INTERPRETATION OF CONTRACTS

CATHERINE MITCHELL

current controversies

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How far should it be possible for courts, through the process of interpretation, to control the bargain made between parties? Are judges applying the principles of interpretation in the same way? What is the relevant context of an agreement? Should contracting parties be able to opt out of a particular interpretative approach by use of mechanisms such as entire agreement clauses?

Many contract disputes ultimately turn upon the meaning attributed to contractual documents by judges. Lord Hoffman's judgment in *Investors Compensation Scheme v West Bromwich Building Society* included a modern restatement of the rules of interpretation to be applied by the courts which favoured a more contextual approach to contractual interpretation. This judgment has generated controversy within the legal profession and sparked academic debate on a previously neglected topic. This short book examines what contextual interpretation means, the arguments for and against contextual interpretation, and suggests ways in which the parties may be able to influence the interpretation methods applied to their agreement.

Examining case law, academic debate and the resurgence of interest in formalist contract interpretation in the US, this text identifies the controversial issues, explores the range of arguments and analyses possible future developments.

Catherine Mitchell is Senior Lecturer in Law at the University of Hull.

Dedicated to Kitty and the memory of Keith

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Preface

This book examines the controversies that surround the question of how contracts should be interpreted by courts, that is, how the courts decide the meaning of a contract, and identify the obligations the parties have undertaken to each other. It is not intended to be a comprehensive statement of interpretation rules applied by courts, nor does it attempt to analyse all the doctrines of contract law that might be reckoned to be 'interpretative' in one sense or another. I have tried to consider some issues that seem to have been neglected by others working in the field, such as the extent to which the parties can influence the courts' interpretative method. I also try to identify the factors that have been, or are likely to become, material in influencing contracts interpretation. The book therefore seeks to present an overview of the subject, rather than a detailed analysis of all its aspects, and I hope it will serve as a useful introduction for those who are relatively new to contract law, and who might wonder why interpretation matters, as well as being of interest to scholars and practitioners.

My friends and colleagues at the Law School, University of Hull, and elsewhere, have provided support, advice and assistance of various kinds while I have been engaged on the book. I would like to thank in particular Bev Clucas, Fiona Cownie, Gerry Johnstone, Peter Paulden and Tony Ward. I am very grateful to Christian Twigg-Flesner, who read the entire work in draft, and offered many helpful suggestions and comments. Some of the material in chapters four and five is based upon an article of mine, 'Entire Agreement Clauses: Contracting Out of Contextualism', which appeared in the 2006 volume of the *Journal of Contract Law*. I am grateful to Professor John Carter for his assistance. Finally, I thank Alex and Tom for their patience, encouragement and sense of humour.

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Chapter 1

The nature and scope of contractual interpretation

Introduction

What is contractual interpretation and how do courts carry it out? This short book examines these related and controversial questions. Much recent work on the subject has been prompted by Lord Hoffmann's restatement of the principles of contractual interpretation in *Investors Compensation Scheme v West Bromwich Building Society*.[1] As has been noted by many, despite the practical importance of interpretation in contract disputes, the subject was largely ignored by contract scholars prior to the *Investors* judgment. This might have been because of the belief that the subject could be reduced to a few simple 'rules of construction', the main rule being that words in the contract should be interpreted according to their plain, natural or ordinary meaning. Lord Hoffmann's restatement has become a point of focus because he articulated a shift away from this simplistic approach in favour of contextual interpretation.[2] This contextual method is variously described as involving reference to the 'background' or 'factual matrix' of the contract, or the 'reasonable expectations of the parties', or the 'commercial purposes' of the agreement or 'business common sense'. These would seem to be just different ways of saying the same thing: that contractual interpretation is not just a process of unreflectingly grasping the plain meaning of the words of the contractual text and applying them to the facts of the dispute, but involves a wider examination of the contractual circumstances, which might include almost any information relevant

1 [1998] 1 All ER 98.

2 Ibid., pp 114–15. See also the statement from Lord Steyn in *Sirius International Insurance Company v FAI General Insurance Ltd* [2004] UKHL 54 at [19].

to understanding the agreement, with one or two notable exceptions. In short, contractual interpretation must now be understood as an inclusive rather than an exclusive process.

The *Investors* decision is almost 10 years old and now would seem to be a good time to take an overview of its impact and influence. Most contract scholars are broadly supportive of the change in direction in interpretation – even arguing that it does not go far enough – whereas practitioners and some judges have been more guarded. Whether there has been any significant change in direction by the courts is a matter of dispute – the transformation in interpretative method may be more apparent than real.[3] But it is not clear that anything of great significance turns on the debate over whether the contextual approach is really novel or whether Lord Hoffmann can claim credit for authoring the change. Rather, while the shift to the contextual approach *appears* to be controversial, the exact lines of the debate are difficult to draw. For example, the obvious controversy in contractual interpretation is over the existence and role of plain or literal meaning, since some will argue that the plain meaning approach should not be displaced by contextual interpretation.[4] But it is certainly a mistake to regard 'contextual' and 'literal' interpretation as polar opposites, or as the only two possible techniques in contractual interpretation. Identifying the genuine debates requires close attention to the questions of what contractual interpretation is, when it is required and what the purposes of it are. The book will not necessarily take judicial pronouncements on interpretation at face value. Rather, it will try to draw out the substance of the changes that have taken place in an attempt to uncover the areas of agreement and controversy in contractual interpretation. In doing so, it will address matters that have so far been largely ignored by contract scholars, such as whether and how interpretation can be distinguished from other tasks a court might undertake, whether it is possible for the parties to control the interpretative method applied to their agreement and the 'context' of the shift to contextual interpretation.

There are two points to make at the outset. First, my concern is with commercial contractual interpretation, rather than consumer

3 For example, see the statement from the trial judge in *Mitsubishi Corp v Eastwind Transport* [2004] EWHC 2924 at [28].

4 See for example, Davenport, B.J., 'Thanks to the House of Lords' (1999) 115 *LQR* 11.

contracting. The latter, characterised as it often is by inequality of bargaining power, raises particular issues that cannot be dealt with here. In relation to consumer contracting, interpretation of terms cannot be the whole story, as policy issues concerning fairness and transparency of terms are also important. Second, the book is not concerned with attempting comprehensive coverage of all the issues and cases in relation to contractual interpretation. Rather, it attempts to concentrate on fewer cases in more detail, and particular areas of difficulty or disagreement.

In the remainder of this chapter the notions of 'interpretation' and 'contract' will be examined more fully. Some introductory points concerning contractual controversies and contractual power will be made. The question of whether it is possible to distinguish interpretation from other techniques, which a court might apply to an agreement to extract its meaning, will also be explored. The range of interpretative problems that arise, and some of the reasons *why* interpretation disputes arise, will be discussed. The overall aim of this chapter is to demonstrate the difficulties of reining in the ideas of both 'contract' and 'interpretation'. The resulting pervasiveness of contextual contractual interpretation has potential implications for the balance of power between judges and the parties. More specifically, it is possible to perceive 'contextual interpretation' as operating on two different levels. The first level is in relation to 'meanings of words' problems in the contractual documents. This is the most familiar area for the operation of 'context' in contract. But the second, broader level is in relation to assessing the contractual relationship and contractual obligations as a whole. In this broader sense, contextualism involves examining a wider range of materials, not only to assist in interpreting the words of the agreement, but also to assist in understanding the entire contractual relationship, including, but not limited to, deciding what the parties were trying to achieve by their agreement. If contextual interpretation cannot be confined to the process of just discovering the meaning of words, it arguably becomes easier to use the process of 'contextual interpretation' to justify a departure from those words.

Chapter 2 will consider the 'contextual' approach to contracts in greater detail, scrutinising Lord Hoffmann's dicta in *Investors* and the subsequent case law. Chapter 3 considers some of the problems that arise from the contextual approach, such as the availability of multiple contexts for an agreement, and the role of plain meaning. Chapter 4 considers what is often taken to be the alternative to

contextualism, some variety of formalism in contractual interpretation. Chapter 5 examines whether and how the parties might have some control over the interpretative method adopted by a court. The broad argument is that, given the courts are required to balance an increasing number of considerations in contractual interpretation, there should be greater scope for the parties to control, or at least influence, the choice of interpretative method applied to their agreement.

What is interpretation?

This basic question is perhaps the most difficult one to answer at the outset, since 'interpretation' is, by its nature, an elusive concept. It is difficult to advance any widely accepted view of what interpretation is and how it should be conducted, since almost everything claimed in relation to interpretation is disputed. Indeed, disputes about the general concept of interpretation account for many of the controversies surrounding contractual interpretation, although this may not always be recognised. Similarly, explaining a 'contract' is not always as straightforward as it might appear. Nevertheless, some preliminary points need to be made. Before that, though, a brief word about terminology needs to be given. Debates in interpretation generally manifest themselves between different 'camps'. Thus there is the 'textualist' (or literalist), who approaches the interpretative task with a belief that the text is largely self-sufficient and can be interpreted without reference to any extrinsic evidence. The textualist may be at odds with both 'contextualists' and 'intentionalists' in interpretation. Contextualism is broadly the position that material other than the text is important to the interpretative task, and intentionalism is the position that interpretation involves the search for author's intent. Despite the possibility for a neat classification, there is a potential source of confusion here, since while one can contrast the 'textualist' with a 'contextualist', one can also refer to *contextual meanings of a text* contrasted with literal, ordinary, plain or natural meanings of a text. In contract, contextual interpretation is usually the process of fixing upon contextual meanings of the words of the text. Hence, the common opposing positions are usually described as between 'literalists' and 'contextualists' or 'literalists' and 'purposivists'. This means that 'contextualism' cannot always be fully distinguished from 'textualism', where this latter word signifies a belief in the freestanding nature of texts. The difficulty is that 'contextualism' may also express the position of scepticism that the contractual

text should carry much weight at all in the identification of the parties' obligations. In other words, there is a version of contextualism in contract that denies the central importance of the text.[5] This is discussed more fully below, but one needs to sound a note of caution, since participants in interpretation debates do not all use the same terminology, nor do they all necessarily mean the same thing by 'contextualism' or 'contextual interpretation'. It will generally be apparent from the discussion which particular position is referred to, and the words literal, ordinary, plain, conventional or natural meaning will be used more or less interchangeably, unless otherwise indicated.

A general theory of interpretation?

The difficulties we may face in explaining the nature of contractual interpretation reflect wider debates about what interpretation means and how it should be undertaken in other areas – in literature and the arts for example. The fact that interpretation operates across many different activities and contexts causes some scholars to doubt whether any general theory of interpretation of texts – whether legal, literary or other – is either possible or desirable. Sunstein, for example, writes, 'Interpretive practices are highly dependent on context and on role, and by abstracting from context and role, any theory is likely to prove uninformatively broad, or to go badly wrong in particular cases.'[6] Many such differences suggested by 'context' and 'role' are, of course, immediately apparent. So, for example, 'interpretations of legal texts invoke coercive state power, while interpretations of literary texts do not'.[7] Similarly, a contract evidently stands in a different position to a statute, since it only has coercive power over the parties to it and only then to the extent that they invoke the law to assist in enforcement. The point is, that the meaning to be extracted from contractual documents may not be just a function of the application of any particular interpretative theory, but depends upon the values that judges take contract law to embody, together

5 Collins, H., 'Objectivity and Committed Contextualism in Interpretation', in S. Worthington (ed.) *Commercial Law and Commercial Practice*, 2003, Oxford: Hart, pp 189, 192 (hereafter 'Committed Contextualism').

6 Sunstein, C., *Legal Reasoning and Political Conflict*, New York: OUP, 1996, p 167.

7 Baron, J., 'Law, Literature and the Problems of Interdisciplinarity' (1999) 108 *Yale LJ* 1059, 1080.