HFW

CONTRACT INTERPRETATION

Has there been a shift since Wood v Capita?

white paper

MAX WIELICZKO

Partner

T: +44 (0)20 7264 8036

E: max.wieliczko@hfw.com

AIM OF CONTRACT INTERPRETATION

- Contract = Agreement
- Interpretation is the process of establishing what Parties *actually* agreed
- Important where some *ambiguity* or *uncertainty*

Investors Compensation Scheme v West Bromwich [1998] HofL

"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...at the time of the contract"

[Lord Hoffmann]

AMBIGUITY?

- What do we mean by ambiguity?

  "I like Dogs and Cats which are black and fluffy"

- Do I like all and ***any*** Dogs? Do I like ***white*** Dogs?

- Or do the Dogs have to be ***black and fluffy***?

LIMITS TO INTERPRETATION

- Courts/Tribunals applying the Common Law should not make a bargain for the Parties
- Tribunal should not ***re-write*** an agreement to accord with what it might think is "fair" or "reasonable"
- Establishing the proper interpretation of a contract is an ***objective process*** aimed at establishing the Parties' ***subjective*** intention
- Supreme Court has summarised the position, and the approach to be applied, in two leading Cases

PRINCIPLES OF INTERPRETATION

- Supreme Court ~ ***Marley v Rawlings [2014]*** and ***Arnold v Britton [2015]***

> ***"When interpreting a contract, the Court is concerned to find the intention of the...Parties, and it does this by identifying the meaning of the relevant words***
>
> ***a. in the light of***
>
> ***i the natural and ordinary meaning of those words***
>
> ***ii the overall purpose of the document***
>
> ***iii any other provisions of the document***
>
> ***iv the facts known or assumed by the parties at the time that the document was executed and***
>
> ***v common sense***
>
> ***but***
>
> ***b. ignoring subjective evidence of any party's intentions"***
>
> ***[Lord Neuberger]***

- Question is what relative ***weight*** to give to each of these Principles

PRINCIPLES (2)

"The natural and ordinary meaning of words"

- Start by looking at the *usual* or *normal* meaning of the words used
- But the meaning of a contract is not the same 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...to conclude that the parties must, for whatever reason, have used the wrong words or syntax"***
>
> ***[Lord Hoffmann]***
>
> ***Investors Compensation Scheme v West Bromwich [1998]***

PRINCIPLES (3)

"The overall purpose of the document"

- To ascertain the underlying aim/objective of the Contract you construe the Contract ***as a whole***
- Don't consider the ambiguous clauses/provisions in isolation
- Court/Tribunal should try and ***give effect to all parts*** of the Contract
- Presumption against there being *redundant* wording
- Wording should not be nullified unless **"*impossible to reconcile*"**

- ***Re Strand Music Hall [1865] CofA***

PRINCIPLES (4)

"The facts known or assumed by the Parties at time document executed"

- Should interpret the Contract wording against the background of:

> ***"...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...***
>
> ***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"***

- But

> ***"The law excludes from the admissible background the previous negotiations of the Parties and their declarations of subjective intent...for reasons of practical policy..."***
>
> ***[Lord Hoffmann]***
>
> ***Investors Compensation Scheme v West Bromwich [1998] HofL***

PRINCIPLES (5)

"Common Sense"

- Why is the ***background*** important?

> ***"The "rule" that words should be given their "natural and ordinary meaning" reflects the common sense 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 Hoffmann]***
>
> ***Investors Compensation Scheme v West Bromwich [1998] HofL***

DIFFERENT APPROACHES TO INTERPRETATION

- Tension always between whether to give more emphasis to:

  (1) ***factual background*** and ***business common sense.*** Adopting a ***"purposive"*** construction of the Contract **"Contextual Approach"**

  or

  (2) ***normal ordinary/meaning of the words*** actually used even if this produces an arguably "unfair" or odd result **"Textual Approach"**

- Danger with (1) is that Courts/Tribunals are tempted to re-write the bargain the Parties actually agreed

WOOD v CAPITA - A CHANGE OF EMPHASIS?

Wood v Capita Insurance [2017] Supreme Court

- Sale of a Company (an Insurance Broker) by a Seller to a Buyer
- Contract being interpreted was the Share Purchase Agreement ("**SPA**") which provided for the Sale of the shares in the Company
- Dispute about mis-selling of insurance by the Seller when it owned the Company and before the purchase of the Shares by the Buyer
- When the Buyer discovered there had been mis-selling of insurance prior to sale the Company (now owned by the Buyer) it referred itself to the Regulator
- The Financial Services Authority ("**FSA**") fined the Company **£2.5million**
- Buyer wanted to recover the fine from the Seller

A CHANGE OF EMPHASIS (2)

Wood v Capita (Cont.)

- ***Warranty*** in the SPA from the Seller to the Buyer which everyone agreed was wide enough to include **any** losses, expenses, claims or ***fines*** imposed on the Company, due to mis-selling of insurance prior to the sale of the Shares
- But Warranty was time-limited - only lasted for 2 years after the date of the sale of the Company. And the 2 years had expired
- Buyer needed instead to rely on a separate ***Indemnity*** in the SPA
- An indemnity is a promise to hold a person harmless
- Depending on its terms an indemnity is either not time limited at all, or has a time for enforcement of either 6 or 12 years from the point at which the losses were actually sustained by the Party to be indemnified

INTERPRETATION OF WOOD v CAPITA INDEMNITY

- The scope and extent of the indemnity was ambiguous:

> ***"The Seller undertakes to pay the Buyer an amount equal to the amount required to indemnify the Buyer against all actions, proceedings, losses, claims, damages, costs, charges, expenses and liabilities suffered or incurred, and all fines, compensation or remedial action or payments imposed on the Company arising out of claims or complaints registered with the FSA, or any other Authority against the Company, and relating to any mis-selling of any insurance product or service"***

- Seller said the indemnity did **not** apply because it did not cover a fine following a ***self-referral*** by the Company
- Seller said the indemnity only applied to a fine following ***"claims or complaints registered with the FSA, or any other Authority against the Company"***

INTERPRETATION THE INDEMNITY (2)

- Buyer claimed indemnity <u>did</u> apply, because the indemnity in relation to mis-selling should be read as being in two Parts:
  - Part (1) ***"all actions, proceedings, losses, claims, damages, costs, charges, expenses and liabilities suffered or incurred"***
    - which the Buyer said was wide and could include a fine following a *self-referral*, because it was not limited in any way

  and

  - Part (2) ***"all fines, compensation or remedial action or payments imposed on the Company arising out of claims or complaints registered with the FSA, or any other Authority against the Company"***
    - which the Buyer accepted might be restricted to where there was a claim or complaint by a Third Party

INTERPRETATION THE INDEMNITY (3)

"The Seller undertakes to pay the Buyer an amount equal to the amount required to indemnify the Buyer against all actions, proceedings, losses, claims, damages, costs, charges, expenses and liabilities suffered or incurred, and all fines, compensation or remedial action or payments imposed on the Company arising out of claims or complaints registered with the FSA, or any other Authority against the Company, and relating to any mis-selling of any insurance product or service"

"The Seller undertakes to pay the Buyer an amount equal to the amount required to indemnify the Buyer against:

all actions, proceedings, losses, claims, damages, costs, charges, expenses and liabilities suffered or incurred,

and

all fines, compensation or remedial action or payments imposed on the Company arising out of claims or complaints registered with the FSA, or any other Authority against the Company,

and relating to any mis-selling of any insurance product or service"

INTERPRETATION THE INDEMNITY (3)

Buyer wanted provision to read as two separate indemnities

"I like Dogs and Cats which are black and fluffy"

"The Seller undertakes to pay the Buyer an amount equal to the amount required to indemnify the Buyer against:

all actions, proceedings, losses, claims, damages, costs, charges, expenses and liabilities suffered or incurred,

(1) Dogs

and

all fines, compensation or remedial action or payments imposed on the Company arising out of claims or complaints registered with the FSA, or any other Authority against the Company,

(2) Cats which are black and fluffy

and relating to any mis-selling of any insurance product or service"

INTERPRETATION OF INDEMNITY (4)

- Buyer argued for a “common sense” ***purposive*** interpretation based on what it said was the underlying objective of the indemnity in relation to mis-selling
- Buyer claimed it made no sense at all for the indemnity to apply where there was a ***complaint*** or ***claim*** by a Third Party to the FSA
- But not to apply (as the Seller claimed) where there was a ***self-referral*** by the Company after it discovered the mis-selling itself

MORE EMPHASIS ON THE WORDS USED

- The Supreme Court rejected the Buyer's case
- Court emphasised "textual" approach
- Supreme Court acknowledged that:

> ***"From [the Buyer's] standpoint the SPA may have become a poor bargain...but it is not the function of the Court to improve their bargain***
>
> ***In this case, the circumstances which trigger the indemnity are to be found principally in a careful examination of the language which the parties have used"***

[Lord Hodge]

Wood v Capita [2017]


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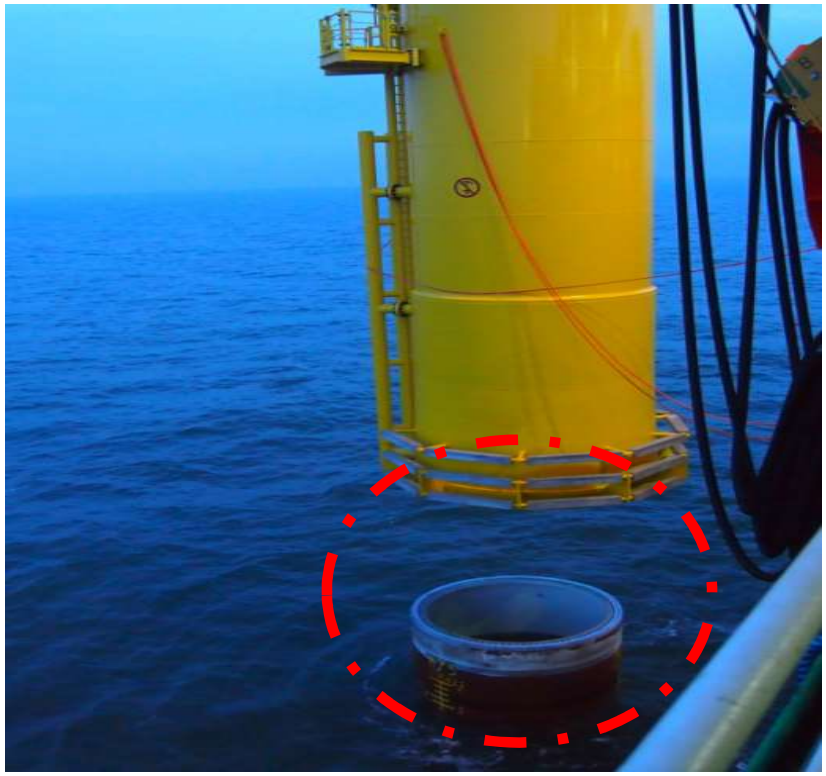
Has Wood v Capita
made a Difference?

EXAMPLE OF WOOD v CAPITA CHANGING THINGS

- ***MT HØJGAARD V E.ON [2017]***



- Robin Rigg Off-Shore Wind Farm, constructed by Højgaard, in Solway Firth
- Issue was liability for the cost of remedial works needed to rectify defects in Foundations
- Defects affected the grouted connections between the Monopiles and the Transition Pieces - which began to fail shortly after Take Over of the Project

MT HØJGAARD v E.ON (2)

- TP/MP Grouted Connections failed due to a problem with their Design
- A key parameter of the Design had been specified by the Employer
- The Employer had made the internationally recognised DNV Design Standard part of the Employer's Requirements
- DNV Design Standard was relied on throughout the Off-Shore Wind Industry
- **But** a basic calculation error in the DNV Standard meant that if followed the Grouted Connection was bound to fail

MT HØJGAARD v E.ON (3)

- **Contract Conditions** set out the Contractor's obligations:

> *"8.1 The Contractor shall, in accordance with this Agreement, design, manufacture, test, deliver and install and complete the Works:*
>
> *(i) with due care and diligence...*
>
> *(iv) in a professional manner...in accordance with...Good Industry Practice...*
>
> *(x) so that each item of...the Works...shall be fit for its purpose as determined in accordance with the Specification using Good Industry Practice...*
>
> *(xv) so that the design of the Works...shall satisfy any performance specifications or requirements...."*

- **Employer's Requirements** contained the following key provision:

> *"3.2 The design of the foundations shall ensure a lifetime of 20 years..."*

COURT OF APPEAL - MT HØJGAARD v E.ON (4)

- Court of Appeal found that provisions in the Employer's Requirements requiring achievement of a ***20 year design life*** were inconsistent with the other requirements in the Contract

- Held that this ***20 year design life*** had to be read in the context of the Employer's requirement, set out in the Contract, that the Contactor should construct in accordance with DNV Standard

Image Per Hakonsen

COURT OF APPEAL - MT HØJGAARD v E.ON (5)

- Court of Appeal noted that the DNV Standard was at the top of the hierarchy of Contract Documents and it was ***"intended to lead to offshore structures with a design life of 20 years"***
- But that this was not the same as a Warranty (i.e. a contractual promise) by the Contractor to definitely achieve that design life
- Therefore the performance requirement of ***20 years*** could:
  - ~ effectively be ignored

    or
  - ~ Should be treated as imposing an obligation to undertake design work with the ***aim*** of providing a 20 year facility, but without imposing on the Contractor any absolute warranty to this effect

COURT OF APPEAL - MT HØJGAARD v E.ON (6)

- Court of Appeal concluded:

> ***"A reasonable person in the position of E.ON and Højgaard would know that the normal standard required in the construction of offshore wind farms was compliance with [DNV Standard] and that such compliance was expected, but not absolutely guaranteed, to produce a life of 20 years***
>
> ***...it does not make sense to regard them as overriding all other provisions of the contract and converting it to one with a guarantee of 20 years life..."***

- Court of Appeal put significant weight on the presumed factual background i.e. What industry expectations were. It adopted a ***purposive*** approach to the interpretation of the Contract
- Court of Appeal approached the Case as if there was an ***ambiguity*** between wording of Contract Documents, that could and should, be resolved by the contractual hierarchy

SUPREME COURT - MT HØJGAARD v E.ON (7)

- ***Højgaard v E.ON*** was appealed by the Employer to the Supreme Court
- Judgement in August 2017 and overturned the Court of Appeal's Decision
- Held that the natural meaning the Employer's Requirements was that the Contractor had ***guaranteed*** the design and
- The Contract did contain a ***fitness for purpose warranty*** that the design would perform for 20 years

SUPREME COURT - MT HØJGAARD v E.ON (8)

- **Lord Neuberger** (4 other Judges agreed) said that the ***natural meaning*** of the Contract was that either:

  (1) the Contractor was warranting that ***the foundations*** would have a lifetime of 20 years

  or

  (2) the Contractor warranted that ***the design*** of the foundations would be such as to give them a lifetime of 20 years

SUPREME COURT - MT HØJGAARD v E.ON (9)

- Supreme Court referred to its Judgment, six months earlier (in March), in ***Wood v Capita [2017]***
- Supreme Court re-asserted a more ***textual*** approach (as opposed to contextual) and re-stated the ordinary principles of contractual interpretation:

> ***"...[3.2] is clear in its terms in that it appears to impose a duty on [the Contractor] which involves the foundations having a lifetime of 20 years (although.....there is room for argument as to its precise effect)***
>
> ***I do not see why that can be said to be an "improbable [or] un-businesslike" interpretation, especially as it is the natural meaning of the words used…."***
>
> ***[Lord Neuberger]***

SUPREME COURT - MT HØJGAARD v E.ON (10)

- ***Højgaard*** contract was an example of different obligations:
  - to exercise "***reasonable skill and care***"
  - that design would be ***"fit for purpose"***
  - and elsewhere that Contractor would ***"ensure a design life of 20 years"***
- Decision reflects that these are not necessarily in conflict
- ***Reasonable Skill and Care*** is normally a ***lesser*** "service" based obligation, but its also a different in nature, and can therefore co-exist with, a "product/performance" based ***Fitness for Purpose*** obligation

IMPORTANCE OF WOOD v CAPITA

- ***Wood v Capita*** – potentially marks a profound change in approach
- Emphasis now to be on a Textual approach
- A severe "clipping of the wings" of lower Courts ability to reinterpret Contracts by reference to ***Investors Compensation Scheme v West Bromwich*** and its infamous ***"factual background/matrix"***
- Contracting Parties increasingly will be held to a more literal wording of the contracts that they sign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MAX WIELICZKO

Max.wieliczko@hfw.com
+44 (0)20 7264 8036

Max Wieliczko is a senior Partner in HFW's International Construction Team and has specialised exclusively in construction law since 1987

He advises in relation to all aspects of project procurement and delivery, and specialises in project support and international dispute resolution both in court and arbitration around the world. He has particular expertise in relation to complex high value international infrastructure projects.

Work includes oil and gas production facilities, process plants, tunnelling, roads, railways and bridges, energy from waste facilities and other power plants; on and off-shore wind, hydro electric, hospitals, hotels, factories, and major city developments. Max is co-author of ***Construction Contract Variations***, published by Informa Law, and which is the only current specialist text book on the subject and described in reviews as ***"a master guide"*** (International Construction Law Review) and ***"an indispensable classic"*** (Law Society Gazette)

Max is also a regular conference speaker and has published articles in a number of legal and construction industry journals

Legal Directories say: ***"He's extremely quick and clever, and I feel assured with him in my corner"*** (Chambers 2018) and he ***"has superb industry knowledge and experience combined with an amazing ability to see through complex matters from the outset"*** (Chambers 2017)