

THE INTERPRETATION OF CONTRACTS

CENTRAL ISSUES

1. The principles applicable to the interpretation of contracts were re-stated in 1998 by Lord Hoffmann in *Investors Compensation Scheme Ltd v. West Bromwich Building Society*. The aim of this re-statement is, subject to one important exception, to assimilate the way in which contractual documents are interpreted to the common sense principles by which any serious utterance would be interpreted in ordinary life. A major component of this chapter consists of an examination of the principles enunciated by Lord Hoffmann. The significance of these principles should not be under-estimated. Many contract cases that come before the courts raise issues of interpretation.
2. In his speech in *Investors Compensation Scheme* Lord Hoffmann referred to the 'fundamental change' that has taken place in this area of contract law. The essence of the change is that the courts have gradually moved away from a literal approach to interpretation towards an approach that favours the adoption of a 'commercially sensible construction' of the term that is in dispute.
3. Lord Hoffmann's re-statement has aroused a degree of controversy, principally because it is said to generate too much uncertainty and on the ground that it threatens to add to the cost and complexity of litigation. It is said to generate uncertainty because it widens the circumstances in which the judges can depart from the 'natural and ordinary meaning' of the words used by the parties. In particular, it is no longer necessary for there to be an ambiguity in the words used by the parties before the courts can have regard to the circumstances surrounding the conclusion of the contract. A court that is persuaded that the parties have used the wrong words or syntax is no longer required to attribute to the parties an intention that they did not have. The re-statement has also been criticized on the ground that it will add to the cost and complexity of litigation because it permits the courts to have regard to a very wide range of materials when interpreting contracts (the 'matrix of fact'). The cost of admitting this material in evidence may exceed any benefits derived from its admission.

1. INTRODUCTION

The principles applied by the courts when interpreting contracts are of enormous significance for contracting parties and their lawyers. This is so for a number of reasons. The first is that a significant number of the disputes that come before the courts raise issues of interpretation. The second is that many commercial parties make use of standard terms of business (or use industry-wide standard forms) and the precise meaning of these terms is a matter of considerable importance to them. The third is that many lawyers spend a considerable amount of time drafting contracts and the drafting process must be carried out against the backdrop of the principles applied by the courts to the interpretation of contracts. An example will illustrate the point. Suppose that a client instructs a lawyer to draft an exclusion clause that will have the effect of excluding the client's liability for negligence in the course of the performance of any contract that it concludes. Drafting such a clause is not a straightforward matter because the courts have adopted restrictive principles which are to be applied when interpreting exclusion clauses that purport to exclude liability in negligence (see *Canada Steamship Lines Ltd v. The King* [1952] AC 192, discussed in more detail at pp. 411–417, Chapter 13, Section 2(a)). The clause must therefore be drafted in the light of these principles and the courts are unlikely to show much sympathy to a commercial party whose lawyer has not complied with them. This view was classically expressed by Hobhouse J in *EE Caledonia Ltd v. Orbit Valve Co Europe* [1993] 4 All ER 165, 173 when he said:

it has to be borne in mind that commercial contracts are drafted by parties with access to legal advice and in the context of established legal principles as reflected in the decisions of the courts. Principles of certainty, and indeed justice, require that contracts be construed in accordance with the established principles. The parties are always able by the choice of appropriate language to draft their contract so as to produce a different legal effect. The choice is theirs.

2. THE EVOLUTION FROM LITERALISM TOWARDS CONTEXTUALISM

Traditionally, the English courts adopted a literal approach to the interpretation of contracts. In *Lovell and Christmas Ltd v. Wall* (1911) 104 LT 85 Cozens-Hardy MR stated (at p. 88):

If there is one principle more clearly established than another in English law it is surely this: It is for the court to construe a written document. It is irrelevant and improper to ask what the parties, prior to the execution of the instrument, intended or understood. What is the meaning of the language that they have used therein? That is the problem, and the only problem. In saying that, I do not mean to assert that no evidence can be admitted. Indeed, the contrary is clear. If a deed relates to Black Acre, you may have evidence to show what are the parcels. If a document is in a foreign language, you may have an interpreter. If it contains technical terms, an expert may explain them. If, according to the custom of a trade or the usage of the market, a word has acquired a secondary meaning, evidence may be given to prove it. A well-known instance is where in a particular trade 1000 rabbits meant 1200. But unless the

case can be brought within some or one of these exceptions, it is the duty of the court, which is presumed to understand the English language, to construe the document according to the ordinary grammatical meaning of the words used therein, and without reference to anything which has previously passed between the parties to it. When we come to the question of rectification,¹ wholly different considerations apply. The essence of rectification is to bring the document which was expressed and intended to be in pursuance of a prior agreement into harmony with that prior agreement.

The meaning of a document was therefore to be found within its four corners. This approach was not without its merits. A court that was called upon to interpret a contract did not have to listen to evidence about the commercial purpose of the clause or the circumstances surrounding the conclusion of the contract. Its task was to rule on the meaning of the words used by the parties and it could do that on the basis of the documents alone. It was therefore possible for the parties to obtain a quick and relatively inexpensive ruling on the meaning of a disputed term in a contract. However the drawbacks of this approach have been deemed to exceed its merits. In particular, it was argued that it was unrealistic to engage in a process of interpretation that was divorced from the context in which the parties found themselves. In other contexts, such as the interpretation of statutes, there has been a shift from ‘a literalist to a purposive approach’ to interpretation (see the dissenting speech of Lord Steyn in *Deutsche Genossenschaftsbank v. Burnhope* [1995] 1 WLR 1580, 1589) and this shift in emphasis has penetrated into the interpretation of contractual documents.

In retrospect the turning point can be seen to be the decision of the House of Lords in *Prenn v. Simmonds* [1971] 1 WLR 1381. The dispute between the parties related to the meaning of the word ‘profit’ in an agreement concluded under seal on 6 July 1960. Lord Wilberforce, giving the only reasoned judgment in the House of Lords, stated (at pp. 1383–1384):

In order for the agreement of July 6, 1960, to be understood, it must be placed in its context. The time has long passed when agreements, even those under seal, were isolated from the matrix of facts in which they were set and interpreted purely on internal linguistic considerations. There is no need to appeal here to any modern, anti-literalist tendencies, for Lord Blackburn’s well-known judgment in *River Wear Commissioners v. Adamson* (1877) 2 App Cas 743, 763 provides ample warrant for a liberal approach. We must, as he said, inquire beyond the language and see what the circumstances were with reference to which the words were used, and the object, appearing from those circumstances, which the person using them had in view. Moreover, at any rate since 1859 (*Macdonald v. Longbottom* 1 E & E 977) it has been clear enough that evidence of mutually known facts may be admitted to identify the meaning of a descriptive term.

The change in emphasis is clearly discernible. Contract documents are no longer to be interpreted ‘purely’ on internal linguistic considerations. Rather, they are to be placed in their

¹ Rectification is discussed in more detail at pp. 565–571, Chapter 16, Section 6. Rectification only comes into play once the meaning of the words used by the parties has been ascertained (for further consideration of the relationship between rectification and interpretation see A Burrows, ‘Construction and Rectification’ in A Burrows and E Peel (eds), *Contract Terms* (Oxford University Press, 2007) p. 77). A contract can be rectified if there has been a defect in the recording of the contract so that the written agreement does not reflect the agreement which the parties intended to make. On the other hand, if the agreement does give effect to the intention of the parties, there is nothing for the court to rectify (*Woodford Land Ltd v. Persimmon Homes Ltd* [2011] EWHC 984 (Ch), [2011] All ER (D) 205 (Apr)).

‘context’. In other words, the court must have regard to the wider circumstances surrounding the conclusion of the contract. Lord Wilberforce returned to the issue in *Reardon Smith Line Ltd v. Yngvar Hansen-Tangen* [1976] 1 WLR 989, 995–997 when he said:

No contracts are made in a vacuum: there is always a setting in which they have to be placed. The nature of what is legitimate to have regard to is usually described as ‘the surrounding circumstances’ but this phrase is imprecise: it can be illustrated but hardly defined. In a commercial contract it is certainly right that the court should know the commercial purpose of the contract and this in turn presupposes knowledge of the genesis of the transaction, the background, the context, the market in which the parties are operating...

It is often said that, in order to be admissible in aid of construction, these extrinsic facts must be within the knowledge of both parties to the contract, but this requirement should not be stated in too narrow a sense. When one speaks of the intention of the parties to the contract, one is speaking objectively—the parties cannot themselves give direct evidence of what their intention was—and what must be ascertained is what is to be taken as the intention which reasonable people would have had if placed in the situation of the parties. Similarly when one is speaking of aim, or object, or commercial purpose, one is speaking objectively of what reasonable persons would have in mind in the situation of the parties... [w]hat the court must do must be to place itself in thought in the same factual matrix as that in which the parties were.

3. LORD HOFFMANN’S RE-STATEMENT

The shift from a literal to a contextual approach to the interpretation of contracts, evident in the speeches of Lord Wilberforce in *Prenn* and *Reardon Smith*, culminated in the speech of Lord Hoffmann in *Investors Compensation Scheme Ltd v. West Bromwich Building Society* [1998] 1 WLR 896 in which he sought to re-state the principles according to which contractual documents are to be interpreted. He set out these principles in the following terms (at pp. 912–913):

My Lords... I should preface my explanation of my reasons with some general remarks about the principles by which contractual documents are nowadays construed. I do not think that the fundamental change which has overtaken this branch of the law, particularly as a result of the speeches of Lord Wilberforce in *Prenn v. Simmonds*, [1971] 1 WLR 1381 at 1384–1386 and *Reardon Smith Line Ltd v. Hansen-Tangen*, *Hansen-Tangen v. Sanko Steamship Co* [1976] 1 WLR 989, is always sufficiently appreciated. The result has been, subject to one important exception, to assimilate the way in which such documents are interpreted by judges to the common sense principles by which any serious utterance would be interpreted in ordinary life. Almost all the old intellectual baggage of ‘legal’ interpretation has been discarded. The principles may be summarised as follows.

- (1) Interpretation is the ascertainment of the meaning which the document would convey to a reasonable person having 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.
- (2) The background was famously referred to by Lord Wilberforce as the ‘matrix of fact’, but this phrase is, if anything, an understated description of what the background may include. Subject to the requirement that it should have been reasonably available to the

parties and to the exception to be mentioned next, it includes absolutely anything which would have affected the way in which the language of the document would have been understood by a reasonable man.

- (3) The law excludes from the admissible background the previous negotiations of the parties and their declarations of subjective intent. They are admissible only in an action for rectification. The law makes this distinction for reasons of practical policy and, in this respect only, legal interpretation differs from the way we would interpret utterances in ordinary life. The boundaries of this exception are in some respects unclear. But this is not the occasion on which to explore them.
- (4) The meaning which a document (or any other utterance) would convey to a reasonable man is not the same thing as the meaning of its words. The meaning of words is a matter of dictionaries and grammars; the meaning of the document is what the parties using those words against the relevant background would reasonably have been understood to mean. The background may not merely enable the reasonable man to choose between the possible meanings of words which are ambiguous but even (as occasionally happens in ordinary life) to conclude that the parties must, for whatever reason, have used the wrong words or syntax (see *Mannai Investment Co Ltd v. Eagle Star Life Assurance Co Ltd* [1997] 2 WLR 945).
- (5) The 'rule' that words should be given their 'natural and ordinary meaning' reflects the commonsense proposition that we do not easily accept that people have made linguistic mistakes, particularly in formal documents. On the other hand, if one would nevertheless conclude from the background that something must have gone wrong with the language, the law does not require judges to attribute to the parties an intention which they plainly could not have had. Lord Diplock made this point more vigorously when he said in *Antaios Cia Naviera SA v. Salen Rederierna AB, The Antaios* [1985] AC 191 at 201:

'...if detailed semantic and syntactical analysis of words in a commercial contract is going to lead to a conclusion that flouts business common sense, it must be made to yield to business common sense.'

On its facts, *Investors Compensation Scheme* was a case concerned with the construction of a claim form. Investors submitted a claim to the Investors Compensation Scheme Ltd ('ICS') for compensation in respect of negligent advice given to them by brokers who had sold them home income plans in contravention of the provisions of the Financial Services Act 1986. The plans proved to be a disastrous investment and rendered the investors' homes vulnerable to re-possession by the building societies to whom the investors had mortgaged their homes as part of the home income plan. The building society involved in this particular case was the West Bromwich Building Society (referred to in the speech of Lord Hoffmann as 'WBBS'). The claim form was drafted by ICS and it required the investors to assign to ICS all their rights arising out of the sale to them of the home income plans. However the claim form, in section 3(b) expressly excluded from the assignment:

any claim (whether sounding in rescission for undue influence or otherwise) that you [the investor] may have against [the building society] in which you claim an abatement of sums which you would otherwise have to pay to that Society in respect of sums borrowed by you from that Society in connection with the transaction and dealings giving rise to the claim.

The investors subsequently brought proceedings against the West Bromwich Building Society seeking damages for negligence and misrepresentation and the rescission of their mortgages. ICS also instituted proceedings against the building society in which it asserted that the investors had assigned to it all their claims, with the exception of their claims for rescission. The claims brought by the investors and ICS against the building society therefore overlapped. The issue of interpretation that arose between the parties related to the construction of the claim form, in particular the scope of the provisions relating to the assignment of the investors' rights against the building society.

Applying his principles to the facts of the case, Lord Hoffmann concluded that all claims for damages and compensation had been validly assigned to ICS (so that ICS and not the investors could bring a claim for damages) but that the investors had retained the right to claim rescission of the mortgages. Thus he concluded that the phrase 'Any claim (whether sounding in rescission for undue influence or otherwise)' was actually used by the parties to mean 'Any claim sounding in rescission (whether for undue influence or otherwise)'. In this respect he approved of the analysis of the trial judge, Evans-Lombe J. In the Court of Appeal Leggatt LJ had rejected the reasoning of Evans-Lombe J on the basis that it was 'not an available meaning of the words'. Lord Hoffmann approved the reasoning of Evans-Lombe J in the following terms:

If one applies these principles [that is, the five principles set out at p. 373, earlier in this section], it seems to me that the judge must be right and, as we are dealing with one badly drafted clause which is happily no longer in use, there is little advantage in my repeating his reasons at greater length. The only remark of his which I would respectfully question is when he said that he was 'doing violence' to the natural meaning of the words. This is an over-energetic way to describe the process of interpretation. Many people, including politicians, celebrities and Mrs Malaprop, mangle meanings and syntax but nevertheless communicate tolerably clearly what they are using the words to mean. If anyone is doing violence to natural meanings, it is they rather than their listeners.

I shall, however, make four points supplemental to those of the learned judge. First, the claim form was obviously intended to be read by lawyers and the explanatory note by laymen. It is the terms of the claim form which govern the legal relationship between the parties. But in construing the form, I think that one should start with the assumption that a layman who read the explanatory note and did not venture into the claim form itself was being given an accurate account of the effect of the transaction. It is therefore significant that paragraph 4 of the note says categorically and without qualification that the investor gives up all his rights against anyone else and transfers them to the ICS. If the effect of the claim form was that the investor retained his claim against the building society, paragraph 4 of the note was very misleading. Secondly, this leads to the conclusion that section 3(b) was intended only to deal with the possibility that a lawyer might argue that some right was a 'claim' when it would not be regarded as a claim by a layman. This is a fair description of the possibility of a reduction of the mortgage debt as part of the equitable taking of accounts upon rescission, which would not result in the investor receiving any money but merely having to pay less to WBBS. Thirdly, any lawyer would think it extremely odd for the ICS to take an assignment of the investor's claim for damages against the solicitors and leave the investor with a claim for the same damages against WBBS. He would be likely to wonder whether this was conceptually possible and, as I shall explain, I think that his doubts would be well founded. The investor and the ICS could not between them recover more than the loss which the investor had actually suffered. As a matter of common sense, one would therefore expect that the ICS either had a right to the damages or it did not. It would seem eccentric to leave this question to be decided (if

such a thing were possible) by a race to judgment. Fourthly, no lawyer in his right mind who intended simply to say that all claims against the WBBS were reserved to the investor would have used the parenthesis. Nor, unless he intended to limit the reservation to the amount, if any, which happened to be outstanding on the mortgage, would he have described them as claims ‘in which you claim an abatement of the sums which you would otherwise have to repay’. And it is difficult to think of any reason for such an arbitrary limitation.

Finally, on this part of the case, I must make some comments upon the judgment of the Court of Appeal. Leggatt LJ said that his construction was ‘the natural and ordinary meaning of the words used’. I do not think that the concept of natural and ordinary meaning is very helpful when, on any view, the words have not been used in a natural and ordinary way. In a case like this, the court is inevitably engaged in choosing between competing unnatural meanings. Secondly, Leggatt LJ said that the judge’s construction was not an ‘available meaning’ of the words. If this means that judges cannot, short of rectification, decide that the parties must have made mistakes of meaning or syntax, I respectfully think he was wrong. The proposition is not, I would suggest, borne out by his citation from *Alice Through the Looking Glass*. Alice and Humpty Dumpty were agreed that the word ‘glory’ did not mean ‘a nice knock-down argument’. Anyone with a dictionary could see that. Humpty Dumpty’s point was that ‘a nice knock-down argument’ was what he meant by using the word ‘glory’. He very fairly acknowledged that Alice, as a reasonable young woman, could not have realised this until he told her, but once he had told her, or if, without being expressly told, she could have inferred it from the background, she would have had no difficulty in understanding what he meant.

Lord Lloyd dissented and he did so in robust terms. He stated (at p. 904) that he knew of ‘no principle of construction’ which enabled a court ‘to take words from within the brackets, where they are clearly intended to underline the width of “any claim”, and place them outside the brackets where they have the exact opposite effect.’ What the parties meant was to be derived from the words they had used. He continued:

purposive interpretation of a contract is a useful tool where the purpose can be identified with reasonable certainty. But creative interpretation is another thing altogether. The one must not be allowed to shade into the other.

We shall return to Lord Lloyd’s speech in the final section of this chapter, which is devoted to an evaluation of the relevant advantages and disadvantages of the modern approach to the interpretation of contracts. Before we do that, it is important to ascertain the scope of the principles set out by Lord Hoffmann.

4. THE SCOPE OF LORD HOFFMANN’S PRINCIPLES

Lord Hoffmann’s re-statement merits careful evaluation. The re-statement can be broken down into six units consisting of the first paragraph extracted earlier (p. 373, Section 3) followed by the five principles which he identifies.

(a) REVOLUTIONS, DISCARDING THE ‘OLD BAGGAGE’, AND THE ROLE OF PRECEDENT

Three principal points can be deduced from the first paragraph of Lord Hoffmann’s re-statement. The first is that it does not purport to be revolutionary. Rather, it attempts to

build on the principles established by Lord Wilberforce in *Prenn v. Simmonds* and *Reardon Smith Line Ltd v. Hansen-Tangen*. While it is true that Lord Hoffmann notes that there has been a ‘fundamental change’ in the applicable legal principles, he attributes that change to Lord Wilberforce and not to himself. Indeed in *New Hampshire Insurance Co v. Philips Electronics North America Corporation (No 2)* [1999] LRLR 66, 70 Clarke J stated that, in his view, Lord Hoffmann had not ‘intended to alter the principles of construction which have been developed in recent years’. His speech is therefore perceived as an affirmation of a change that had already taken place, rather than as an initiator of change. The law thus appears to be in a process of evolution rather than revolution. It is evolving slowly both in relation to the range of materials which the court is willing to admit into evidence and in relation to the extent to which it is prepared to depart from the literal meaning of the words used by the parties and adopt a construction which leads to a commercially sensible construction.

The second point relates to the significance of Lord Hoffmann’s phrase that ‘almost all the old intellectual baggage of “legal” interpretation has been discarded’. At first sight this does not appear to be a particularly significant statement. But first appearances can deceive. Its true significance was explained by Lord Hoffmann in *Bank of Credit and Commerce International SA v. Ali* [2001] UKHL 8, [2002] 1 AC 251 (see further pp. 409–410, Chapter 13, Section 2) when he explained that the baggage that had been discarded included the ‘artificial rules’ relating to the construction of exemption (or exclusion) clauses. After referring to the judgments of Lord Denning in *George Mitchell (Chesterhall) Ltd v. Finney Lock Seeds Ltd* [1983] QB 284, 296–297 and Lord Wilberforce in *Photo Production Ltd v. Securicor Transport Ltd* [1980] AC 827, 843 Lord Hoffmann concluded (at [62]) that:

the disappearance of artificial rules for the construction of exemption clauses seems to me in accordance with the general trend in matters of construction which has been to try to assimilate judicial techniques of construction to those which would be used by a reasonable speaker of the language in the interpretation of any serious utterance in ordinary life.

As we shall see (pp. 416–417, Chapter 13, Section 2(a)), matters are not quite so straightforward. Some of the cases concerned with the interpretation of exemption clauses, in particular the line of cases represented by the decision of the Privy Council in *Canada Steamship Lines Ltd v. The King* [1952] AC 192 (on which see pp. 411–417, Chapter 13, Section 2(a)), have been approved on a number of occasions both by the Court of Appeal and by the House of Lords. These cases are too well entrenched to be uprooted by a passing remark of Lord Hoffmann in the House of Lords. Nevertheless, cases can be found in which the courts have applied the principles set out in *Investors Compensation Scheme* to the interpretation of exemption clauses (see, for example *National Westminster Bank v. Utrecht-America Finance Company* [2001] EWCA Civ 658, [2001] 3 All ER 733). The result is a degree of uncertainty in the law. Many of the old cases in which a restrictive approach was adopted towards the interpretation of an exemption clause have not been overruled but the likelihood of their long-term survival seems rather low.

This takes us to the third point, which is the impact of Lord Hoffmann’s re-statement on cases decided prior to it and, more generally, the role of precedent in cases concerned with the interpretation of contracts. What impact does Lord Hoffmann’s re-statement have on previous case-law? In *NLA Group Ltd v. Bowers* [1999] 1 Lloyd’s Rep 109 Timothy Walker J stated (at p. 112) that ‘Lord Hoffmann was simply overruling old and outdated cases by reference to an approach on construction which has been followed in the Commercial Court

for many years.’ The obvious difficulty is that neither Lord Hoffmann nor Timothy Walker J make clear which ‘old and outdated cases’ have in fact been overruled.

This lack of clarity may not be of great significance given that the precedent value of a case concerned with the interpretation of a contract is generally low. Thus in *Surrey Heath Borough Council v. Lovell Construction Ltd* (1990) 48 Build LR 113 Dillon LJ stated (at p. 118) that ‘a decision on a different clause in a different context is seldom of much help on a question of construction’. Further, in *Midland Bank plc v. Cox McQueen* [1999] 1 FLR 1002 Mummery LJ stated (at p. 1012):

Detailed comparisons of one document with another and of one precedent with another do not usually help the court to reach a decision on construction. Indeed, that exercise occupies a disproportionate amount of valuable time which would be better spent on the arguments that really count: those which focus on the precise terms of the relevant documents and the illuminating environment of the transaction.

However, the authorities are not all one way. A rather different approach was taken by the House of Lords in *Bank of Credit and Commerce International SA v. Ali* [2001] UKHL 8, [2002] 1 AC 251. The case concerned the interpretation of a release that was drafted in the following terms:

The applicant agrees to accept the terms set out in the documents attached in full and final settlement of all or any claims whether under statute, common law or equity of whatsoever nature that exist or may exist and, in particular, all or any claims, rights or applications of whatsoever nature that the applicant has or may have or has made or could make on or to the industrial tribunal, except the applicant’s rights under [the bank’s] pension scheme.

Such clauses are generally used when parties settle or compromise a dispute. The aim of the clause is to draw a line under the dispute. As Lord Nicholls stated (at [22]) the parties want ‘to wipe the slate clean’. The particular issue that arose in *Ali* was whether or not the release was effective to exclude a claim, the existence of which neither party could have been aware at the time of entry into the release. At first sight, the clause does appear to be effective to encompass such a claim. It is drafted in wide terms. As Lord Hoffmann noted (at [38]):

the draftsman meant business. He has gone to some trouble to avoid leaving anything out. He uses traditional style: pairs of words like ‘full and final settlement’, ‘all or any claims’, ‘that exist or may exist’ and phrases like ‘whether under statute, Common law or in Equity’ and ‘of whatsoever nature’.

But the majority held that the clause was not effective to exclude unknown claims. In reaching this conclusion the majority placed considerable emphasis on a line of cases going back to the eighteenth century. While Lord Bingham accepted (at [17]) that ‘the authorities must be read in the context of their peculiar facts’, he nevertheless had regard to them for the purpose of establishing the principle that the courts are reluctant to infer that a party intended to give up something which neither he, nor the other party, knew or could have known that he had. Lord Hoffmann dissented. He adopted a stance similar to that taken by Dillon LJ and Mummery LJ (extracted earlier). He asked (at [51]):

If interpretation is the quest to discover what a reasonable man would have understood specific parties to have meant by the use of specific language in a specific situation at a specific time and place, how can that be affected by authority? How can the question of what a reasonable man in 1990 would have thought BCCI and Mr Naeem meant by using the language of an ACAS form be answered by examining what Lord Keeper Henley said in 1758...? I can understand that if parties in a legal context use words in what appears to have been a technical sense, it may be necessary to ascertain that technical meaning from authorities. But there is nothing of that kind here.

There is much to be said for the approach of Lord Hoffmann. The authorities are obviously important in the situation where parties have chosen to use words that have acquired an established technical meaning. In such a case the courts are likely to give the words the meaning that they have been given in the case-law. Thus in *British Sugar plc v. NEI Power Projects Ltd* (1997) 87 BLR 42, 50 Waller LJ stated, when considering the meaning of the words ‘consequential loss’, that:

once a phrase has been authoritatively construed by a court in a very similar context to that which exists in the case in point, it seems to me that a reasonable businessman must more naturally be taken to be having the intention that the phrase should bear the same meaning as construed in the case in point. It would again take very clear words to allow a court to construe the phrase differently.

However Lord Hoffmann’s approach did not commend itself to the majority. They were prepared to have regard to the precedents for a wider range of purposes than simply to ascertain the technical meaning of the words used by the parties. In particular, they were able to deduce from the cases a ‘cautionary principle’ that ‘in the absence of clear language, the court will be very slow to infer that a party intended to surrender rights and claims of which he was unaware and could not have been aware’ (see [10] and [22]). It is important to note that the latter principle is stated at a fairly high level of abstraction. It may therefore be that the courts can deduce broad principles of general application from the case-law but that the precedents themselves are unlikely to shed much light on detailed points of construction that arise in individual cases. In the latter context, the approach of Mummery LJ in *Midland Bank plc v. Cox McQueen* (p. 378, extracted earlier) is likely to prevail, namely that the authorities are unlikely to be of much assistance to the courts.

(b) THE OBJECTIVE NATURE OF THE TEST

Lord Hoffmann’s first principle is, or appears to be, relatively uncontroversial. It emphasizes the objective nature of the test applied by the courts. The ‘methodology’ of the common law is ‘not to probe the real intentions of the parties but to ascertain the contextual meaning of the relevant contractual language. Intention is determined by reference to expressed rather than actual intention’ (per Lord Steyn in *Deutsche Genossenschaftsbank v. Burnhope* [1995] 1 WLR 1580, 1587). This principle has been cited on a number of occasions by the judges but it does not seem to have given rise to any difficulty. The judges have understood it as an affirmation of the traditional, objective approach to the interpretation of contracts.

(c) THE 'FACTUAL MATRIX'

Lord Hoffmann's second principle has proved to be more controversial. It is its breadth that has attracted criticism. The use of the language of 'matrix of fact' can be traced back to the speech of Lord Wilberforce in *Prenn v. Simmonds* [1971] 1 WLR 1381. However its use has been attacked, in particular by Sir Christopher Staughton, a former judge in the Court of Appeal (see 'How Do the Courts Interpret Commercial Contracts?' [1999] *CLJ* 303, 306–308). He criticized the use of language such as 'the matrix of fact' on the ground that 'counsel have wildly different ideas as to what a matrix is and what it includes'. Particularly difficult was the use by Lord Hoffmann of the words 'absolutely anything' which appeared to encourage lawyers to trawl through all the documentation relating to the transaction and then seek to introduce it all in evidence as part of the 'matrix of fact'. Lord Hoffmann sought to meet this criticism in *Bank of Credit and Commerce International v. Ali* [2001] UKHL 8, [2002] 1 AC 251 when he stated (at [39]) that:

I did not think it necessary to emphasise that I meant anything which a reasonable man would have regarded as *relevant*. I was merely saying that there is no conceptual limit to what can be regarded as background. It is not, for example, confined to the factual background but can include the state of the law (as in cases in which one takes into account that the parties are unlikely to have intended to agree to something unlawful or legally ineffective) or proved common assumptions which were in fact quite mistaken... I was certainly not encouraging a trawl through 'background' which could not have made a reasonable person think that the parties must have departed from conventional usage.

This qualification is, however, limited in its scope. It does not purport to fix a formal limit to the scope of the 'factual matrix'. That said, the significance of the factual matrix does vary from case to case. In particular, it is likely to play a lesser role in the case where the issue before the court is the interpretation of a document which is in standard use throughout a particular industry (*Re Sigma Finance Corp (in administrative receivership)* [2009] UKSC 2, [2010] 1 All ER 671).

There is little evidence that judges have experienced difficulty in ascertaining what does and what does not fall within the 'matrix of fact' or in restraining the excesses of counsel. The point was well put by Arden LJ in *Static Control Components (Europe) Ltd v. Egan* [2004] EWCA Civ 392, [2004] 2 Lloyd's Rep 429 when she stated:

When the principles in the *ICS* case were first enunciated, there were fears that the courts would on simple questions of the construction of deeds and documents be inundated with background material. Lord Hoffmann recognised this risk by emphasising in *BCCI v. Ali* [2002] 1 AC 251 at 269 that his reference to 'absolutely anything' in his second proposition was to anything that a reasonable man would have regarded as relevant. Speaking for myself, I am not aware that the fears expressed as to the opening of floodgates have been realised. The powers of case management in the Civil Procedure Rules could obviously be used to keep evidence within its proper bounds. The important point is that the principles in the *ICS* case lead to a more principled and fairer result by focusing on the meaning which the relevant background objectively assessed indicates that the parties intended.

To the extent that uncertainty persists it would appear to relate to the weight to be given to the evidence once it has been admitted rather than to the decision whether to admit the evidence or not.

(d) THE EXCLUSIONARY RULES

Lord Hoffmann's third principle is his exception to the rule that documents are to be interpreted in accordance with the common sense principles by which any serious utterance would be interpreted in ordinary life. It is a principle that declares certain types of evidence to be inadmissible. In so far as it states that 'declarations of subjective intent' are inadmissible, it has not given rise to debate. The first principle establishes that the test to be applied by the court is an objective one and so the exclusion of statements of subjective intent does not occasion surprise. More difficult is the exclusion of 'previous negotiations'. In *Investors Compensation Scheme* Lord Hoffmann acknowledged that the boundaries of this exclusion are 'in some respects unclear' and it was not until the decision of the House of Lords in *Chartbrook Ltd v. Persimmon Homes Ltd* [2009] UKHL 38, [2009] 1 AC 1101 that the issue was resolved.

In *Chartbrook* the House of Lords affirmed the existence of this general exclusionary rule. In declining to depart from the general rule, their Lordships attached importance to the need to uphold the value of certainty in the interpretation of contracts and to the imperative not to increase the costs of litigation by increasing still further the range of admissible evidence. As Lord Hoffmann observed (at [37]), the law of contract is 'designed to enforce promises with a high degree of predictability' and 'the more one allows conventional meanings or syntax to be displaced by inferences drawn from background, the less predictable the outcome is likely to be'. Lord Hoffmann summed up the reasoning of their Lordships in the following passage (at [41]):

The conclusion I would reach is that there is no clearly established case for departing from the exclusionary rule. The rule may well mean ... that parties are sometimes held bound by a contract in terms which, upon a full investigation of the course of negotiations, a reasonable observer would not have taken them to have intended. But a system which sometimes allows this to happen may be justified in the more general interest of economy and predictability in obtaining advice and adjudicating disputes. It is, after all, usually possible to avoid surprises by carefully reading the documents before signing them and there are the safety nets of rectification and estoppel by convention. Your Lordships do not have the material on which to form a view. It is possible that empirical study (for example, by the Law Commission) may show that the alleged disadvantages of admissibility are not in practice very significant or that they are outweighed by the advantages of doing more precise justice in exceptional cases or falling into line with international conventions. But the determination of where the balance of advantage lies is not in my opinion suitable for judicial decision.

It is, however, important to observe the scope of the rule which excludes evidence of pre-contractual negotiations. As Lord Hoffmann observed (at [47]):

There are two legitimate safety devices which will in most cases prevent the exclusionary rule from causing injustice. But they have to be specifically pleaded and clearly established. One is rectification. The other is estoppel by convention ... If the parties have negotiated an agreement upon some common assumption, which may include an assumption that certain words will bear a certain meaning, they may be estopped from contending that the words should be given a different meaning. Both of these remedies lie outside the exclusionary rule, since they start from the premise that, as a matter of construction, the agreement does not have the meaning for which the party seeking rectification or raising an estoppel contends.

Lord Hoffmann's confidence in the ability of these 'safety devices' to prevent injustice may be questioned. Both rectification (see pp. 565–571, Chapter 16, Section 6) and estoppel by convention (see pp. 224–225, Chapter 5, Section 3(d)) operate within narrow confines and so may provide little solace for the party seeking to rely on them in a particular case. More comfort may be found in a broader exception subsequently recognized by the Supreme Court, namely that pre-contractual negotiations which are 'part of the factual matrix' may be admissible in evidence (*Oceanbulk Shipping and Trading SA v. TMT Asia Ltd* [2010] UKSC 44, [2011] 1 AC 662, [40]). The likelihood is that the decision in *Chartbrook* will give rise to the occasional injustice but, in the view of their Lordships, that injustice is outweighed by the certainty and predictability which the maintenance of the general exclusionary rule will provide.

Lord Hoffmann made no express reference in his speech in *Investors Compensation Scheme* to the admissibility of evidence of conduct subsequent to the making of the contract. Pre-*Investors Compensation Scheme* authority establishes that such evidence is inadmissible (*Schuler AG v. Wickman Machine Tool Sales* [1974] AC 235), although it may be relevant to a plea of estoppel, including estoppel by convention (*James Miller & Partners Ltd v. Whitworth Street Estates (Manchester) Ltd* [1970] AC 583; *Mannai Investment Co Ltd v. Eagle Star Life Assurance Co Ltd* [1997] AC 749, 768 (Lord Steyn) and 779 (Lord Hoffmann)), to the question whether a contract has been subsequently varied (*Philip Collins Ltd v. Davis* [2000] 3 All ER 808, 822) and it does not apply to oral contracts (*Maggs (t/a BM Builders) v. Marsh* [2006] EWCA Civ 1058, [2006] BLR 395). The reason given for the exclusion of this evidence is that, were it admissible, the contract could mean one thing on the day on which it was signed but mean something completely different six weeks later by virtue of the subsequent conduct of the parties. This exclusionary rule has been affirmed in a number of cases post-*Investors Compensation Scheme* (see, for example, *The 'Tychy' (No 2)* [2001] EWCA Civ 1198, [2001] 2 Lloyd's Rep 403, [33]) but has been departed from in New Zealand (see *Wholesale Distributors Ltd v. Gibbons Holdings Ltd* [2007] NZSC 37, [2008] 1 NZLR 277, noted by Berg (2008) 124 LQR 6).

(e) THE MEANING IS NOT A MATTER OF DICTIONARIES

The fourth principle has given rise to some disquiet, particularly when taken in combination with the fifth principle. While the meaning which a document would convey to a reasonable man may not be the same thing as the meaning of its words, it does not of course follow that the meaning of its words is irrelevant. Lawyers often draft documents using a finely tuned linguistic fork (see, for example, *Kleinwort Benson Ltd v. Malaysia Mining Corporation Berhad* [1989] 1 WLR 379, p. 386, Section (f)) and, when they do, they expect the courts to give effect to them according to their terms and not to re-write them under the guise of interpretation. In such cases the parties expect the court to interpret the words and give them their ordinary, natural (dictionary) meaning. Having said that, there are cases in which the parties use language in a much looser way or attribute a meaning to a word that it would not ordinarily bear. In such a case the dictionary meaning of the words will not give effect to the intention of the parties and, for that reason, is unlikely to be adopted by the court. So, for example, in a case where the court is persuaded that the drafting of the relevant clause is poor, it is less likely to conclude that the words should be given their ordinary, natural meaning (*Multi-Link Leisure Developments v. North Lanarkshire Council* [2010] UKSC 47, [2011] 1 All ER 175).

In the abstract this sounds entirely reasonable. In practice, however, it can be more problematic. One problem arises in the case where the meaning of the words is clear (at least in their dictionary sense) but one party alleges that they did not use the words in their ordinary sense but attributed to them some special meaning. For example, in *Tucker v. Tucker*, unreported, Chancery Division, 19 March 1999 it was argued that the word ‘gave’ meant ‘received’. Park J rejected the argument and stated that he was unable ‘to construe the agreement as if it said the opposite of what it actually says’. Lord Hoffmann’s fourth principle could be said to give to the parties an incentive to raise this type of argument. In the past the courts could only resort to evidence of the surrounding circumstances where the meaning of the words used by the parties was obscure or ambiguous. Although statements can still be found which suggest that this remains the case (see, for example, Lord Hope in *Multi-Link Leisure Developments v. North Lanarkshire Council* [2010] UKSC 47, [2011] 1 All ER 175, [11]), the generally accepted view is that ‘an ambiguity need not be established before the surrounding circumstances may be taken into account’ (*Westminster City Council v. National Asylum Support Service* [2002] UKHL 38, [2002] 1 WLR 2956, [5]). Indeed, it is the fact that the court can have regard to the surrounding circumstances even where the meaning of the words used is clear that has attracted criticism. It generates uncertainty. In what circumstances will the courts be prepared to depart from the dictionary meaning of the words used by the parties? The answer is unclear. One suspects that the courts will not lightly depart from the dictionary or accepted meaning of the words used by the parties, but there is no formal limit on their ability to do so. Where, however, a term of a contract is open to more than one interpretation, it is generally appropriate to adopt the interpretation which is most consistent with business common sense (*Rainy Sky SA v. Kookmin Bank* [2011] UKSC 50, [2011] 1 WLR 2900, [30]).

(f) SOMETHING HAS GONE WRONG WITH THE LANGUAGE

The fifth principle comes into play in the case where ‘something must have gone wrong with the language’. In such a case the law ‘does not require the judges to attribute to the parties an intention which they plainly could not have had’. There is, however, an initial hurdle that must be overcome by a party who wishes to submit that something has ‘gone wrong with the language’. That hurdle is that the courts ‘do not easily accept that people have made linguistic mistakes’.

The importance of this hurdle was affirmed by the House of Lords in *Chartbrook Ltd v. Persimmon Homes Ltd* [2009] UKHL 38, [2009] 1 AC 1101 where Lord Hoffmann acknowledged (at [15]) that it ‘requires a strong case to persuade the court that something must have gone wrong with the language’. In order to establish such a ‘strong case’ it is necessary to do more than demonstrate that a particular interpretation results in an outcome which is especially favourable to one party. As Lord Hoffmann observed (at [20]):

It is of course true that the fact that a contract may appear to be unduly favourable to one of the parties is not a sufficient reason for supposing that it does not mean what it says. The reasonable addressee of the instrument has not been privy to the negotiations and cannot tell whether a provision favourable to one side was not in exchange for some concession elsewhere or simply a bad bargain. But the striking feature of this case is not merely that the provisions as interpreted by the judge and the Court of Appeal are favourable to Chartbrook. It is that they make the structure and language of the various provisions of Schedule 6 appear arbitrary and irrational, when it is possible for the concepts employed by the parties... to be combined in a rational way.

Thus there comes a point (which is not easy to define) where the results are so startling that the court will conclude that the contract does not mean what it says and it will then look to adopt a construction of the contract which gives effect to the intention of the parties.

Once this point has been reached, the court's powers to adapt the language of the contract in order to give effect to the intention of the parties would seem to be broad. Lord Hoffmann in *Chartbrook* summarized these powers as follows (at [21]):

I do not think that it is necessary to undertake the exercise of comparing this language with that of the definition in order to see how much use of red ink is involved. When the language used in an instrument gives rise to difficulties of construction, the process of interpretation does not require one to formulate some alternative form of words which approximates as closely as possible to that of the parties. It is to decide what a reasonable person would have understood the parties to have meant by using the language which they did. The fact that the court might have to express that meaning in language quite different from that used by the parties ('12th January' instead of '13th January' in *Mannai Investment Co Ltd v Eagle Star Life Assurance Co Ltd* [1997] AC 749; 'any claim sounding in rescission (whether for undue influence or otherwise)' instead of 'any claim (whether sounding in rescission for undue influence or otherwise)' in *Investors Compensation Scheme Ltd v West Bromwich Building Society*)... is no reason for not giving effect to what they appear to have meant.

He continued (at [25]):

What is clear... is that there is not, so to speak, a 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 the language and that it should be clear what a reasonable person would have understood the parties to have meant.

The importance of these statements lies in their willingness to engage in a measure of re-writing of the contract under the guise of interpretation. It is no longer necessary to resort to the remedy of rectification (see pp. 565–571, Chapter 16, Section 6) in order to achieve this measure of re-writing. This change has not been to everyone's taste. Sir Richard Buxton, writing extra-judicially ("Construction" and Rectification after *Chartbrook*' [2010] *CLJ* 253, 256), criticized Lord Hoffmann's fifth principle on the ground that it was 'revolutionary because it overrode the previous understanding that, rectification apart, the court could not depart from the words of the document to find an agreement different from that stated in the document' and that it confused 'the meaning of what the parties said in the document with what they meant to say but did not say'. In *Oceanbulk Shipping and Trading SA v. TMT Asia Ltd* [2010] UKSC 44, [2011] 1 AC 662, [44] Lord Clarke accepted that there was a 'close relationship between interpretation and rectification' but did not otherwise endorse the criticism of Lord Hoffmann's fifth principle.

However, it is important to note the limits of Lord Hoffmann's principle, in particular the requirement that 'it should be clear what a reasonable person would have understood the parties to have meant'. In other words, both the mistake and the intended outcome must be clear. As Rix LJ observed in *ING Bank NV v. Ros Roca SA* [2011] EWCA Civ 353, [2012] 1 WLR 472, [110] 'judges should not see in *Chartbrook* an open sesame for reconstructing the parties' contract, but an opportunity to remedy by construction a clear error of language which could not have been intended.' Further, construction cannot be 'pushed beyond its proper limits in pursuit of remedying what is perceived to be a flaw in the working of a contract.'

The final point to note in relation to Lord Hoffmann's fifth principle is his reference to the speech of Lord Diplock in *The Antaios*. This links Lord Hoffmann's re-statement with a theme that has underpinned some of Lord Steyn's speeches in the House of Lords where he emphasized the shift towards an approach to the interpretation of contracts which favours the adoption of a 'commercially sensible construction'. Thus in *Lord Napier and Ettrick v. R F Kershaw Ltd* [1999] 1 WLR 756, 763 Lord Steyn stated:

Loyalty to the text of a commercial contract, instrument, or document read in its contextual setting is the paramount principle of interpretation. But in the process of interpreting the meaning of the language of a commercial document the court ought generally to favour a commercially sensible construction. The reason for this approach is that a commercial construction is likely to give effect to the intention of the parties. Words ought therefore to be interpreted in the way in which a reasonable commercial person would construe them. And the reasonable commercial person can safely be assumed to be unimpressed with technical interpretations and undue emphasis on niceties of language.

The drift is clear but whether it is a wholly desirable development is less clear cut. There are at least three potential difficulties. The first lies in the ability of the court to identify the commercial purpose which underpins the disputed term. In some cases the commercial purpose is not immediately obvious. Lord Gribner has argued ('The Iterative Process of Contractual Interpretation' (2012) 128 *LQR* 41, 46) that it is 'critically important' that the commercial purpose of the disputed clause is 'derived from the contract as a whole and from an accurate understanding of the way in which the various provisions interact' but concedes that in practice its invocation 'often turns out to be little more than an appeal to the court for a more reasonable result' (p. 50). A possible example of the latter occurrence is *Multi-Link Leisure Developments v. North Lanarkshire Council* [2010] UKSC 47, [2011] 1 All ER 175 where the Supreme Court had to ascertain the price to be paid on the exercise of an option to purchase land during the currency of a lease. The land had increased in value after entry into the lease and the particular issue which divided the parties was whether account was to be taken of these developments in fixing the price to be paid. The Supreme Court held that they were to be taken into account. Lord Hope stated that it was unlikely that the landlords would have agreed to confer a substantial windfall on the tenant. In his judgment the reasonable commercial man would have agreed that the option price was to be determined by the full market value of the land as described, taking full account of its potential, if any, for development. This being the case, had the parties intended to confine the valuation of the land by reference to its initial use, the court would have expected to see this expressed in clearer terms. This approach has been criticized (see DW McLauchlan, 'A Construction Conundrum?' [2011] *LMCLQ* 428) on the ground that one of the parties was likely to make a substantial windfall on the facts and so why assume that that party must be the landlord?

This leads on to the second difficulty which is that an emphasis on the adoption of a commercially sensible construction may have the effect of rescuing one party from its bad bargain. As Martin Hogg has stated ('Fundamental Issues for Reform of the Law of Contractual Interpretation' [2011] *Edinburgh Law Review* 406, 420), if one of the parties 'has acted in a less than sensible commercial fashion, the superimposition of a commercially sensible approach to interpretation may result in providing that party with unwarranted assistance.' There is a suspicion in some recent cases (such as *Multi-Link Leisure Developments*) that the courts have provided one party with such 'unwarranted assistance' (although the danger

has been acknowledged judicially by Lord Hope in *Aberdeen City Council v. Stewart Milne Group Ltd* [2011] UKSC 56, [2011] All ER (D) 51, [21], albeit that it was held to be inapplicable on the facts of the case).

The final difficulty arises from the last sentence in the quotation extracted from Lord Steyn's speech in *Lord Napier and Ettrick*. Is his assumption about the 'reasonable commercial person' correct? What about the case in which our 'reasonable commercial person' consults a lawyer before entering into a transaction? Is a lawyer also assumed to be unimpressed with 'technical interpretations and undue emphasis on niceties of language'. Take *Kleinwort Benson Ltd v. Malaysia Mining Corporation Berhad* [1989] 1 WLR 379 as an example. A parent company gave a letter of comfort to a bank that had agreed to provide a £10 million credit facility to a subsidiary of the parent company. The bank asked the parent company to provide a guarantee of the subsidiary's debts. The parent company refused. Instead the parent company gave the bank a letter of comfort which stated that: 'it is our policy to ensure that the business of [the subsidiary company] is at all times in a position to meet its liabilities to you under the above arrangements.' The subsidiary defaulted under the credit facility and the bank brought a claim against the parent company. The parent company denied any liability to the bank. The crucial question was: did the parent company promise that it would continue to ensure that its subsidiary would remain in a position to meet its liabilities? The Court of Appeal held that it did not. It reached this conclusion on the basis of a careful evaluation of the terms of the letter of comfort. Given the significance of the letter of comfort to the parties we can be confident that the lawyers fought hard over its precise wording. The letter bears the hallmarks of a carefully drawn document. It conspicuously stops short of a promise by the parent company to continue its policy. It sets out the current policy of the parent company but refrains from making any commitment as regards the future. In other words there is a difference between a document which states 'it is our policy' (which makes no commitment in relation to the future) and one which states 'it is and will at all times continue to be our policy' (which clearly does make such a commitment). A different result to that reached in *Kleinwort Benson* was reached by Rogers CJ in the Supreme Court of New South Wales in *Banque Brussels Lambert SA v. Australian National Industries Ltd* (1989) 21 NSWLR 502. He held that the letter of comfort was promissory in nature. In reaching his conclusion he stated (at p. 524) that 'it is inimical to the effective administration of justice in commercial disputes that a court should use a finely tuned linguistic fork'. Further, after referring to the fact that the Court of Appeal in *Kleinwort Benson* had subjected the letter of comfort to minute textual analysis, stated (at p. 523) that 'courts will become irrelevant in the resolution of commercial disputes if they allow this to dominate their consideration of commercial documents.' Many English commercial practitioners will recoil in horror at the latter statements. In their view it is the function of the judge to give effect to the agreement as it stands and not to re-write it in accordance with his own perception of what 'commercial good sense' requires.

Has Lord Hoffmann begun to take English law down a road that will lead to the approach taken by Rogers CJ? Probably not. Lord Hoffmann is in fact concerned to ensure that the courts give effect to the intention of the parties and that they do not attribute to them an intention that they did not have. This being the case, where the parties intend to use a finely tuned linguistic fork, a judge applying Lord Hoffmann's re-statement should use such a fork. Conversely, where the parties do not so intend, a judge should resist the temptation to get out his finely tuned linguistic fork because the effect of doing so would be to impose upon the parties an agreement they did not intend to conclude.

5. FUTURE DEVELOPMENTS?

How will the law develop in the future? There are three principal choices open to the courts. The first is to return to the old days and to resurrect the traditional, literal approach to the interpretation of contracts. This is unlikely to happen, although it is possible that the courts will try to curb the scope of Lord Hoffmann's re-statement, particularly through a restrictive interpretation of the 'matrix of fact'. The second is to keep the law as it is now. This would appear to be the view of the House of Lords in *Chartbrook Ltd v. Persimmon Homes Ltd* [2009] UKHL 38, [2009] 1 AC 1101. The third view is that the law should continue to evolve and that the courts should continue to expand the range of materials to which they have regard when interpreting contracts. The model here might be Article 5:102 of the Principles of European Contract Law which states:

In interpreting a contract, regard shall be had, in particular, to:

- (a) the circumstances in which it was concluded, including the preliminary negotiations;
- (b) the conduct of the parties, even subsequent to the conclusion of the contract;
- (c) the nature and purpose of the contract;
- (d) the interpretation which has already been given to similar clauses by the parties and the practices they have established between themselves;
- (e) the meaning commonly given to terms and expressions in the branch of activity concerned and the interpretation similar clauses may already have received;
- (f) usages; and
- (g) good faith and fair dealing.

This Article has not, as yet, been referred to in any of the cases concerned with the interpretation of contracts in the English courts. Paragraphs (a) and (b) clearly go beyond the current limits of English law. Paragraph (g) also raises difficult issues for English lawyers because, as we shall see (Chapter 15), English law does not currently recognize the existence of a doctrine of good faith and fair dealing in contract law. But these may not prove to be insuperable obstacles. For those who wish to see English law continue to evolve, Article 5:102 may prove to be a useful tool in persuading others that English law on the interpretation of contracts has not yet reached its final destination.

FURTHER READING

BUXTON, R, "Construction" and Rectification after *Chartbrook*' [2010] *CLJ* 253.

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HOGG, M 'Fundamental Issues for Reform of the Law of Contractual Interpretation' [2011] *Edinburgh Law Review* 406.

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BOILERPLATE CLAUSES

CENTRAL ISSUES

1. Contracting parties frequently have a set of standard terms and conditions which they seek to incorporate into all the contracts which they conclude. In the case of more complex contracts they will also have a set of clauses (generally referred to as 'boilerplate clauses') which they will attempt to incorporate into these contracts. Some of these standard terms can be the subject of protracted negotiations between the parties. These standard terms therefore assume considerable significance in commercial practice.
2. The aim of this chapter is not to examine the content of these standard terms in detail. Rather, it is to identify, and briefly examine, some of the standard terms and to outline the structure of modern commercial contracts.

1. INTRODUCTION

The aim of this chapter is not to examine contracting practices as such. Such an enterprise would require not only a separate book but a major research project to examine the diverse contracting practices that exist throughout the country. While there have been some extremely valuable analyses of contracting practices in certain sectors of the economy or certain geographical areas (see, for example, H Beale and A Dugdale, 'Contracts Between Businessmen: Planning and the Use of Contractual Remedies' (1975) 2 *British Journal of Law and Society* 45 and R Lewis, 'Contracts Between Businessmen: Reform of the Law of Firm Offers and an Empirical Study of Tendering Practices in the Building Industry' (1982) 9 *Journal of Law and Society* 153), there remains a great deal to be done in terms of obtaining information about the way in which contracts are concluded and their content. The study carried out by Beale and Dugdale in the early 1970s consisted of interviews with 'representatives of nineteen firms of engineering manufacturers, mainly in Bristol, about their firm's contracts of purchase and sale'. One of the principal points that emerged from this study was the relatively limited use that was made by the parties of the law of contract in the regulation of their relationships. But it would be dangerous to generalize from this study and conclude that contracting parties generally make little use of the rules of law. Thus Beale, Bishop, and

Furmston (*Contract Cases and Materials* (5th edn, Oxford University Press, 2008)) conclude (at p. 83):

although this study suggests that some businesses make only limited use of contract law, it must be remembered that it was studying only a small sample from one industry. Other trades may well demonstrate a much more ‘legalistic’ approach: for instance, a glance into Lloyd’s Reports, which concentrate on commercial cases, suggests that businesses in some commodity trades and in the charter markets litigate much more regularly—frequently taking points that lack any real merit in order to escape unprofitable contracts . . . The contracts seem to have been planned in quite some detail . . .

Even in those cases where the relationship between the parties is heavily influenced by informal understandings, it should not be assumed that this is to the exclusion of the formal terms of the contract. In many cases the relationship between the parties is governed both by informal understandings (or ‘relational norms’) and by the formal contract document and the rules of contract law. The extent of the influence of these different factors is likely to depend upon the circumstances of the individual case (see generally C Mitchell, ‘Contracts and Contract Law: Challenging the Distinction Between the “Real” and the “Paper” Deal’ (2009) 29 *OJLS* 675).

The aim of the chapter is to examine some of the principal standard terms used in commercial contracts today. The examination is limited in two important respects. First, it is confined to commercial contracts. Contracts concluded informally between members of the public are not examined at all. Contracts between businesses and consumers also fall largely outside the scope of this chapter. They are included to the extent that many businesses seek to incorporate their standard terms and conditions into contracts with consumers as well as with other businesses. But the regulation of these standard terms as they apply to consumer contracts raises distinct issues which are examined in Chapter 14. Secondly, this chapter is confined to terms that will, in all probability, have been drafted by lawyers. It therefore examines the clauses very much through the lens of a lawyer. It does not purport to examine more informal methods of contracting that may be developed by businesses (important though these methods may be in practice).

2. BOILERPLATE CLAUSES AND STANDARD TERMS

Standard terms can be divided into two broad groups. The first consists of standard terms that are inserted into a written contract which has been drawn up by the contracting parties (more usually, their lawyers). These are often known as ‘boilerplate clauses’. The second consists of a set of standard terms and conditions which a business attempts to incorporate into all of its contracts. These terms are often appended to an order form or are incorporated into the standard documentation sent out on behalf of the business whenever a transaction is concluded. The distinction between these two groups is a very loose one. A term can be both a boilerplate clause inserted into a written contract and a term that is included in a standard set of terms and conditions. The distinction that is drawn relates not to the substance of the term itself but to the process by which the contract is concluded. The first group consists of cases where two parties negotiate a contract and then draw up a formal written contract which records the agreement that the parties have reached. The second group is made up of those cases in which one party sends out an order form on his own standard

terms of business and the other party ‘accepts’ the order and in doing so often sends back his own terms and conditions (the so-called ‘battle of the forms’ discussed at pp. 82–98, Chapter 3, Section 3(a)). In the first situation it is important to see the boilerplate clauses in their context. The first extract, taken from a book by Richard Christou, does this by locating the discussion of boilerplate clauses within the structure of the agreement as a whole. The second extract, taken from *Schmitthoff’s Export Trade*, sets out a list of commonly used standard form clauses. These are particularly suitable for incorporation in a set of standard terms and conditions but they can also be incorporated into a written contract as one of the boilerplate clauses. The section that follows these two extracts is devoted to a brief examination of the standard clauses listed in *Schmitthoff* and will also include one or two other boilerplate clauses not included in that list.

R Christou, *Boilerplate: Practical Clauses*
(5th edn, Sweet & Maxwell, 2010), pp. 1 and 4–9

The term ‘boilerplate’ is most properly used in its widest sense to describe the clauses, common to nearly all commercial contracts, which deal with the way in which the contract itself operates, as opposed to the rights of the parties under the particular transaction that they have agreed upon and embodied in the substantive clauses. Boilerplate clauses regulate, control, and in some cases modify, these substantive rights and their operation and enforcement. They are thus a vital part of every contract, without which the substantive rights of the parties embodied in the agreement would have little meaning.

If one can take the analogy from the field of computing, boilerplate is like the operating system of a computer, while the substantive content of the contract relating to the particular transaction could be likened to the application software. All commercial contracts have an underlying ‘operating system’ that is (at least in the jurisdictions based on common law and even in some others) approximately the same....

In the absence of boilerplate the parties must rely on the general system of law applicable to the contract, and ask the court to apply this in settling disputes. In extreme cases, however, even the systems of law to be applied, and the question of which court has jurisdiction, would have to be decided by reference to some system of private international law. This approach defeats the whole aim of commercial contracts: to create certainty in dealings between the parties, and an easy method of enforcement of rights where necessary.

The different parts of a commercial contract

(a) Designation of the parties

At the head of the contract it is usual to set out the names and identifying details of each of the parties. Although it is not uncommon to preface this section with a statement such as ‘This Agreement is made the..... day of 20.....’, this is not legally necessary. It is vital, however, that the agreement states from what date it is effective. The actual date upon which the agreement is signed (if this is different to the effective date) is therefore desirable but not essential.

(b) Recitals

After the details of the parties, a set of paragraphs called recitals will usually appear. These set out the background to the transaction and the purpose for which the parties are entering into the transaction. It is not legally necessary to include recitals in a contract, but it is customary to do so. However... current drafting practice is to keep recitals as short as possible.

Without express words later on in the agreement, recitals are not regarded as a part of the agreement which actually gives rise to legal obligations, and yet they will, at the least, be taken into account by a court which has to interpret the substantive portion of the agreement. Even worse, a court may regard them as, or as evidence of, pre-contract representations, the breach of which would ground an action for misrepresentation . . .

(c) Definitions

Although it is possible to insert definitions in any of the foregoing or in substantive parts of the agreement, where there are a great many definitions it is usual to arrange them together in a separate section straight after the recitals. As a drafting tip, it can be easier to insert definitions throughout the agreement, as drafting the clauses throws up the need for them, and then to remove these definitions at the end, collect and edit them, and arrange them in a suitable order (either alphabetical or logical) in the initial definition section.

The definitions form part of the substantive agreement because they prescribe that certain terms shall mean certain things. This prescriptive language can take various forms. The most unambiguous is: 'In this Agreement A shall mean B'. Another form often used, is: 'Where the context so admits, in this Agreement A shall mean B'. A third form provides a partial definition: 'In this Agreement [where the context so admits] A includes B'. An example of this is: 'In this Agreement taxation includes income tax, corporation tax and value added tax'. We do not have a complete definition of 'taxation', but do know some items which are included in the term. The parties are left free to argue, by reference to the ordinary dictionary meaning of taxation, whether other items such as stamp duty or inheritance tax fall within the definition or not . . .

Besides pure definitions, this section will also contain general interpretation clauses . . .

(d) Substantive clauses

After the definitions follow the main clauses of the agreement—the substantive provisions. These clauses are sometimes introduced by: 'Now it is hereby agreed as follows . . .' Although customary, this phrase does not appear to serve any legal purpose, since the substantive clauses will obviously be seen as matters upon which the parties are agreeing.

(e) Schedules

To ensure that the logical flow of the substantive clauses is not interrupted and obscured with a great deal of detail, it is useful to put many of the more detailed substantive provisions into schedules. A clause in the substantive part of the agreement could then read: 'All orders for the Products placed by the Buyer with the Seller shall be upon the terms and conditions set out in Schedule . . .' The schedule concerned could then carry a detailed set of conditions of sale which, had they been left within the main clauses, would have completely disrupted the sequence.

Another use for schedules is to remove transaction-specific details so that the main document can be more easily used as a standard form. Standard form distributor or agency agreements, for example, usually place details of the products, territories covered and sales targets within the schedules.

Schedules are a substantive and integral part of the agreement, and there should always be a specific provision in the main clauses stating that this is so.

(f) Appendices

Where documents are referred to in an agreement they are often attached as appendices so that they can be easily referred to. Such appendices are usually signed by the parties by way of identification of the document concerned.

Such documents are not necessarily part of the agreement. For instance, a warranty can be given that a set of accounts, or a copy of a memorandum and articles attached as an appendix, is true and correct. The document is then attached for reference but its provisions are not incorporated in the agreement. Where a document is actually incorporated by reference (for example a set of standard conditions of sale or a technical specification) the document is sometimes also attached as an appendix. However, even in this case, the *provisions* of the document are incorporated by reference in the main clause, but the appended copy of the document only serves as a record of those terms and is not itself a part of the agreement.

(g) Signature section

This section should come after the schedules and before the appendices. It is often, but need not be, introduced with wording such as: 'The duly authorised representatives of the parties hereto have hereunto set their hands, the day and year first above written'. A shorter and equally acceptable method is 'Signed by X for and on behalf of ABC Ltd' followed by X's signature.

Commercial agreements do not normally need witnesses to the signatures: they are certainly not necessary under English law.

Most commercial agreements are just signed...and not executed as deeds...One great advantage (or drawback, depending upon which party is concerned) to the use of a deed under English law, is that the statute of limitations prescribes 12 years for an action on a deed, but only six years for a document under hand.

Deeds are also used by bodies such as local authorities in England and Wales whose processes for authorisation of signature of contracts are very complicated...

Mention should also be made of the new possibilities for the electronic signature of contracts provided by s. 7 of the Electronic Communications Act 2000...

(h) Counterparts and copies

Copies of commercial documents are usually supplied for each of the parties: these are signed by all the parties and include a special counterpart clause inserted to make each of them fully signed original copies for purposes of enforcement. As an alternative to counterparts, there is sometimes only one original, with the other parties being given certified copies which are regarded as equivalent to originals.

Conformed copies are sometime produced. These are copies of documents which contain manuscript amendments made at the last minute, or illegible signatures. The manuscript (including the signatures) is reproduced in the documents in typed form. Such copies are obviously not originals and are often just used for ease of reference, but they may also, of course, be certified copies.

(i) Headings and contents pages

Headings to clauses, sections and schedules, and contents pages, are often introduced into long documents for ease of reference. Such matters should not be part of the agreement or their drafting becomes too complicated and they no longer serve the purpose of providing easy reference guides. Usually a provision appears in the substantive clauses stating that this is the case.

(j) Contract numbering systems

Numbering systems can vary. Traditionally, they consist of hierarchical mixtures of Arabic and Roman numerals and letters of the alphabet. In a long document one spends more time than it is worth working out and adjusting such hierarchies and keeping them consistent. The aim of all numbering systems is to provide a unique and easy way of referring to each part of each clause of the contract.

C Murray, D Holloway, and D Timson-Hunt, *Schmitthoff's Export Trade: The Law and Practice of International Trade*

(11th edn, Sweet & Maxwell, 2007), paras 32–014 and 32–015

The importance, for international sales, of well-drafted general terms of business can hardly be exaggerated. They are particularly important where neither uniform conditions of export sales nor standard contract forms are used. Litigation can often be avoided when the seller is able to refer the buyer to a clause in his printed terms of business which was embodied in the quotation or acceptance, and the fact that these terms apply to all transactions concluded by the seller adds persuasive force to his argument.

Some important clauses

The most important clauses which the exporter should incorporate in his general terms of business are:

- (a) *General clause* which subjects every contract of sale to the seller's conditions of sale;
- (b) *Retention of title clause* which provides that until the seller receives the purchase price fully in cash,
 - (i) the seller retains the legal property in the goods and is given the irrevocable right to enter into the premises of the buyer at any time and without notice in order to retake possession of the goods; and
 - (ii) the buyer may resell the goods only as an agent of the seller and only in the ordinary course of business to a bona fide repurchaser and, if he does so, shall receive the proceeds of the resale as an agent of and trustee for the seller and shall place the proceeds of sale in a separate account in the name of the seller.
- (c) *Price escalation clause* which provides that unless firm prices and charges are agreed upon, the seller shall be entitled to increase the agreed prices and charges in the same proportion in which the prices or charges of the goods or their components, including costs of labour to be paid or borne by the seller, have been increased between the date of the quotation and the date of the delivery;
- (d) *Interest* which provides where payment is made after the agreed date, interest shall be paid at a specified rate;
- (e) *Force majeure clause* . . . ;
- (f) *Choice of law clause* which specifies that the contract be governed by English law;
- (g) *Arbitration* which provides that any disputes between the parties are to be settled by arbitration; or
- (h) *Jurisdiction*, providing for the jurisdiction of the English courts.

3. BOILERPLATE CLAUSES: SOME ILLUSTRATIONS

This section is devoted to an analysis of some standard or boilerplate clauses. It takes as its starting point the clauses listed in *Schmitthoff*. But it also adds one or two additional clauses. *Schmitthoff*'s list is directed towards export sellers and it is therefore necessary to supplement it by reference to standard terms that are found in other types of contract.

(a) GENERAL CLAUSE

While many sellers include such a ‘general clause’ in their standard terms, it by no means follows that it will be effective. The sellers in *Butler Machine Tool Co Ltd v. Ex-Cell-O Corporation (England) Ltd* [1979] 1 WLR 401 (p. 82, Chapter 3, Section 2(a)) included such a clause in their standard terms. The clause there stated:

All orders are accepted only upon and subject to the terms set out in our quotation and the following conditions. These terms and conditions shall prevail over any terms and conditions in the Buyer’s order.

The clause was not effective to achieve its goal because the sellers, in signing the buyer’s tear-off acknowledgement slip, were held to have entered into a contract on the buyer’s standard terms of business. While the clause may not work in a given fact situation, it is nevertheless included in standard terms and conditions.

(b) RETENTION OF TITLE CLAUSES

The aim of this type of clause is to protect the seller in the event of the insolvency of the buyer. While such a clause is commonly found in sellers’ standard terms and conditions it is by no means certain that it will achieve its goal. The case-law on this issue is difficult. Retention of title clauses came to prominence as a result of the decision of the Court of Appeal in *Aluminium Industrie Vaasen BV v. Romalpa Aluminium Ltd* [1976] 1 WLR 676, where a retention of title clause was held to be effective not only to reserve to the sellers’ property in the goods sold to the buyer but also to trace into the proceeds of sub-sales which had been entered into by the buyer, where the goods the subject matter of the sub-sales included goods supplied by the sellers to the buyer. The clause stated:

The ownership of the material to be delivered by A.I.V. will only be transferred to purchaser when he has met all that is owing to A.I.V., no matter on what grounds. Until the date of payment, purchaser, if A.I.V. so desires, is required to store this material in such a way that it is clearly the property of A.I.V. A.I.V. and purchaser agree that, if purchaser should make (a) new object(s) from the material, mix this material with (an) other object(s) or if this material in any way whatsoever becomes a constituent of (an) other object(s) A.I.V. will be given the ownership of this (these) new object(s) as surety of the full payment of what purchaser owes A.I.V. To this end A.I.V. and purchaser now agree that the ownership of the article(s) in question, whether finished or not, are to be transferred to A.I.V. and that this transfer of ownership will be considered to have taken place through and at the moment of the single operation or event by which the material is converted into (a) new object(s), or is mixed with or becomes a constituent of (an) other object(s). Until the moment of full payment of what purchaser owes A.I.V. purchaser shall keep the object(s) in question for A.I.V. in his capacity of fiduciary owner and, if required, shall store this (these) object(s) in such a way that it (they) can be recognized as such. Nevertheless, purchaser will be entitled to sell these objects to a third party within the framework of the normal carrying on of his business and to deliver them on condition that—if A.I.V. so requires—purchaser as long as he has not fully discharged his debt to A.I.V. shall hand over to A.I.V. the claims he has against his buyer emanating from this transaction.

Two points are worth noting about this clause. The first is its length and the second is the fact that it is not very well drafted. Notwithstanding its obvious shortcomings the Court of

Appeal held that it was effective to entitle the sellers to claim the proceeds of the sub-sales entered into by the buyer in priority to the secured and unsecured creditors of the insolvent buyer. The result was to confer a right of enormous value on the sellers in the insolvency of the buyers. It is not surprising, in the light of this decision, that sellers immediately began to insert retention of title clauses into their standard terms. Since *Romalpa* was decided, however, the courts have taken a more restrictive view of the efficacy of retention of title clauses. While they continue to be effective where the goods which have been sold to the buyers have not been mixed irrevocably with other goods (*Hendy Lennox (Industrial Engines) Ltd v. Graham Puttick Ltd* [1984] 1 WLR 485; *Armour v. Thyssen Edelstahlwerke* [1991] 2 AC 339) they are generally not effective where the goods have been mixed irrevocably (*Borden (UK) Ltd v. Scottish Timber Products Ltd* [1981] Ch 25) nor in relation to attempts to trace into the proceeds of sub-sales (*Compaq Computer Ltd v. Abercorn Group Ltd* [1991] BCC 484). The drafting of the clause in the example given by Schmitthoff is based on *Romalpa* but, in the light of cases such as *Compaq v. Abercorn*, it is probably ineffective to enable the sellers to claim the proceeds of any sub-sales. It is necessary to take great care when drafting a retention of title clause but even a well-drafted clause may be held to be ineffective to entitle a seller to trace into the proceeds of sub-sales (see *Compaq v. Abercorn*).

(c) PRICE ESCALATION CLAUSES

Price escalation clauses are of considerable importance to sellers in long-term contracts and in cases where there is a time-lag between entry into the contract and the time at which the buyer is to pay for the goods or services supplied by the seller. The clause that was in issue between the parties in *Butler Machine Tool Co Ltd v. Ex-Cell-O Corporation (England) Ltd* [1979] 1 WLR 401 was a price variation or a price escalation clause (see clause 3 of the sellers' terms and conditions, set out at p. 83, Chapter 3, Section 2(a)). As *Butler* demonstrates it is important not only to ensure that standard terms are properly drafted but also to ensure that they are incorporated into the contracts that the sellers conclude.

(d) INTEREST

The reason for inserting a clause into the contract dealing with interest is that until recently the common law rule was that interest could not be recovered as damages in respect of a failure to pay a debt when it fell due. It was therefore necessary for the parties to create a contractual right to interest by an appropriately drafted term of the contract. The need for a contractual term entitling a party to recover interest has been reduced by the enactment of the Late Payment of Commercial Debts (Interest) Act 1998. Section 1(1) of the Act provides that:

It is an implied term in a contract to which this Act applies that any qualifying debt created by the contract carries simple interest subject to and in accordance with this Part.

Section 2(1) of the Act states that the Act applies to:

a contract for the supply of goods or services where the purchaser and the supplier are each acting in the course of a business, other than an excepted contract.

A debt is a ‘qualifying debt’ unless it consists of a sum to which a right to interest or to charge interest arises by virtue of some other enactment. The parties remain free to make their own provision for the payment of interest, although any attempt to exclude the right to statutory interest in relation to the debt is void unless the contract provides a ‘substantial contractual remedy for late payment of the debt’ (see sections 8 and 9 of the Act).

(e) FORCE MAJEURE CLAUSES

A force majeure clause is a clause which entitles a party to suspend or terminate the contract on the occurrence of an event which is beyond the control of the parties and which prevents, impedes, or delays the performance of the contract (see more generally E McKendrick, ‘Force Majeure Clauses: The Gap between Doctrine and Practice’ in A Burrows and E Peel (eds), *Contract Terms* (Oxford University Press, 2007), p. 233). The precise scope of the clause will depend upon its wording and the details of the clause may be the subject of difficult negotiations between the parties. Force majeure clauses are generally inserted into contracts because the doctrine of frustration operates within very narrow limits (see pp. 701–711, Chapter 21, Section 1). Given that the courts are unwilling to adjust the contract in the event that performance becomes more onerous for one party, contracting parties who wish to preserve to themselves a degree of flexibility in the performance of a contract may agree to insert a force majeure clause into their contract. An example of a force majeure clause is provided by clause 17 of the contract between the parties in *J Lauritzen AS v. Wijsmuller BV (The ‘Super Servant Two’)* [1990] 1 Lloyd’s Rep 1 (reproduced at pp. 716–721, Chapter 21, Section 4).

A rather more complex force majeure clause was the version of clause 22 of GAFTA 100 that was litigated in *Toepfer v. Cremer* [1975] 2 Lloyd’s Rep 118. It provided:

Sellers shall not be responsible for delay in shipment of the goods or any part thereof occasioned by any Act of God, strike, lockout, riot or civil commotion, combination of workmen, breakdown of machinery, fire or any cause comprehended in the term ‘force majeure’. If delay in shipment is likely to occur for any of the above reasons, Shippers shall give notice to their Buyers by telegram, telex or teleprinter or by similar advice within 7 consecutive days of the occurrence, or not less than 21 consecutive days before the commencement of the contract period, whichever is later. The notice shall state the reason(s) for the anticipated delay. If after giving such notice an extension to the shipping period is required, then Shippers shall give further notice not later than 2 business days after the last day of the contract period of shipment stating the port or ports of loading from which the goods were intended to be shipped, and shipments effected after the contract period shall be limited to the port or ports so nominated. If shipment be delayed for more than one calendar month, Buyers shall have the option of cancelling the delayed portion of the contract, such option to be exercised by Buyers giving notice to be received by Sellers not later than the first business day after the additional calendar month. If Buyers do not exercise this option, such delayed portion shall be automatically extended for a further period of one month. If shipment under this clause be prevented during the further one month’s extension, the contract shall be considered void. Buyers shall have no claim against Sellers for delay or non-shipment under this clause provided that Sellers shall have supplied to Buyers, if required, satisfactory evidence justifying the delay or non-fulfilment.

There are three principal components of a force majeure clause. The first and most important component is the description of the events that trigger the operation of the clause. There

is no doctrine of force majeure in English law and so the phrase ‘force majeure’ is not a term of art (see *Thomas Borthwick (Glasgow) Ltd v. Faure Fairclough Ltd* [1968] 1 Lloyd’s Rep 16, 28). It is therefore for the parties to define the list of events which they intend should fall within the scope of the clause. The events included in the list are generally events that are beyond the control of the parties, such as acts of God and war. Not much significance tends to be attached to the words ‘force majeure’ themselves. Either the event will fall within the list of specific events listed in the clause or it will fall within the general words at the end of the clause. But it is rare for any dispute between the parties to focus explicitly on the words ‘force majeure’. The description of the force majeure events is generally divided into two parts. The first part consists of a list of specific events. The length of the list can vary enormously. Sometimes it is very short; at other times, it can be very long. The second part consists of a general provision which is intended to cover events not included in the specific list. Views differ as to the utility of the specific list. Some draftsmen are of the view that it is largely useless and that it suffices to use general words only. Others prefer the list on the ground that it can help reduce disputes over whether events, such as strikes, fall within the scope of the clause (although in the case of internal industrial action it can be difficult to persuade a court that it falls within the scope of a force majeure clause: see *B & S Contracts and Design Ltd v. Victor Green Publications Ltd* [1984] ICR 419).

The second component of a force majeure clause consists of the obligations of the parties in relation to the reporting of the occurrence of a force majeure event. Not all force majeure clauses set out the obligations of the parties in this regard. The clause in *Super Servant Two* does not, whereas the more elaborate clause in *Toepfer* does set out the procedure to be followed by the parties. The reporting obligations of the parties should cover matters such as the person to whom the report is to be made, the time at which the report is to be made, the form it should take, and the consequences of a failure to make a report in the prescribed fashion.

The third component consists of the remedial consequences of the occurrence of a force majeure event. Once again, the clause in *Super Servant Two* is in a simple form in that it only provides for a right to cancel the contract. The clause in *Toepfer* is a little more elaborate in that it makes provision for the extension of the contract as well as the possibility of cancellation. Force majeure clauses in fact give to the parties a high degree of remedial flexibility. Thus provision can be made for the granting of extensions of time, the suspension or variation of the contract, or even the termination of the contract. It is common for parties to make provision for the initial suspension of the contract which can lead to termination should the force majeure event continue to prevent or impede performance for a considerable period of time (such as twenty-eight days). The remedial flexibility that a force majeure clause potentially affords to the parties compares favourably with the remedial rigidity of the doctrine of frustration (on which see p. 730, Chapter 21, Section 6).

(f) CHOICE OF LAW CLAUSES

A choice of law clause assumes considerable significance when dealing with a contracting party from another jurisdiction. Take the example of a contract concluded between a seller in England and a buyer in France. The seller is likely to wish to have the contract governed by English law, whereas the buyer will, in all probability, wish to ensure that the contract is governed by French law. This gives rise to what is known as the conflict of laws. What is to happen in such a case? The answer depends upon the parties. The law allows the parties to

choose the law that is to govern the transaction. Article 3 of Regulation (EC) No 593/2008 on the law applicable to contractual obligations (generally referred to as ‘Rome I’), provides:

A contract shall be governed by the law chosen by the parties. The choice shall be made expressly or clearly demonstrated by the terms of the contract or the circumstances of the case. By their choice the parties can select the law applicable to the whole or to part only of the contract.

Article 3 of Rome I is drafted in similar terms to its predecessor, Article 3 of the Rome Convention on the Law Applicable to Contractual Obligations, the significance of which has been described in the following terms (A Briggs, *An Introduction to the Conflict of Laws* (2nd edn, Oxford University Press, 2008), p. 166):

The Convention... broadly adopts the principle of party autonomy, and draws certain conclusions from it, allowing a choice to be decisive except only in relation to limited and clearly specified matters; but it requires two things: the choice to be made, and that choice to be expressed or demonstrable. This will preclude the argument that the parties, as reasonable people, must have made a choice but which they did not trouble to express.

A choice expressed in the form ‘this contract shall be governed by the law of France’ will therefore be effective to make French law the governing law; and a less artful choice, such as ‘this contract shall be construed in accordance with French law’, will probably be taken in the same way. Life is easier when parties take advantage of the freedom to choose and express that choice clearly: Article 3 helps those who help themselves. But one could be forgiven for thinking that some draftsmen regard a clear expression of choice as being too easy, rejecting it for something more likely to generate work for the litigation department. A choice of the law of the United Kingdom, or of British law, for example, cannot be given literal effect, because there is no such law to be chosen; and to interpret this as an express choice of English law is to make an assumption which is probably factually correct but politically incorrect. Certain items are not on the menu. The Convention limits the choice which may be made to the law of a country, which excludes the possibility of choosing the *lex mercatoria*, or the principles of a religion or other cult to govern a contract; whatever these are, they do not constitute the law of a country, and they cannot govern a contract.

Greater difficulty arises in the case where the parties do not make an express choice of law. In such a case Article 4 of Rome I sets out various rules which are to be applied in determining the law that is to govern the contract. While these rules go some way to providing some certainty in terms of the identification of the governing law, they are no substitute for an express choice of law and so contracting parties who deal with foreign parties should wherever possible insert a choice of law clause into their contracts and into their standard terms and conditions of business.

(g) ARBITRATION CLAUSES

Parties frequently make provision in their contracts for the dispute resolution mechanism that is to apply in the event of a dispute between them arising out of their contract. The principal choice which the parties must make is between arbitration and litigation (although mediation and alternative dispute resolution (‘ADR’) are becoming increasingly common in commercial practice). Arbitration is commonly associated with international contracts.

Arbitration is claimed to have a number of advantages. First, it is private. It does not take place in a public court and the result of the arbitration is not publicly available. Secondly, it can have the appearance of neutrality in that it can take place at a neutral venue (unlike litigation which will often take place in the courts of the country of one of the parties to the contract). Thirdly, arbitration is more flexible in that the parties can choose where and when to arbitrate, they can often choose their arbitrators, and they can also decide, albeit within limits, the form that the arbitration is to assume. Party autonomy is a very important principle in international arbitration. Fourthly, arbitration is said to be speedier than litigation and finally it is often claimed to be cheaper.

These arguments are not, however, conclusive. Arbitration does have its disadvantages. It can be very expensive and it is not necessarily quick. A party who loses an arbitration may decide to appeal to the courts and, if the courts accept that they have jurisdiction to hear the appeal, the parties' privacy is lost as may be all hope of a quick and relatively inexpensive conclusion to the proceedings. Some of the awards issued by arbitrators are also of rather doubtful pedigree. The quality control in litigation appears to be much higher than in the case of arbitration. The parties therefore have to make a choice as to the form of dispute resolution mechanism that they wish to utilize. There is no requirement that they make that choice at the moment of entry into the contract. They can defer the decision until such time as a dispute occurs between the parties. But many parties do make the decision at the time of entry into the contract.

Parties who wish to ensure that disputes arising out of their contract are referred to arbitration rather than litigation must draft a suitably worded arbitration clause and the clause must be drafted with care. It is not necessary to go into the drafting details here. It suffices to give two examples of an arbitration clause, one taken from an international arbitral institution and the other from a clause in the contract between the parties in one of the leading contract cases in recent years. The clause taken from the international arbitral institution is the UNCITRAL Model Arbitration clause which provides:

any dispute, controversy or claim arising out of or relating to this contract, or the breach, termination or invalidity thereof, shall be settled by arbitration in accordance with the UNCITRAL Arbitration Rules as at present in force.

The clause taken from the leading case is the opening part of the arbitration clause agreed between the parties in *Alfred McAlpine Construction Ltd v. Panatown Ltd* [2001] 1 AC 518 (discussed in more detail at pp. 833–845, Chapter 23, Section 3). Clause 39.1 of the contract provided:

When the Employer or the Contractor require a dispute or difference as referred to in Article 5 to be referred to arbitration then either the Employer or the Contractor shall give written notice to the other to such effect and such dispute or difference shall be referred to the arbitration and final decision of a person to be agreed between the parties as the Arbitrator, or, upon the failure so to agree within 14 days after the date of the aforesaid written notice, of a person to be appointed as the Arbitrator on the request of either the Employer or the Contractor by the person named in Appendix 1 to the Conditions.

One of the interesting features of the litigation between Panatown and McAlpine was that the corporate group of which Panatown was a member had a choice between litigating the dispute with McAlpine in the courts or invoking the arbitration clause in the contract

between Panatown and McAlpine. They chose the latter option. With the benefit of hindsight it can be seen that the choice was a dubious one because McAlpine exercised its rights under the contract to appeal to the High Court against the provisional award of the arbitrator. So, in the event, the parties found themselves embroiled in complex litigation as well as arbitration (see further E McKendrick, ‘The Common Law at Work: The Saga of *Alfred McAlpine Construction Ltd v. Panatown Ltd*’ (2003) 3 *Oxford University Commonwealth Law Journal* 145). The choice between arbitration and litigation is an important one that must be made with some care.

(h) JURISDICTION CLAUSES

If litigation is the preferred method of dispute resolution then consideration ought to be given to the jurisdiction in which the dispute is to be litigated. Within Europe the law gives the parties considerable freedom of choice in relation to the selection of the appropriate jurisdiction. Article 23 of Council Regulation (EC) No 44/2001 of 22 December 2000 provides:

If the parties, one or more of whom is domiciled in a Member State, have agreed that a court or the courts of a Member State are to have jurisdiction to settle any disputes which have arisen or which may arise in connection with a particular legal relationship, that court or those courts shall have jurisdiction. Such jurisdiction shall be exclusive unless the parties have agreed otherwise. Such an agreement conferring jurisdiction shall be either:

- (a) in writing or evidenced in writing;
- (b) in a form which accords with practices which the parties have established between themselves; or
- (c) in international trade or commerce, in a form which accords with a usage of which the parties are or ought to have been aware and which in such trade or commerce is widely known to, and regularly observed by, parties to contracts of the type involved in the particular trade or commerce concerned.

Jurisdiction is a complex issue and it is beyond the scope of this book (see more generally A Briggs, *The Conflict of Laws* (2nd edn, Oxford University Press, 2008), ch. 3). We shall, however, encounter jurisdiction clauses in the context of the important decision of the Privy Council in *The Mahkutai* [1996] AC 696, a case which is discussed at some length at pp. 991–998, Chapter 25, Section 3(d).

Some other standard terms not mentioned in *Schmitthoff* are as follows:

(i) HARDSHIP CLAUSES

A clause which is frequently inserted into a contract to deal with unforeseen events which make performance of the contract more onerous than originally anticipated is a hardship clause. An example of such a clause can be found in *Superior Overseas Development Corporation v. British Gas Corporation* [1982] 1 Lloyd’s Rep 262, 264–265 in the following terms:

- (a) If at any time or from time to time during the contract period there has been any substantial change in the economic circumstances relating to this Agreement and (notwithstanding the effect of the other relieving or adjusting provisions of this Agreement)

either party feels that such change is causing it to suffer substantial economic hardship then parties shall (at the request of either of them) meet together to consider what (if any) adjustments(s) in the prices...are justified in the circumstances in fairness to the parties to offset or alleviate the said hardship caused by such change.

- (b) If the parties shall not within ninety (90) days after any such request have reached agreement on the adjustments (if any) in the said prices...the matter may forthwith be referred by either party for determination by experts...
- (c) The experts shall determine what (if any) adjustments in the said prices or in the said price revision mechanism shall be made...and any revised prices or any change in the price revision mechanism so determined by such experts shall take effect six (6) months after the date on which the request for review was first made.

Such a clause should define the circumstances in which ‘hardship’ exists and should then lay down a procedure to be adopted in the event that these circumstances occur. The vitally important matter is to ensure that the clause provides a mechanism or a sanction to be applied in the event that the parties fail to reach agreement or refuse to enter into negotiations with a view to adjusting the contract. A common sanction, employed in *Superior Overseas Development Corporation*, is to provide for the intervention of a third party expert or arbitrators (but not a judge sitting in a court of law) should the parties fail to reach agreement themselves.

The advantage of a hardship clause is that it is designed to enable the relationship between the parties to continue, albeit on different terms. Given that the courts at common law have no power to adjust the terms of a contract to meet changed circumstances (see p. 730, Chapter 21, Section 6), this can be a useful clause to incorporate should the parties wish to make provision for the adjustment (rather than the suspension or termination) of the contract.

(j) ENTIRE AGREEMENT CLAUSES

Entire agreement clauses are frequently relied upon in an attempt to prevent one party from asserting that the written contract is not the sole repository of the terms of the contract and that there is in fact another term of the contract which has been broken by the other party. The aim is thus to prevent liability arising for breach of contract outside of the terms of the written agreement. Entire agreement clauses can also be utilized for another purpose, namely to attempt to eliminate any possible liability for misrepresentation. Not all entire agreement clauses attempt to fulfil this second function. For example, in *Deepak Fertilisers and Petrochemicals Corporation v. ICI Chemicals & Polymers Ltd* [1999] 1 Lloyd’s Rep 387 the entire agreement clause consisted of the following:

This contract comprises the entire agreement between the parties, as detailed in the various Articles and Annexures and there are not any agreements, understandings, promises or conditions, oral or written, expressed or implied, concerning the subject matter which are not merged into this contract and superseded hereby. This contract may be amended in the future only in writing executed by the parties.

It was held that this clause was effective to exclude liability in respect of a collateral warranty. But it does not attempt to exclude liability for misrepresentation. A slightly more elaborate entire agreement clause is illustrated by *Watford Electronics Ltd v. Sanderson CFL*

Ltd [2001] All ER (Comm) 696 where the entire agreement clause was drafted in the following terms:

The parties agree that these terms and conditions (together with any other terms and conditions expressly incorporated in the Contract) represent the entire agreement between the parties relating to the sale and purchase of the Equipment and that no statement or representations made by either party have been relied upon by the other in agreeing to enter into the Contract.

The addition of the words ‘and that no statement or representations made by either party have been relied upon by the other in agreeing to enter into the Contract’ were inserted in order to exclude liability for misrepresentation. Clear words are required in order to exclude liability for misrepresentation (*Axa Sun Life Services plc v. Campbell Martin Ltd* [2011] EWCA Civ 133, [2011] 2 Lloyd’s Rep 1), although whether the words are effective so to exclude liability depends upon an evaluation of the words which have been used in the particular clause (at pp. 623–624, Chapter 17, Section 6). The modern practice of inserting entire agreement clauses into contracts is in many ways a reaction to the relaxation of the parol evidence rule (on which see pp. 308–312, Chapter 8, Section 4).

(k) TERMINATION CLAUSES

Contracting parties frequently produce standard form termination clauses which they insert into their contracts. Termination tends to be seen as an important right (or, if one prefers, remedy) in English contract law. The drafting of termination clauses can be a difficult matter (for an example see *Rice (t/a Garden Guardian) v. Great Yarmouth Borough Council* [2003] TCLR 1 CA, at pp. 789–792, Chapter 22, Section 3(e)). We shall examine termination clauses in more detail in a subsequent chapter (see pp. 789–793, Chapter 22, Section 3(e)).

(l) ASSIGNMENT

The law allows parties, within prescribed limits, to assign their rights under the contract to another party. Standard terms of contract frequently regulate the entitlement of contracting parties to assign their rights. For example, clause 17(1) of the contract between the parties in *Linden Gardens Trust Ltd v. Lenesta Sludge Disposals Ltd* [1994] 1 AC 85 provided:

The Employer shall not without the written consent of the Contractor assign this Contract.

This clause is, in fact, drafted rather loosely in that it is the rights under the contract that are assigned and not the contract itself (see further pp. 983–985, Chapter 25, Section 3(c)(iii)). But the House of Lords nevertheless gave effect to the clause and held that an attempted assignment of contractual rights in breach of the prohibition contained in clause 17 was ineffective to transfer any such contractual rights to the assignee.

(m) EXCLUSION AND LIMITATION CLAUSES

Exclusion and limitation clauses are both extremely important boilerplate clauses and they constitute the subject matter of the next chapter.

FURTHER READING

CHRISTOU, R, *Boilerplate: Practical Clauses* (4th edn, Sweet & Maxwell, 2005).

McKENDRICK, E, 'Force Majeure Clauses: The Gap between Doctrine and Practice' in A Burrows and E Peel (eds), *Contract Terms* (Oxford University Press, 2007), p. 233.