

# Insight

*Insight* provides practical information on topical issues affecting the building, engineering and energy sectors.

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A cold wind blows: the impact of a more literal approach to contractual interpretation on construction contracts



# A cold wind blows: the impact of a more literal approach to contractual interpretation on construction contracts<sup>1</sup>

The key to resolving disputes is all too often working out what a particular provision or provisions actually means. Parties may have wildly different views on what something means even after spending hours negotiating the fine print and signing on the dotted line.

In the last few years the Supreme Court has signalled a distinct change of approach from the judiciary with regard to contractual interpretation. Instead of looking at the “surrounding circumstances” and “commercial common sense” to interpret contractual provisions whose meaning is disputed, a series of judgments have underlined the primacy of language even where this results in a one-sided, unfair or even absurd result.<sup>2</sup>

In this Insight we look at the impact this has already had on the interpretation of construction contracts. We then ask what in particular those negotiating and drafting construction contracts should be aware of in light of this change of approach.

## Contractual interpretation over the last 30 years

Interpretation has been defined as ascertaining the meaning that a contractual document would convey to a reasonable person, but what this means in practice is by no means straightforward.<sup>3</sup>

Over the past 30 years, two threads of case law have moved the rules on interpreting contracts away from looking primarily at the literal meaning of the words themselves. The first thread opened the door to looking at the surrounding circumstances in which the contract was agreed. The second used “commercial common sense” to allow a more sensible, and potentially less harsh, interpretation of the words in dispute.

The first three principles in the famous House of Lords case, *Investors Compensation Scheme Ltd v West Bromwich Building Society*,<sup>5</sup> were recently described as broadening:

*“the range of facts which could serve as relevant surrounding circumstances, so as to include ‘absolutely anything’ which would have affected the way in which the contract would have been understood by a reasonable man apart from pre-contractual negotiations and information unavailable to the parties.”<sup>6</sup>*

Further, the suggestion was that if

something had gone wrong with the words in the contract the law may attribute a different intention to them.<sup>7</sup>

The idea of interpreting contracts in line with “commercial common sense” began to appear in the early 1990s. In *Mannai Investment Co. Ltd v Eagle Star Life Assurance*<sup>8</sup> Lord Steyn stated:

*“Words are therefore interpreted in the way in which a reasonable commercial person would construe them. And the standard of the reasonable commercial person is hostile to technical interpretations and undue emphasis on niceties of language.” [Emphasis added]*

For those seeking to wriggle out of an unduly harsh result, the attractions of such an approach are obvious: “If there are two possible constructions, the court is entitled to prefer the construction which is consistent with business common sense and to reject the other.”<sup>9</sup>

## The cold wind: a more literal approach

In the last couple of years, however, there has been a return to a more literal interpretation of contracts, even where that results in a harsh result. Although it has been described by some as being carried out in “muffled tones”,<sup>10</sup> the trend has been widely recognised.

The key case sounding the retreat is the Supreme Court case of *Arnold v Britton*.<sup>11</sup> Lord Neuberger emphasised seven principles the last of which is not widely applicable to construction contracts. The six relevant principles were:

1. *“reliance placed on commercial common sense and surrounding circumstances ... should not be invoked to undervalue the importance of the language of the provision which is to be construed”;*
2. *“when it comes to considering the centrally relevant words to be interpreted, I accept that the less clear they are, or, to put it another way, the worse their drafting, the more ready the court can properly depart from their natural meaning”;*
3. *“commercial common sense is not to be invoked retrospectively”*
4. *“while commercial common sense is a very important factor to take into account when interpreting a contract, a court should be very slow to reject the natural meaning of a provision as correct simply because it appears to be a very imprudent term for one of the parties to have agreed, ignoring the benefit of wisdom of hindsight”*
5. *“When interpreting a contractual provision, one can only take into account facts or circumstances which existed at the time that the*

contract was made, and which were known or reasonably available to both parties"; and

6. "in some cases, an event subsequently occurs which was plainly not intended or contemplated by the parties, judging from the language of their own contract. In such a case, if it is clear what the parties would have intended, the court will give effect to that intention."

What is the rationale behind this change of approach? The underlying reasoning is to give parties greater certainty that the literal words they have written will be upheld. As Lord Sumption has suggested:

*"[It is] time to reassert the primacy of language in the interpretation of contracts. It is true that language is a flexible instrument. But let us not overstate its flexibility. Language, properly used, should speak for itself and it usually does. The more precise the words used and the more elaborate the drafting, the less likely it is that the surrounding circumstances will add anything useful."*  
[Emphasis added]

Certainly in *Arnold v Britton* the result was very harsh on those who were subject to the leases at the heart of the dispute. They ended up being liable to pay a huge amount of rent which was, on anyone's interpretation, a harsh result given that the properties in question were chalets on a leisure park on the Gower Peninsula. It is also plain that the debate continues, with the Supreme Court, in *Wood v Capita Insurance Services Limited*,<sup>12</sup> denying that *Arnold v Britton* marked a shift away from the *Rainy Sky* position.

### So what does this all mean in practice?

Well the impact has already been seen in the context of both payment terms and extension of time provisions. What is clear is that what has sometimes been used as a "get

out of jail card" (i.e. arguing business common sense to escape an otherwise harsh result) is going to be an increasingly hard card to use in the future.

### Payment terms

*Arnold v Britton* was applied in the case of *Balfour Beatty Regional Construction Ltd v Grove Developments Ltd*,<sup>13</sup> which concerned interim payments under the JCT contract. Within the contract was a payment schedule which stipulated the precise dates for payment. However, these only scheduled payments until July 2015 and the works ran past that point by a substantial period of time.

The Court of Appeal held that on a proper construction of the contract and the payment schedule, there should be no interim payments after the contractual date for completion, i.e. July 2015.

*Balfour Beatty* took account of *Arnold v Britton* and Lord Neuberger's seven principles (listed above). Counsel drew the Court's attention particularly to Lord Neuberger's fourth principle on commercial common sense. Relying on that, Jackson LJ stated:

*"Commercial common sense can only come to the rescue of a contracting party if it is clear in all the circumstances what the parties intended, or would have intended, to happen in the circumstances which subsequently arose."*<sup>14</sup>

The lesson is clear – **pay attention to the literal meaning of what you have written down.** Commercial common sense will not come to the rescue if the meaning of a provision is clear, however harsh the result is. More specifically on payment provisions, check there is an express provision for payments to continue past the planned completion date for the works.

### Extension of time provisions

Similarly, in the Court of Appeal case of *Carillion Construction Ltd v Woods*

*Bagot Europe Ltd*,<sup>15</sup> *Arnold v Britton* was cited in order to justify a literal interpretation of the extension of time provisions within a JCT subcontract. The contract in question was based on the DOM/2 form, 1981 edition.

During the hearing of preliminary issues, the Court was asked whether, assuming that Emcor (a subcontractor) was entitled to an extension of time, that extension should:

1. run contiguously from the end of the current period for completion to provide an aggregate period within which Emcor's works should be completed; or
2. fix further periods in which Emcor could undertake their works, which were not necessarily contiguous but reflected the period for which it had been delayed.

Clause 11.3 provided as follows:

*"11.3 If on receipt of any notice, particulars and estimate under clause 11.2 the Contractor properly considers that:*

*.1 any of the causes of the delay is an act, omission or default of the Contractor, his servants or agents or his sub-contractors, their servants or agents (other than the Sub-Contractor, his servants or agents) or is the occurrence of a Relevant Event; and*

*.2 the completion of the Sub-Contract Works is likely to be delayed thereby beyond the period or periods stated in the Appendix, part 4, or any revised such period or periods,*

*then the Contractor shall, in writing, give an extension of time to the Sub-Contractor by fixing such revised or further revised period or periods for the completion of the Sub-Contract Works as the Contractor then estimates to be reasonable."*

The Judge held that the natural

meaning of the words used of the subcontract conditions, when read in context, was that any period of extension granted will be added contiguously to the end of the current period within which the subcontractor is required to complete its works. The Court of Appeal agreed. They accepted that there may be situations in which clause 11.3 may lead to an unsatisfactory result. For example it could exempt a subcontractor from liability during a period when it was in culpable delay, or render the subcontractor liable to the contractor for a period when it was not in culpable delay. However, clause 11.3 was practicable, workable and accorded with commercial common sense.

At paragraph 46 of the judgment, Jackson LJ notes:

*“Recent case law establishes that only in exceptional circumstances can considerations of commercial common sense drive the court to depart from the natural meaning of contractual provisions. See Arnold at [19] and [20]. In Grove the Court of Appeal applied those principles to a construction contract, which operated harshly against the interests of a contractor. The court declined to depart from the natural meaning of the contractual provisions.” [Emphasis added]*

## Conclusion

A shift away from the, arguably, more lenient interpretation of rules over the previous 30 years appears to be under way. The exact scope and nature of this shift is still being debated and ascertained. Indeed, Lord Hodge did not accept that there had been a “recalibration” in a recent Supreme Court case in contrast to Lord Sumption’s view.<sup>16</sup>

However, in the author’s view there does indeed appear to be a trend towards a more literal interpretation of contracts. The impact of this has already been seen in two Court of Appeal cases on the interpretation of construction contracts. For those negotiating contracts the message is clear: don’t rely on the courts to get you out of a hole by arguing that the literal meaning of the words in

question do not accord with commercial common sense. Ask yourself what the literal meaning of your words is and check you are happy with the answer, including, most importantly, if the contract doesn’t proceed as planned.

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## Footnotes

1. With thanks to Laura Bowler for her research on assistance.
2. See *Arnold v Britton* [2015] AC 169; and *Krys v KBC Partners* [2015] UKPC 46 by way of example. For detailed discussion on this shift see Lord Sumption’s paper “A Question of Taste: The Supreme Court and the Interpretation of Contracts” delivered at the Harris Society Annual Lecture at Keble College, Oxford.
3. *Investors Compensation Scheme Ltd v West Bromwich Building Society* [1998] 1 WLR 896 at 912.
4. As per Lord Hoffman in *Investors Compensation Scheme Ltd v West Bromwich Building Society* [1998] 1 WLR 896 at 912. In that House of Lords judgment, interpretation was defined as being “the ascertainment of the meaning which the document would convey to a reasonable person having all background knowledge which would reasonably have been available to the parties in the situation in which they were at the time of the contract” [emphasis added]. See Lord Sumption’s speech dated 8 May 2017 made at the Harris Society Annual Lecture, Keble College, Oxford, entitled “A Question of Taste: The Supreme Court and the Interpretation of Contracts”.
5. [1998] 1 WLR.
6. See page 6 of Lord Sumption’s Harris Society Annual Lecture.
7. See page 7 of Lord Sumption’s Harris Society Annual Lecture.
8. [1997] UKHL 19.
9. *Rainy Sky S.A. v Kookmin Bank* [2011] 1 WLR 2100, paragraph 21.
10. See Lord Sumption’s Harris Society Annual Lecture, page 13.
11. [2015] UKSC 36.
12. [2017] UKSC 24.
13. [2016] EWCA Civ 990.
14. See *Balfour Beatty Regional Construction Ltd v Grove Developments Ltd* [2016] EWCA Civ 990 at para 41.
15. [2017] EWCA Civ 65.
16. See *Wood v Capita Insurance Services Limited* [2017] UKSC24 at paragraph 9. In *Arnold v Britton*, something Lord Sumption would presumably disagree with.

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