving priority to the natural meaning of the words used, the other to considerations of "business common sense".

But in its most recent decision in this area, *Wood v Capita Insurance*, the Supreme Court reconciles the apparent differences and promotes a more balanced approach. In my view, this is to be welcomed.

Competing approaches?

The Supreme Court's judgment in *Rainy Sky v Kookmin Bank* is seen as encouraging the business common sense approach, emphasising the importance of the commercial context in choosing between alternative interpretations. Its later judgment in *Arnold v Britton* is sometimes viewed as having rowed back from the guidance in *Rainy Sky*, bringing the primary focus back to the words used and their natural meaning.

In *Wood*, however, the Supreme Court rejects the notion that there is any inconsistency. Its unanimous judgment declares firmly that *Rainy Sky* and *Arnold* were saying the same thing on the approach to contractual interpretation.

And indeed there is a great deal of common ground. In *Rainy Sky*, the court stated expressly that, where the parties have used unambiguous language, the court must apply it – even if that leads to an improbable commercial result. And in *Arnold*, the court recognised that business common sense is a very important factor in interpreting a contract, though it should not be used to "undervalue" the importance of the words used.

A difference of emphasis

But even if *Arnold* is not to be seen as a departure from the principles set out in *Rainy Sky*, there is a clear difference of emphasis. *Rainy Sky* highlights the flexibility of language, and the likelihood that in many contracts there will be more than one available interpretation such that business common sense has an important role to play. In *Arnold*, there is a firm focus on the words used and their natural meaning. As the judgment puts it, the less clear the words used, the more ready the court will be to depart from their natural meaning. However:

> "... that does not justify the court embarking on an exercise of searching for, let alone constructing, drafting infelicities in order to facilitate a departure from the natural meaning."

It may be argued that in *Arnold* the court was so keen to discourage a search for drafting infelicities that it found clarity where there was none. Lord Neuberger, for the majority, accepted that there were "one or two very small errors in the drafting", but did not consider that anything had gone significantly wrong with the wording. The contrary view (which is expressed by Lord Carnwath in his dissenting judgment in the case, and which I share) is that something clearly had gone wrong and there was an inherent ambiguity to resolve.

Looking at the bigger picture, the aim of the majority in *Arnold* appears to have been to rein in the excesses of the business common sense approach, and in particular the temptation to apply what appears sensible with the benefit of hindsight, when at the time things may have looked very different. This approach can result in the court replacing what was actually agreed with what it now seems reasonable for the parties to have agreed. That is certainly not permissible under English law.

The latest word

So that leads us back to *Wood* and the Supreme Court's latest word on contractual interpretation. The court does not seek to resile from its

comments in *Arnold*. This is not surprising, as three of the justices in *Wood* (Lord Hodge, who gave the court's judgment, and Lords Neuberger and Sumption) were also in the majority in *Arnold*. But the emphasis seems different again, with the words used in the contract and the factual / commercial context taking more equal places in the contractual construction toolbox. As the judgment puts it:

> "Textualism and contextualism are not conflicting paradigms in the battle for exclusive occupation of the field of contractual interpretation. Rather, the lawyer and the judge, when interpreting any contract, can use them as tools to ascertain the objective meaning of the language which the parties have chosen to express their agreement."

As the court says, the relative importance of the tools will vary depending on the circumstances of the particular agreement. Some agreements, particularly those prepared with the assistance of skilled professionals, may be interpreted primarily by reference to the words used. Others may require greater reliance on other factors.

That only makes sense. Where the wording of the contract is clear and unambiguous, it's likely to take something fairly dramatic to persuade the court that the contractual wording does not reflect its objective meaning. Conversely, where there is an ambiguity, the words used are a less reliable guide to the correct interpretation, so the court will necessarily be searching for other clues. That is where the commercial context is likely to matter most.

This may be seen as a more balanced approach to interpretation, with neither natural meaning nor commercial context given particular priority. Interestingly, on this approach, it seems that the starting point does not matter. Whereas *Arnold* gave the impression (rightly or wrongly) that one should start with the natural meaning of the words used, and only look further if there is some ambiguity on the face of the contract, *Wood* suggests in terms that it does not matter which tool is deployed first – the factual background and implications of rival constructions (that is, business common sense) or a close examination of the relevant language – so long as the court balances the indications given by each.

Continuity rather than change

So the Supreme Court's message in *Wood* is that nothing has changed. *Rainy Sky* and *Arnold* were not promoting different approaches to contractual interpretation; it is simply that different factors in the overall balanced approach took greater prominence in the different factual scenarios involved in those cases.

In its judgment, the court seems particularly concerned to dispel any perception that English contract law may be a moveable feast, which could potentially make it less attractive to international commercial parties. As the judgment puts it:

> "The recent history of the common law of contractual interpretation is one of continuity rather than change. One of the attractions of English law as a legal system of choice in commercial matters is its stability and continuity, particularly in contractual interpretation."

The desire to shore up the reputation of English contract law is particularly understandable at the moment, given the pressures the English courts are facing from international competition and the uncertainties associated with Brexit. Against this background, it is comforting that the higher courts recognise the need for a stable, balanced approach.