



Client Alert
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SAY WHAT YOU MEAN THEN YOU'LL MEAN WHAT YOU SAY

Are you in a dispute over a policy term?

If you are involved in a coverage dispute involving the interpretation of a policy term, you will be interested in the judgment handed down by the House of Lords on Wednesday 1 July in *Chartbrook -v- Persimmon Homes* [2009] UKHL 98.

This judgment had been eagerly anticipated as it was expected to deal with the vexed question as to whether evidence of pre-contract negotiations is admissible in interpreting the meaning of a contract. The existing rule is that such evidence is not admissible (known as 'the exclusionary rule') but this has been questioned by academics and members of the judiciary.

Lord Hoffman gave the lead judgment in the *Persimmon* case. He has had considerable influence on the law of interpretation of contracts, having also given the lead judgment in *ICS -v- West Bromwich* [1998] 1 WLR 896 which summarises the universal principles which courts will apply when attempting to ascertain the meaning of words used by parties in an agreement (see box below: "Hoffman's principles").

Judgment

Early reports have overstated the significance of the judgment by suggesting that evidence of pre-contract negotiations can now be used to clarify the meaning of a contract. In fact, the House of Lords:

- applied a different interpretation of the Hoffman principles and common law rules, and interpreted the contract in question without reference to the pre-contract negotiations;
- upheld a long and consistent line of authority that evidence of pre-contract negotiations should not be used in interpreting contracts;
- confirmed that rectification may be available if, by a common mistake, the contract does not reflect what an objective observer would have thought the intentions of the parties to be.

Interpretation of the contract

The issue in this case was the construction of a term in the contract which provided how much *Persimmon* would have to pay to *Chartbrook*. The term was expressed as a formula. *Chartbrook's* interpretation led to £4.5 million being due, whereas *Persimmon's* interpretation led to just under £1 million being due. Both the court of first instance and the Court of Appeal found in favour of *Chartbrook* on the basis of the plain meaning of the contract (supported by drafts of the contract), even though all other contemporaneous documents supported *Persimmon's* case. *Persimmon* invited the House of Lords, contrary to the exclusionary rule, to take account of pre-contract negotiations in interpreting the contract.

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The House of Lords declined to do so. *ICS -v- West Bromwich* allowed the court to look at the background against which the contract was entered into. Having looked at the background and context the only interpretation possible was that something must have gone wrong with the language in drafting the contract. This meant that to interpret the contract in accordance with the normal rules of syntax made no commercial sense. This was a case in which "the drafting was careless and no one noticed". Lord Hoffman did not feel constrained, as the Court of Appeal had done, by the extent to which the contract would need to be amended in order to correct it. It was sufficient that something had gone wrong with the language and that it was clear what a reasonable person would have understood the parties to have meant.

1. How will a court apply these principles to coverage disputes? The Court will first seek to ascertain the meaning of the words as used in that policy (a question of fact) and, then, determine the legal effect of those words (a question of law).

2. Words can only be understood within the context in which they have been used. The context determines the idea that is prompted in a person's mind by the words used.

3. To find out what this idea is, the Court should not ask "What did the parties mean to say?", but "What is the meaning of what the parties have said?". Parties are assumed to have intended that which they said.

4. The Court will therefore consider the actual language used in light of its context - the surrounding circumstances and the agreed or proven object of the policy. This is an objective exercise - what would a reasonable person in the position of the parties have intended by the words used. The Court may examine the commercial purpose of the clause in the policy and may draw on its experience of other insurance contracts or understanding of the particular nature of insurance/reinsurance but may not examine the pre-contract negotiations.

5. The Courts may look at dictionaries and other materials. If a word has a technical meaning, the Courts may consult an appropriate technical dictionary, unless that meaning is itself in dispute, in which case the Courts can only proceed upon evidence.

Practical Implications

This judgment confirms the importance of making sure that policy terms are clearly understood and drafted. If a particular term is inserted that has been drafted by the parties ensure and agree that interpretation with the other party, then document your agreement.

Best practice for lawyers after poring over a complex document for hours (or days) is to give it to someone not involved in the preparation of the document. They will be able to see the wood while you are still lost in the trees. Parties to commercial contracts and insurance parties would be well advised to observe this best practice because the wording is (and always will be) at the heart of things when there is a coverage dispute. Lord Hoffman gave his own practical tip. "It is... usually possible to avoid surprises by carefully reading the documents before signing them". Better still; get someone not involved to read them.

And what about the pre-contract negotiations? They remain inadmissible in interpreting the contract, but it is still important to document those negotiations fully and retain that documentation. Lord Hoffman commented that such evidence is not excluded for the purpose of establishing that a fact which may be relevant as background was known to the parties, or to support a claim for rectification or estoppel. In fact, Lord Hoffman went further and recognised that,

as evidence of pre-contract negotiations is almost invariably tendered in support of an alternative claim for rectification or estoppel, the court will in any event read such evidence and may be influenced by it, even if the claim for rectification or estoppel does not succeed.

Hoffman's Principles

Principle 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."

Principle 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."

Principle 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."

Principle 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 Investments Co Ltd v Eagle Star Life Assurance Co Ltd* [1997] 2 W.L.R. 945)."

Principle 5: "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 Diplock made this point more vigorously when he said in *The Antaios Compania Neviera S.A. v Salen Rederierna A.B.* [1981] A.C. 191, 201:

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

With our thanks to members of our Specialist Litigation team for researching and commenting on this case.

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