



The Right Honourable Lord Clyde

Construction of Commercial Contracts: Strict Law and Common Sense



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Baron Clyde of Briglands in Perthshire and Kinross has had a long and distinguished judicial career, culminating in his appointment in 1996 as a Lord of Appeal in Ordinary in 1996. He comes from a judicial dynasty—his father was President of the Court of Session in Edinburgh, as was his grandfather.

He was born in Edinburgh and was educated at Corpus Christi College, Oxford and at Edinburgh University. He was called to the Scottish Bar in 1959, and made a Queen's Counsel in 1971. He became a Judge of the Courts of Appeal for Jersey and Guernsey, where he served from 1979–1985 and then returned to his native Scotland to serve as a Senator of the College of Justice until 1996.

In 1996, together with Lord Hope of Craighead, he was promoted to the House of Lords, to succeed Lord Keith of Kinkel and Lord Jauncey of Tullichettle as the Scottish Lords of Appeal in Ordinary.



The Times of London described Lord Clyde as “industrious and pleasant with a human touch” (27 October 1998).

He retired as a Lord of Appeal in Ordinary on 1 October 2001.

Lord Clyde has been widely involved in promoting and sustaining the legal and academic institutions of his homeland, Scotland. He was Honorary President of the Young Scottish Lawyers’ Association from 1988–1997; Vice Chairman of the Court of Edinburgh University from 1993–1996; President of the Scottish Universities’ Law Institute from 1991–1998; as well as Director of the Edinburgh Academy from 1979–1988. He is also an Honorary Fellow of Corpus Christi College, University of Oxford.

Lord Clyde has served on a number of official tribunals and public inquiries, including serving as Chairman of the Orkney Children Inquiry (Child Abuse Inquiry) 1991–1992. More recently, he was appointed as the Justice Oversight Commissioner of the newly established Oversight Commission which is to provide independent scrutiny of the implementation of the Criminal Justice Review in Northern Ireland.

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15 Construction of Commercial Contracts: Strict Law and Common Sense

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A considerable time ago when I was a law student at the University of Edinburgh the class on Roman law was required to read the *Institutes of Gaius*. I fear that much of it has slipped from my consciousness, but one passage has remained alive in my memory, no doubt because of the vivid impression which it created on my mind at that time.

The passage is in Book IV where the author is dealing with the older forms of action in the Roman law. It concerned the case of an action brought by someone complaining about the cutting down of his trees. The trees in question were vines. The claim failed because the claimant in formulating his claim had used the word vines, when he should have said trees. Now that seemed to me to be taking rules of procedure to an absurd length and using technicalities to deny justice when the substances of the claim was perfectly evident.

This lecture is concerned with the tension which may exist between the strict application of legal rules and the need for mitigation of those rules to meet the evident needs of justice. The immediate context is that of the law of commercial contracts. My reference to the *legis actio* about cutting down trees is of course a far cry from commercial contracts. But it may be that rules of procedure can inspire a cast of mind which inclines to a rigid formalism and can produce unfairness and unreality in the practice of the law. So this lecture is concerned with

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the way in which the exercise of a judicial function may modify the strict application of legal rules to achieve a result which accords with common sense. Just as the excessive technicality of the early Roman procedures gave way to more equitable methods of proceeding, so may rigidities in the law of contract give way to more realistic approaches.

It is appropriate at the outset to make four observations by way of setting the scene.

First, it has been said that words are the tools of a lawyer. But on the contrary I think that words are the raw material of the law. It is in language that our rights and our obligations are prescribed and defined. The understanding, let alone the application of those rights and obligations, is a matter for the reading and the understanding of what has been written, whether it be in legislation or in any form of written deed, public or private. So it is with words and phrases with which so much of a lawyer's time is engaged. The work of commercial lawyers significantly involves the preparation of legal texts. The work of drafting requires a high degree of care in securing that the meaning is clearly expressed. The resolving of legal problems is very often a matter of the construction of a legal text. Among the lawyer's tools are principles and rules, such as the principle of *contra proferentem*, or *eiusdem generis*, but it is essentially with a particular problem in a particular context that he is involved. More often than not the cases in this area of the law provide examples and illustrations rather than precedents which will exactly conclude other cases.

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Secondly, problems of construction only arise where there is a dispute between the parties to the contract. There may be many cases where contracts are entered into which contain obscurities, ambiguities or even errors, but these pass unnoticed and fade harmlessly into history because the performance of the contract

proceeds in a way which is acceptable to both parties so that no one requires to invoke the critical provision. It is usually only when things go wrong that the rights and obligations require to be examined more precisely. Even then it is always possible for some agreement or compromise to be reached so that the lawyers or at least the courts do not come to be involved. Written contracts may of course in certain circumstances be rectified by the court, but it is with matters of construction rather than rectification that we are presently concerned.

Thirdly, we are concerned here properly with commercial contracts, and indeed with written contracts, because in the case of oral contracts questions of construction do not so easily arise. But in relation to written commercial contracts the approach to be adopted and the principles to be applied will be found in many respects to be followed in the case of other kinds of contracts and other kinds of written deeds, so reference can be made to problems of construction in other kinds of case. Such differences in construction as there may be between mercantile and other deeds are substantially due to the different context and purpose of the deeds or agreements in question. They relate rather to the intensity with which the rules are applied than to the substance of the rules themselves.

Finally, in these introductory remarks I must say a word about the basic principle of construction. The grand rule of construction is

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that effect is to be given to the intention of the parties. But how is the intended sense of the deed to be discovered? It is certainly not to be discovered directly from the authors of the document. One party cannot

be allowed to escape a contractual obligation on the easy plea that he did not mean what he said. The law requires an objective and not a subjective approach. And in finding an objective construction the intention must be sought in the first place from the deed itself. Long ago it was said, "One must consider the meaning of the words used,

not what one may guess to be the intention of the parties.”¹ But the words are not to be read in isolation. If an objective approach is to be adopted then the court must have a sufficient understanding of the surrounding circumstances to put itself in the position of the parties when they reached their agreement. That is a point to which I shall return.

The strict approach

With these introductory observations may I turn to consider the strict approach. On that approach, effect must be given to the words if they are clear and unambiguous. The court must not search for ambiguities and evidence cannot be admitted to show an ambiguity where it is not evident from the ordinary meaning of the words. And so far as slips or mistakes in the text are concerned, the strict rule requires that, provided that the deed has some meaning, then the court cannot intervene, even if the mistake defeats the intention of the author and even if no one has in fact been misled by the mistake.

In order to illustrate the point I shall refer to certain cases where there has been some possible mistake in identification. The problem here is to decide whether the thing or person identified by the author of the deed is or is not clear and certain. Is there or is there not error?

Let me take first the case where there is a reference to someone or something which does not exist, so that the deed as it stands is meaningless. In such a case, the court has been able to construe the deed so as to overcome the error. For example, on the face of it the deed may seem to make sense, but when one comes to apply it, a problem arises. Such a case can occur where there is a misdescription of a place or a person. In one early case,² the landlord of a public house in Limehouse called The Bricklayer’s Arms, gave notice to the tenant to quit. The notice required the tenant to quit “the premises which you hold of me ... commonly called or known by the name of

¹ Sir George Jessel MR in *Smith v Lucas* (1881) 18 Ch D 531 at 542.

² *Doe d Cox v Roe* (1803) 4 Esp 185.

The Waterman's Arms". Evidence disclosed that the only premises let by the landlord to the tenant were The Bricklayer's Arms and that there was no public house called The Waterman's Arms. The notice was held to be effective, despite the error.³ A like line of reasoning can be found in a more recent case⁴ where the words "bill of lading" were read as inferring to a charterparty. The House of Lords held that in the circumstances of the case the reference was a misnomer. It did not make sense.

If the name given in the deed does not reflect any reality, it may be easy to intervene and give effect to the presumed intention. But if the name is held by an identified body, can the courts ignore that reference? What if the words are not meaningless? What if they have a meaning?

I begin with a Scottish case concerning the construction of a will.⁵ Alexander Hogg Nasmyth was a Scotsman. Apart from occasional visits to England, said to be for his health or for business purposes, he had lived all his life in Scotland. He died in 1911. His interests and associations were exclusively Scottish. His will was drawn in Scotland, by Scottish solicitors and his testamentary trustees were Scottish. Among other provisions he left a legacy to "the National Society for the Prevention of Cruelty to Children". That was precisely the title of an English body. They claimed the legacy, but that was challenged by a Scottish body called the Scottish National Society for the Prevention of Cruelty to Children. The Scottish court in the first place took the view that the word "National" in the will was ambiguous and accordingly allowed evidence to establish the sense in which the word was being used by the testator. From the evidence which was then led it appeared that the deceased had taken some notice of the Scottish society before his death on account of some incident which had occurred on his own lands and further that the operations of the claimants, the English Society, had never extended to Scotland. The Scottish courts held, in light of the background evidence, that the deceased had intended to benefit the Scottish

3 In that kind of case the doctrine of *falsa demonstratio non nocet* might be invoked. One part of the reference was perfectly clear and correct and the other applied to no subject at all (cf *Cowen v Truefitt Ltd* [1899] 2 CLJ 309).

4 *Adamastos Shipping Co Ltd v Anglo-Saxon Petroleum Co* [1959] AC 133.

5 *Nasmyth's Trustees v National Society for the Prevention of Cruelty to Children* [1914] SC(HL) 76.

Society and the legacy should go to it. But that decision was reversed by the House of Lords on appeal. Lord Dunedin, one of the Scottish judges sitting in the House of Lords, recognised an ambiguity in the fact that the name used by the testator could fit the Scottish Society, but held that strong evidence was needed to displace the accurate description which exactly fitted the English body. The other four of their Lordships held that there was no ambiguity in the designation of the beneficiary and considered that extrinsic evidence should not have been allowed.

The second example is the English case of *In re Fish (Ingram v Rayner)*.⁶ There a testator left the residue of his estate to his “niece Eliza Waterhouse”. He had no such niece but his wife had both a legitimate and an illegitimate grand-niece, each of whom was called Eliza Waterhouse. It was held that the description could extend to the legitimate relation, but not to the illegitimate one. There was thus no ambiguity, and accordingly evidence was not admissible to establish the claim by the illegitimate grand-niece that she was the person whom the testator intended to benefit. That case may be contrasted with that of *In re Jackson*.⁷ The testatrix in that case left a share of the residue of the estate to “my nephew Arthur Murphy”. The evidence disclosed that she had two legitimate nephews of that name. That then gave rise to an ambiguity justifying the leading of evidence about the state of the family with a view to identifying which of the two was intended to benefit. That evidence however disclosed not only that there was no likely intention to prefer one of the two to the other but also that there was a third nephew, who was illegitimate and who was also called Arthur Murphy, and who from his close connection with the testatrix was the most likely person to have been the intended beneficiary. *Fish* was distinguished on the ground that in that case there had been no ambiguity, there having been only one legitimate relation of the correct name.

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[1894] 2 Ch 83.

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*Re Jackson, Beattie v
Murphy* [1932] All ER
Rep 696; [1933] 1 Ch 237.

The subtle distinctions which these cases display and the questionable fairness of the results to which the strict approach may

lead, give rise to questions about the validity of the approach. In the Scottish case an express regret was voiced, by Lord Dunedin, because as he put it, “I cannot help having the moral feeling that this money is probably going to a society to which, if we could have asked him, the testator would not have sent it.” In *Fish* Lindley LJ said, “This is one of those painful cases in which it is probable that the testator’s intention will be defeated, but the rule of law is too strong for the appellant”.⁸ If the grand purpose of the law in construction is to give effect to the intention of the author of the deed then it might be thought that something has gone wrong with the law. The supposition must be that the parties intended what the court decides as a matter of construction they must have intended. The words of Mr Bumble in *Oliver Twist* come to mind, “If the law supposes that, the law is a ass, a idiot.”

The cases which I have been considering have concerned the identification of persons or objects. But they illustrate a much more general problem of approach. I turn next to look at the adoption of the strict approach in relation to the construction of a notice seeking to terminate a lease. I do so because it is in this context that the earlier approach has been challenged. I deal first with an example of the strict approach.

In *Hankey v Clavering*⁹ under a lease for 21 years from 25 December 1934 either party could terminate it at the end of seven years on giving six months’ notice. The landlord gave the tenant notice as from 21 June 1941 purporting to terminate the lease on 21 December 1941. He should of course have referred to the 25th and not the 21st of the month. It was held that the notice was ineffective.

Lord Goddard observed:

The whole thing was obviously a slip on (the landlord’s) part, and there is a natural temptation to put a strained instruction on language in aid of people who have been unfortunate enough to make slips. That, however,

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Above, note 6, at 84.

⁹
[1942] 2 KB 326.

is a temptation which must be resisted, because documents are not to be strained and principles of construction are not to be outraged in order to do what may appear to be fair in an individual case.¹⁰

Later he said:

It is perfectly true that in construing such a document as in construing all documents, the court in a case of ambiguity will lean in favour of reading the document in such a way as to give it validity, but I dissent entirely from the proposition that where a document is clear and specific, but inaccurate, on some matter, such as that of date, it is possible to ignore the inaccuracy and substitute the correct date or other particular because it appears that the error was inserted by a slip.¹¹

Hankey was distinguished in a later case¹² where the notice specified an impossible date: it was served in 1974 to come into effect in 1973. That was an impossibility. It was meaningless. That was a slip which would be obvious to a reasonable tenant reading it and knowing the terms of the lease to which it related. So it was interpreted as relating to 1975. In *Hankey* the erroneous date could make sense. But is that a sufficient reason for refusing to recognise the error? The House of Lords have now held that it is not and I turn to a case which has now overruled the decision in *Hankey*.

This is the case of *Mannai Investment Company Limited v Eagle Star Life Assurance Company Limited*.¹³ Here the tenant was entitled in terms of clause 13(7) of the lease to terminate the lease “by serving not less than six months’ notice in writing to the Landlord ... such notice to expire on the third anniversary of the term commencement date”. The commencement date was 13 January 1992. The third anniversary of that date was 13 January 1995. The tenant sent a notice which stated, “Pursuant to clause 13(7) of the lease we as tenant hereby give you notice to terminate the lease on 12 January 1995”. Two of the judges in the House of Lords held that the notice to be effective had to conform strictly with the requirements specified in the clause, that the law was well-settled, and that the specification of 12 January was fatal to the validity

¹⁰
Ibid, at 328.

¹¹
Ibid, at 330.

¹²
Carradine Properties Ltd v Aslam [1976] 1 WLR 442; [1976] 1 All ER 573, Ch D.

¹³
[1997] AC 749; [1997] 3 All ER 352, HL.

of the notice. The majority however held that the notice was effective and that *Hankey* should be overruled. The question was whether the notice construed in its contractual setting unambiguously informed a reasonable recipient how and when the notice was to operate.¹⁴

In the circumstances this notice did so. One point which was particularly emphasised by Lord Hoffmann was that it is not just the ordinary meaning of words which matters but also the way in which words are ordinarily used in everyday life:

If one meets an acquaintance and he says, “How is Mary?” it may be obvious that he is referring to one’s wife, even if she is called Jane. One may even, to avoid embarrassment, answer, “Very well, thank you” without drawing attention to his mistake. The message has been unambiguously received and understood.¹⁵

The context and the background enables us to understand the meaning of what has been said, even if the speaker has used the wrong words.

The speeches in *Mannai* appear to recognise a shift in the approach to be taken in the construction of commercial contracts. Lord Steyn observed, “Nowadays one must substitute for the rigid rule in *Hankey v Clavering* the standard of commercial construction”.¹⁶ So also the rule of construction which was faithfully observed in such cases as *Naysmith* and *Fish*, that if the reference is clearly made to someone or something which does exist then no evidence can be admitted to show that the author was intending to refer to someone or something else, can now barely survive the decision in *Mannai*. That the words used can be given content is no longer the end of the matter. That the notice in *Mannai* specified a date which was a real date, albeit the wrong one, was not conclusive.

So far I have been dealing with cases where the source of the problem was a name or a description or a date. The test preferred in *Mannai* is by reference to how a reasonable recipient of the notice, in the

¹⁴ In relation to the notice Lord Steyn stated, “The construction of the notices must be approached objectively. The issue is how a reasonable recipient would have understood the notices. And in considering this question the notices must be construed taking into account the relevant objective contextual scene”. [1997] 3 All ER 352 at 369.

¹⁵ Ibid, at 375.

¹⁶ Ibid, at 372.

context and circumstances of the case, would have understood it. But that approach is by no means confined to notices to terminate leases. It is of quite general application, including its application in the construction of commercial contracts. If I may quote Lord Hoffmann:¹⁷

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.

I turn then to consider the application of the approach in the more general cases of construction.

Ordinary meaning

It is useful first to recall the traditional rule of construction, namely that words should be given their ordinary English meaning. Reference has often been made¹⁸ to the ordinary rule of construction, namely that words should be read and understood in their “ordinary and natural sense”. If the ordinary meaning gives the only reasonable sense then there will almost certainly be no room for dispute. Even if there is an ambiguity then one may lean towards the ordinary meaning, on the basis that people generally will be expected to use words in their ordinary sense. But particularly in light of the decision in *Mannai* reference to the ordinary and natural sense of the words may require further elaboration. Let me mention four particular matters.

Dictionaries

The first point to be made is about dictionaries.

One possible danger in looking at once to the ordinary and natural sense of the words may be that it diverts attention from the contract and focuses too strongly upon particular words. One must

¹⁷
Investors Compensation Scheme Ltd v West Bromwich Building Society [1998] 1 All ER 98 at 114; [1998] 1 WLR 896 at 912.

¹⁸
Eg, Lord Halsbury LC in *Crosse v Bankes* 13 (HL) 30.

beware of confusing construction and definition. The construction of a deed is not solved by recourse to a dictionary. What a dictionary does is to provide the meaning or a range of meanings for particular words and expressions. The meaning of an expression in that sense “can be seen as a question of fact and not a question of law”.¹⁹ There are cases where the parties may attach a particular meaning, perhaps an unusual meaning, to a particular expression. Or they may use words which have some established technical meaning. Or there may be some custom of trade which colours or explains the particular words used. Or they may make use of a foreign language. But these kinds of cases do not, at least primarily, give rise to problems of law.

The words are of course important, but it is the deed which has to be construed. The meaning of a word may be a matter of fact, but where the word admits of several meanings then it is a matter of law, a matter for a court, to decide which is the meaning to be preferred.²⁰ We should not allow the attention to be so concentrated on particular words as to lose sight of the purport of the document as a whole.²¹

The difficulty about a rule which looks to the ordinary and natural meaning of the words is that the ordinary meaning of a word may vary according to the context. The immediate grammatical context and the wider setting of the contract may add a colour which determines the meaning so that it may be difficult to attribute an ordinary and natural meaning to a word in the abstract without any context at all. The dictionary endeavours to do that. But as I have already sought to explain, dictionaries give definitions, not interpretations.

Ambiguities

The second point arising from *Mannai* relates to the question whether or not the text of the contract is ambiguous. If there is now a greater awareness of the importance of the context of the contract in the understanding of its terms then ambiguities in the words used may more readily be identified and more satisfactorily resolved.

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Lord Reid in *Cozens v Brutus* [1973] AC 854 at 861; [1972] 2 All ER 1297, HL.

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The meaning of a letter, or a deed, is not a matter of fact but a matter of law: *Wodhouse Ltd v Nigerian Produce Ltd* [1972] AC 741.

21
Investors Compensation Scheme Ltd v West Bromwich Building Society [1998] 1 All ER 98 at 115. Lord Hoffmann in *West Bromwich* said, “The meaning a document (or any other utterance) would convey to a reasonable man is not the same thing as the meaning of the 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 a 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.”

The question whether there is or is not a plain meaning, or what is the plain meaning, arose sharply in *Investors Compensation Scheme Ltd v West Bromwich Building Society*.²² That case concerned the misfortunes which certain investors had suffered through entering home income plans under which they had taken out mortgages on their homes with certain building societies and then invested the advances in equity-linked bonds. Thereafter the value of equities fell and the level of interest rates rose with consequent grave financial problems for the investors. The investors were compensated by a statutory body set up for that kind of purpose, the Investors Compensation Scheme (ICS), and the ICS sought as assignees of the investors to recover from the building societies. In the deed by which the assignation was contained there was excepted from claims transferred to ICS and so retained by the investor “any claim (whether sounding in rescission from undue influence or otherwise) that you may have against the ... Building Society in which” certain abatements were claimed. The difficulty arose because of the words in parenthesis. One of their Lordships took the view that the clause in question had a plain meaning and that there was no ambiguity. The clause was intended to cover all claims. The words in parenthesis were otiose, merely showing that all claims were to be covered. The majority of the House of Lords, however, took the view that that was too odd a result to be acceptable, that the words in parenthesis were to be construed as identifying certain particular kinds of claims, namely claims sounding in rescission, which alone were not to pass to ICS, and that accordingly the claims for damages and compensation could be properly maintained by ICS.

Now it can certainly be stated that the words “any claim” in the natural and ordinary use of language can be taken to mean all claims. And when the words are followed by a parenthesis which can certainly be taken, in the ordinary use of words, to be emphasising the comprehensive scope of the reference to “any claim”, an application of the rule that the ordinary use of words should be preferred is initially attractive. But the concept of a natural and ordinary meaning is not very helpful when on any view the words have not

²²
[1998] 1 All ER 98;
[1998] 1 WLR 896.

been used in an ordinary and natural way. Critical to the decision was the consideration that the alternative reading of the clause made commercial nonsense. Common sense was preferred to a strict interpretation of the words.

Extrinsic evidence

The third point which arises concerns the use of evidence extrinsic to the contract.

Evidence extrinsic to the contract itself may of course be permitted in order to see whether the written deed in fact constitutes or comprises the extent of the agreement between the parties. Whether there was agreement, whether there was mistake, or duress, or fraud, are open to investigation on extrinsic evidence. So also the truer nature of the agreement can be elucidated by evidence. But we are concerned here with the use of extrinsic evidence in the construction of the contract, once it is accepted that there was intended to be a contract in the terms expressed in the deed.

If the courts are now to be more conscious of the possibility of the recognition of ambiguities, it may be that there will now come to be a greater readiness on the part of the courts to allow consideration of evidence extrinsic to the contract. But that does not mean that there should be an open inquiry into anything which might throw some light, however remote, on the meaning of the contract. The evidence here is essentially restricted to the factual background against which the parties contracted, with the one possible exception of pre-contract negotiations. In the words of Lord Wilberforce:²³

No contracts are made in a vacuum; there is always a setting in which they have to be placed ... In a commercial contract it is certainly right that the court know the commercial purpose of the contract and this in turn presupposes knowledge of the genesis of the transaction, the background, the context, the market in which the parties are operating.

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Reardon Smith Line Ltd v Hansen-Tangen [1976] 1 WLR 989 at 995–996; [1976] 1 All ER 570, HL, at 574.

I should mention in this context an observation by Lord Hoffmann in the *West Bromwich Building Society* case which has given rise to what I consider to be a misplaced alarm. Lord Hoffmann said of the background material that, subject to the exception of pre-contract negotiations, “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”. This observation has been received with some concern. It has been suggested that the statement is expressed far too widely (eg *National Bank of Sharjah v Delborg*,²⁴ and *Scottish Power plc v Britoil (Exploration) Ltd*²⁵). But just as expressions in contracts should be construed in their context, so also it is proper to read the whole of Lord Hoffmann’s statement. There is an express limit on the phrase “absolutely anything” in the words which follow. Those words confine the scope of the evidence to matters which would have affected the way in which the language would have been understood by a reasonable man, and that is to say a reasonable man in the position of the party to the contract. One cannot then ignore any of the considerations relevant to the contract which would reasonably have weighed with the parties when they concluded their agreement. Lord Hoffmann’s observation simply serves to emphasise the need to construe commercial documents in a wider context than that defined by the documents themselves.²⁶

Absurdity

The fourth and last of the comments arising from *Mannai* has to do with cases where the text appears to be meaningless. Where the court finds itself able to say that one reading of a clause leads to a result which is patently absurd, what may be seen as the ordinary meaning of the words can be rejected. The desire to achieve a workable contract, rather than see it fail altogether points to the propriety of adopting a construction which will enable it to survive.

But such a course is not limited to cases where the text is absurd or meaningless. Intervention is also recognised where on a lower standard a case of unreasonableness can be identified. This approach

²⁴ 9 July 1997, Unreported.

²⁵ [1998] TLR 616.

²⁶ *LAW Construction Co Ltd and Others v LAW Holdings Ltd and Others*, Court of Session, Lord Penrose, 9 April 1998.

is by no means new. In *Glynn v Margetson & Co*²⁷ a bill of lading contained a deviation clause framed in wide terms. It allowed the ship to proceed to and stay at any port or ports in any rotation in several named seas and coasts for the purpose of delivering coals, cargo or passengers, or for any other purpose whatsoever. The ship went 350 miles in the opposite direction to that of its destination before turning round and heading for the home port. Strictly, and adopting the ordinary use of words, such a deviation could be seen as within the scope of the clause. But the House of Lords imposed a construction which limited it to a deviation to ports which were in the course of vessel's route to its destination. In that case the counter-construction might not properly be labelled as nonsensical or absurd, but what the House did consider was that the construction sought by the shipowners defeated the object of the contract. The Lord Chancellor observed, "it seems to me that the construction contended for would be an unreasonable one, and there is no difficulty in construing this clause to apply to a liberty in the performance of the stipulated voyage to call at a particular port or ports in the course of the voyage".²⁸ It may be noted that in a much later case (*Wickman Machine Tools Ltd v Schuler AG*²⁹) Lord Reid was influenced by the "very unreasonable result" to which one construction would lead. He added, "The more unreasonable the result the more unlikely it is that the parties can have intended it."

It has been said in one case that the reasonableness of the provision cannot be the starting point for construing a contract.³⁰ But in some cases the unreasonableness of the immediately obvious reading will be evident at the outset of the exercise. On the other hand, the initial reading may disclose a meaning which at first sight is clear, obvious and unambiguous on an ordinary use of language. But the context in which the expression appears, even without reference to evidence to explain the point, may show that the apparently normal meaning is not a true reflection of the parties' intention. Thus, for example, in one recent case³¹ the words, "the sum actually paid" were held in light of the context of the contract of reinsurance to mean not the actual disbursement of funds but the finally ascertained amount

27
[1893] AC 351.

28
Ibid, at 355.

29
[1974] AC 235 at 251.

30
Saville J in *Palm Shipping Inc v Kuwait Petroleum Corporation, The Sea Queen* [1998] 1 Lloyd's Rep 500 at 502.

31
Charter Reinsurance Co Ltd v Fagan [1997] AC 313.

of the liability, a meaning far from the ordinary meaning of the words.

May I then offer some reflections by way of conclusion.

Conclusion

The decision in *Mannai* has been greeted in some quarters with surprise. One writer has said that two basic rules of construction have begun to experience seismic disturbances through the decision in *Mannai*.³² It, and the *West Bromwich* case, have been described as landmark decisions.³³ Indeed Lord Hoffmann has observed:

I do not think that the fundamental change which has overtaken this branch of the law ... is always sufficiently appreciated. The result has been, subject to one important exception, to assimilate the way in which such documents are interpreted by judges to the common sense principles by which any serious utterance would be interpreted in ordinary life. Almost all of the old intellectual baggage of “legal” interpretation has been discarded.³⁴

While the words which commercial people use are still the focus to which construction is directed, the emphasis is not on literalism, but on the expectation of commercial people. Commercial contracts “must be construed in a business fashion”.

But is this anything new? What we have been seeing in recent years is I think a move away from strict formality to a degree of realism which I characterise as common sense. While the words which commercial people use are still the focus to which construction is directed, the emphasis is not on literalism, but on the expectation of commercial people. It was recognised over a hundred years ago that commercial contracts “must be construed in a business fashion”.³⁵ More generally it has long been accepted that the court has to endeavour to place itself in the position of a reasonable and disinterested third party, duly instructed, if necessary, as to the law.³⁶ As Lord Diplock has observed:³⁷ “There must be

³² PF Baker (1998) 114 LQR 55.

³³ Paul Morgan QC, “The Construction of Leases and Other Documents” (1999) 3 L&T Rev Issue No 4.

³⁴ [1998] 1 WLR 896 at 912.

³⁵ *Southland Frozen Meat and Produce Export Co Ltd v Nelson Brothers Ltd* [1898] AC 442 at 444.

³⁶ *Gloag on Contract*, 398.

³⁷ *Miramar Corporation v Holborn Oil Ltd* [1984] 1 AC 676 at 682.

ascribed to the words a meaning that would make good commercial sense.” In another case³⁸ he stated that “if detailed semantic and syntactical analysis of words in a commercial contract is going to lead to a conclusion that flouts business common sense, it must yield to business common sense”.

In the context of statutory interpretation, one can discern a leaning towards a greater regard for the purpose of the legislation. This is a tendency which no doubt has been influenced by the jurisprudence of the European Court of Justice. Something of a similar trend can be seen in the recognition of a purposive construction of contracts, although the use of such an expression in this context has been deprecated.³⁹ That there has been a change in approach to construction there can be no doubt, and in practice this has been referred to as a purposive approach.⁴⁰ It has been said that “language is a very flexible instrument and, if it is capable of more than one construction, one chooses that which seems most likely to give effect to the commercial purpose of the agreement”.⁴¹

In the changes which have taken place in the construction of contracts there has not been any changing of the goal posts, nor any seismic upheaval of the pitch, but rather a greater role has been given to the performance of some of the players. The development of the law has been not to depart from established principles, but to focus more strongly upon the commercial reality of the situation which lies behind the dispute. The changes which have taken place in the approach to construction are changes of emphasis. Nor have they occurred suddenly or instantaneously. The development of the approach to construction which was noticed and affirmed in *Mannai* began at least 20 or 30 years before that case.⁴² Even the idea of a purposive construction is by no means a novelty. Over 150 years ago it was observed that “greater regard is to be had to the clear intention of the parties than to any particular words which they may have used in the expression of their intent”.⁴³ Even ten years ago the approach to the construction of a pension scheme was agreed by the parties to be one which was “practical and purposive rather than detached

38 *Antaios Cia Naviera SA v Salen Rederierna* [1985] AC 191 at 201; [1984] 3 All ER 229 at 233.

Lord Steyn has said, “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” (*Mannai* [1997] 3 All ER 352 at 372).

39 *Antaios Cia Naviera SA v Salen Rederierna* [1985] AC 191.

40 Examples can be found where express reference has been made to the need to give effect to the basic purpose of a rent review clause (*British Gas Corporation v Universities Superannuation Scheme Ltd* [1986] 1 WLR 398 at 401) or what is normally the commercial purpose of such a clause (*Basingstoke and Deane BC v Host Group Ltd* [1988] 1 WLR 348).

41 *Co-operative Wholesale Society Ltd v National Westminster Bank plc* [1995] 1 EGLR 97 at 99.

42 See Lord Wilberforce in *Prenn v Simmonds* [1972] 1 WLR 1381 and *Reardon Smith Line Ltd v Yagvar Hansen-Tangen* [1976] 1 WLR 989.

43 *Ford v Beech* (1848) 11 QBD 852 at 866.

and literal”.⁴⁴ The shift towards a more relaxed approach was already reflected in the words of Sir Thomas Bingham MR (as he then was)⁴⁵ several years ago:

To my mind construction is a composite exercise, neither uncompromisingly literal nor unswervingly purposive; the instrument must speak for itself, but it must do so in situ and not be transported to the laboratory for microscopic analysis.

There is of course a strong case which can be presented for an approach which follows strict legal rules, even at the expense of the actual intention of the parties.

In the world of commercial affairs speed is usually of the essence. The demands of commercial business can rarely tolerate the lengthy delays which recourse to legal processes may involve. What is required above all is certainty. So it is important that commercial contracts should be clear and precise in their terms. If the text is obscure then it is necessary that the rules by which such problems are to be resolved should be clear and certain. What the court would say, if the matter comes before it, should be predictable. If the matter is left to a judicial interpretation which is not governed by strict rules, then commercial interests may be ill-served. If, to use Selden’s expression, the measure of the law becomes the measure of the Chancellor’s foot, then the law is failing the needs of the commercial world.

If, to use Selden’s expression, the measure of the law becomes the measure of the Chancellor’s foot, then the law is failing the needs of the commercial world.

But, on the other hand, commercial interests will not be well-served if the intention of parties can be sufficiently clearly seen to have been frustrated by a slip. Bad drafting may often be due to the speed at which the drafting has been done. One of the features of modern life is the speed of communication. Telecommunications in all their forms, whether fax or e-mail, enable, and so come to require, that drafting is done in hours where it once would have taken days.

44 *Mettoy Pension Trustees v Evans* [1990] 1 WLR 1587.

45 *Arbuthnot v Fagan*, 30 July 1993, quoted by Mance J in *Charter Reinsurance Co Ltd v Fagan* [1997] AC 313 at 326.

The relative leisure under which earlier generations worked gave a far greater opportunity for reading and re-reading drafts without undue pressure and so reduced the risk of error. Now that that risk must be significantly higher, it is not unreasonable that the courts should recognise that there is the greater room for mistakes to occur.

But it is not to be thought that a more relaxed approach to the construction of contracts should allow a more relaxed standard of draftsmanship. As Lord Bridge has said:

[bad drafting] affords no reason to depart from the fundamental rule of construction of contractual documents that the intention of the parties must be ascertained from the language they have used interpreted in the light of the relevant factual situation in which the contract was made. But the poorer the quality of the drafting, the less willing any court should be to be driven by semantic niceties to attribute to the parties an improbable and unbusinesslike intention ...⁴⁶

That the court may be more ready to come to the rescue does not mean that parties should not still strain to express themselves accurately and precisely.

Furthermore, the modifications which can be identified have their limits. The courts may not rewrite the contracts which the parties have made. And however boldly the purposive approach may be proclaimed, beyond the limited field of rectification the court cannot “re-write the language which the parties have used in order to make the contract conform to business common sense”.⁴⁷ As Lord Mustill has observed, “to force upon the words a meaning which they cannot fairly bear is to substitute for the bargain actually made one which the court believes could better have been made. This is an illegitimate role for a court”.⁴⁸ The warning on the limit to the court’s power is timely. But it might be thought that there is no question but that the court will endeavour to enforce the contract. The problem is: What does the contract mean? What are the rights or obligations which are to be enforced? The parties require not only to have the

46
Mitsui Construction Co Ltd v AG of Hong Kong (1986) 33 Buil LR 14.

47
[1995] 1 EGLR 99.

48
Charter Reinsurance Co Ltd v Fagan [1997] AC 313 at 388.

confidence that the court will enforce their bargain but also that it will spell out a construction of the agreement which accords with their intention.

Rules of procedure should not be allowed to defeat the substantial complaints of litigants and deprive them of the opportunity to have the court resolve their disputes. Nor should rules of construction be formulated or applied in terms so strict as to fail to recognise the real intention of the authors of a deed. If there has in the past been a tension between strict law and common sense in this area of the law, I would hope that the developments which have been occurring particularly in the last decade or so have served to reduce that tension and restore the traditional equation between common law and reason. Results which may appear to the ordinary person to be technical or absurd diminish the standing of the courts and do little to serve commercial interests. The developments which I have sought in this lecture to describe should help to meet the requirements of the present age and to secure that the courts will not insist upon so strict an observance of forms or rules as to allow the forms and rules to override reason and common sense. 