Wood v Capita Insurance Services [2017] UKSC 24 – the last word on contractual interpretation for the time being

Whether the case resolves the differences in approach that recent Supreme Court judgments on contractual interpretation have created and where it leaves contractual intention in the interpretation process.

Charlie Newington-Bridges, Barrister, St John's Chambers

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Introduction

1. Lord Sumption gave a lecture soon after the judgment in Wood v Capita, the most recent Supreme Court case on contractual interpretation. He opened the lecture by saying[1]:

   "Judges are fond of speculating about the motives and practices of businessmen in drafting contracts. It is a luxurious occupation. The rules of admissibility protect them from the uncomfortable experience of being confronted by actual facts."

2. There is little denying that judges and the Supreme Court have luxuriated in the occupation of opining on the rules of contractual interpretation in recent years.

[1] A Question of Taste: The Supreme Court and the Interpretation of Contracts – Harris Society Annual Lecture, Keble College, Oxford, 8 May 2017.

3. There is a line of authority, stretching back to Investors Compensation Scheme Ltd v West Bromwich Building Society[2] and beyond, in which the Supreme Court or its predecessor have tried to articulate the principles by which contracts should be interpreted by the courts.

4. It may be overstating the case to say that the authorities in questions have created controversy, but it is certainly the case that they have created some confusion as to what the principles of contractual interpretation actually are; and in particular which approach to contractual interpretation – contextualism or textualism – holds sway.

5. For the reasons that are set out below, although it can appear as such, this is not a purely academic debate and a fairly dry one at that. There are real practical challenges that practitioners and courts have faced and continue to face as a result of the apparent lack of clarity in this area.

6. The following notes, the accompanying presentation slides and the seminar itself are an attempt to interpret what the Supreme Court position is on contractual interpretation and how the principles can be practically applied.

Background Facts

7. The background to the case of Wood v Capita was the sale of a specialist insurance company ('the Company'). The Company specialised in insuring classic cars. The owner/sellers of the Company included Mr Wood and the buyer was Capita Insurance Services Limited ('Capita'). The share purchase agreement contained a series of warranties and an indemnity, which were broadly intended to protect the buyer from mis-selling claims

[2] [1998] 1 WLR 896

8. Shortly after the acquisition had completed, employees of the Company raised concerns about the Company's sale processes. A Company review revealed that in many cases the Company's telephone operators had misled customers to make a sale.

9. Capita and the Company informed the Financial Services Authority ("FSA") of the findings. The FSA ordered the Company to set up a remediation scheme at a cost of c. £2.5 million. However, the time limits for claiming under the warranties had expired, so Capita instead claimed under the following indemnity:

> *"The Sellers undertake to pay to the Buyer an amount equal to the amount which would be required to indemnify the Buyer and each member of the Buyer's Group against [1] all actions, proceedings, losses, claims, damages, costs, charges, expenses and liabilities suffered or incurred, and [2] all fines, compensation or remedial action or payments imposed on or required to be made by the Company [A] following and arising out of claims or complaints registered with the FSA, the Financial Services Ombudsman or any other Authority against the Company, the Sellers or any Relevant Person [B] and which relate to the period prior to the Completion Date pertaining to any mis-selling or suspected mis-selling of any insurance or insurance related product or service."*

10. Pausing there, the drafters of that sentence must have squirmed as they read judgment after judgment including that of the Supreme Court criticising their drafting. The Supreme Court described it as an '*opaque provision which, as counsel for each party acknowledged, could have been drafted more clearly'* and also said that '*clause 7.11 has not been drafted with precision and its meaning is avoidably opaque'*. What can neutrally be observed is that the sentence runs to 119 words ('*torrential drafting'* in the words of Lord Hodge), that it has no or no apparent structure and relatively little useful punctuation.

11. In that context the Supreme Court, as the Court of Appeal and the High Court had been, was presented with two competing interpretations:

    11.1. The first was in essence that the indemnity did not apply as liability under [1] and [2] is conditional on both limb [A] and [B]. Put simply, for any liability to arise there must always be "claims or complaints" with the FSA (limb [A]). No such claims or complaints had been made as the issue had been self-reported by Capita.

    11.2. The alternative interpretation proposed was that the indemnity applied as liability under [1] was only conditional on limb [B]. In other words, it is possible to recover costs, charges liabilities etc. without there needing to be "claims and complaints" with the FSA (limb [A]).

12. The difficulty that presented itself to the court was that the contract apparently made an arbitrary distinction between the cases where customers complained and cases where the company was forced to compensate by the regulator.

The Authorities leading to Wood v Capita

13. Before examining the Supreme Court's decision in Wood v Capita, it may be helpful to step back and consider the line of authority, Supreme Court, House of Lords and Court of Appeal, that sets out the principles of contractual interpretation.

14. The starting point could be 19th century cases which provide some of the substantiation for judicial opinion on contractual interpretation. However, a more recent and reasonable place to start may be Prenn v Simmonds [1971] 1 WLR 1381 and Reardon Smith Line Ltd v Hansen-Tangen [1976] 1 WLR 989, two judgements of Lord Wilberforce.

15. In both of those cases, Lord Wilberforce made clear that when reading a contract the court should put itself in the position that the parties were in at the time that the contract was formed, with all the knowledge that they had about the origin and purpose of the transaction and the circumstances in which it should be performed. There is no or little suggestion in either of those judgments that the surrounding circumstances or context were an alternative way of determining the parties' intentions. The surrounding facts were merely a way of assisting the court in interpreting the words of the contract. Put in another way, they may narrow the range of possible interpretations because they would cast light on what a reasonable man may have had in mind at the time of contract formation.

16. The House of Lords case of Antaios[3] in 1984 marked a departure in the House of Lords approach to contractual interpretation. The charter in that case provided right of termination on the shipowner for non-payment of hire '*or on any breach of this charterparty'*. The critical point being that if a right of termination arose for any breach however minor it would be harsh result for the charterer. In that case, Lord Diplock said:

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

17. This has been regarded as an exposition of the view that commercial common sense can in certain circumstances not just assist in the construction of contract, but override the language if necessary.

18. This decision was reviewed by Lord Steyn in Sirius International Co v FAI General Insurance[4]. His view was that it marked a shift from literal methods of interpretations to a more

[3] Antaios Compania Naviera v Salen Rederierna AB [1985] AC 191
[4] [2004] 1 WLR 3251

commercial approach. He gives an example of literalism which Lord Sumption in the Harris Lecture, while finding amusing, believes is a travesty of the state of the common law at the time[5]. His view is that the tension is not and has not been between literal and commercial interpretation. The different approaches can be described on the one hand as those which attempt to elucidate the meaning of words and on the other those which modify or even contradict words in an attempt to generate a reasonable result in the mind of the judge.

19. One of the more important decisions on the construction of contracts is Investors Compensation Scheme v West Bromwich Building Society [1998] 1 WLR 896 in which Lord Hoffman gave the leading speech. This was a case in which five principles were set out. The first there of those principles in essence broaden the range of surrounding circumstances or the factual matrix so that anything or almost anything can be included in the investigation. The exception to that then, as it remains now, is that pre-contractual negotiations and information unavailable to the parties cannot be used in the construction process.

20. The fourth and fifth principles were, arguably, the more radical. They set out that language is about grammars and dictionaries, but that meaning is something entirely different, namely what a document conveys to the reasonable person given the relevant background. The context is all or almost all. Lord Hoffman opined that the background:

"may not merely enable the reasonable man to choose between the possible meanings of words which are ambitious but even (as occasionally happens in ordinary life) to conclude that the parties, must for whatever reason, have used the wrong words or syntax."

21. The fifth principle set out by Lord Hoffman continues in the same vein. In essence it is that words should have their '*natural and ordinary meaning',* but with the proviso that if the background shows that something has gone wrong with the words, the court can attribute

[5] This anecdote forms part of the presentation.

a different intention. What this means is that where the background shows that the parties to a contract as reasonable people cannot have meant what was said then the courts may substitute something else – possibly even new words.

22. The decision in Rainy Sky v Kookmin Bank[6], took the position further. The dispute in that case concerned the extent of a bank guarantee relating to a shipbuilding contract. The guarantee covered the repayment of certain advance instalments of the price in the event that the ship was not actually delivered. The issue was what type of advance instalments were captured by the relevant clause. The Bank argued that not all advances were covered and prima facie the clause supported this view. The Court of Appeal found for the Bank holding that if they did not do so there would be a '*real danger of substituting our own judgment of the commerciality of the transaction for that of those who were actually party to it'*. However, the Supreme Court reversed the decision finding that it was not necessary to show that the meaning was irrational or absurd. The critical object was to understand rather than override the language.

23. In Arnold v Britton[7], the Supreme Court started to sound the retreat from the contextualism that was advocated in Investors and Rainy Sky. The case involved the contract for the sale of leasehold property. The contract provided for the payment of a service charge with an escalation clause. In the 1970s when it was drafted it probably made sense, but it had produced terrifying results once economic conditions had changed. Lord Neuberger set out the principles of contractual interpretation laying more emphasis on the traditional precepts such as the primacy of language than perhaps Investors Compensation Scheme and Rainy Sky had. He also pointed out the danger of applying a contemporary idea of commercial sense influenced by what had gone wrong after the contract had been made.

[6] [2011] 1 WLR 2100
[7] [2015] AC 1619

24. However, it would be wrong to characterise the Supreme Court as having overruled the decisions in Rainy Sky and Investors Compensation Scheme; far from it, in fact there was no direct criticism of those judgments and there were powerful dissenting decisions given that in essence said that far too much weight had been given to the language of the contract and not enough to the unreasonableness of the result.

The Decision in Wood v Capita

25. This takes us to the recent decision in Wood v Capita. The High Court found that although the indemnity appeared to extend only to cases where the customer had complained, it must have been intended to apply in either case. The Court of Appeal disagreed and gave effect to the words of the clause.

26. The Court of Appeal found the indemnity did not apply. Capita appealed to the Supreme Court on the basis this placed too much emphasis on the words, and too little on the wider factual matrix. Capital claimed this was mistaken and based on the misconception that the Supreme Court's decision in Arnold v Britton meant contracts must now be interpreted more literally.

27. The commercial reality at trial was that the buyers had an interest in getting the broadest possible indemnity, and the sellers had an equal and opposite interest in conceding the narrowest possible one. Lord Hodge, who gave the leading judgment stated:

"But, in striking a balance between the indications given by the language and the implications of the competing constructions the court must consider the quality of drafting of the clause (Rainy Sky para 26, citing Mance LJ in Gan Insurance Co Ltd v Tai Ping Insurance Co Ltd (No 2) [2001] 2 All ER (Comm) 299 paras 13 and 16); and it must also be

alive to the possibility that one side may have agreed to something which with hindsight did not serve his interest: Arnold (paras 20 and 77)."

He continued:

"*Business common sense is useful to ascertain the purpose of a provision and how it might operate in practice. But in the tug o' war of commercial negotiations, business common sense can rarely assist he court in ascertaining on which side of the line the centre line marking on the tug o' war lay, when the negotiations ended."*

28. In reaching the conclusions he did, Lord Hodge closely examined the language of the contract, which he found favoured the sellers. Tellingly, he commenced the analysis of the contract itself with the words '*the contractual context is significant in this case'*. He found that the indemnity should be read in the context of detailed warranties that were time limited. The Sellers had a business interest in limiting their liability in time and quantum which they had done in the warranties and the indemnity should be understood in that light. The warranties effectively gave the Buyer two years to uncover mis-selling. The indemnity read in the way argued for by counsel for the Buyer would have made the Seller liable for an unlimited time. Lord Hodge said it is not contrary to business common sense for a Seller in these circumstances to give a time limited warranty and a further indemnity which is not subject to any such limit but is triggered only in limited circumstances.

29. The outcome was that '*the circumstances which trigger that indemnity are to be found principally in a careful examination of the language which the parties have used'*. The result was harsh, but there were reasons apparent from the provisions of the contract why the parties could rationally have intended it.

Conclusions

30. Lord Hodge's view set out in Capita was that textualism and contextualism are not '*conflicting paradigms in a battle for exclusive occupation of the field of contractual interpretation'*. His opinion was that the lawyer and the judge, when interpreting any contract, can use them as tools to ascertain the objective meaning of the language which the parties have chosen to express their agreement.

31. It is probably true that Investors Compensation Scheme changed the judicial mood in favour of context, but recent cases including Wood v Capita have shifted the emphasis back to more balance between language and background. The intentions of the parties may be found in an examination of the language of the contract as whole and while the background may assist in the construction exercise, it should not have primacy.

32. The last words might be left to LJ Jackson who in the recent cases of Sutton Housing v Rydon [2017] EWCA Civ 359 observed:

"Lawyers are now lucky enough to live in a world overflowing with appellate guidance on how to construe contracts."

If we are overflowing now, the waters will probably not recede in the near future as cases continue to come before the appellate courts and further refinement and explanation of the principles is added to the pool.

Charlie Newington-Bridges
St John's Chambers

charlie.newington-bridges@stjohnschambers.co.uk
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