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Seeing the *Wood* for the trees

Rebecca Williams and David Wright examine a recent Supreme Court judgment

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'The judgment in *Wood* is a reaffirmation that the court will use all the tools available to it to seek to understand the meaning of the wording in a contract, using the text itself, but also the wider contract and commercial intention of the parties.'

The very recent judgment (29 March 2017) of the UK Supreme Court in *Wood v Capita Insurance Services Ltd* [2017] is an important clarification of the English courts' approach to the interpretation of the meaning of words in a contract.

While, as outlined below, this case involved the correct interpretation of the wording of the indemnity provisions of a sale and purchase agreement (SPA), the judgment is informative as to how English law will approach ambiguous wording in any contract in any sphere of industry, commerce and finance, and particularly in the construction industry where parties are often contracting under complex documentation that has been heavily negotiated. The clarification is welcome to both practitioners and commercial parties alike since, although the English law approach to the interpretation of contract terms is long established, two previous Supreme Court decisions handed down in 2011 and 2015 seem at first glance to confuse the position somewhat. However, as we discuss, the Supreme Court's decision has certainly not shut the door to future disputes.

Background

Capita entered into an SPA with Wood for the entire issued share capital of Sureterm Direct Ltd (Sureterm), a company offering insurance for classic cars. Shortly after Capita's purchase, the employees of Sureterm raised concerns about the sales process used, and an internal review revealed that Sureterm's telephone operators had in many cases misled customers to make a sale.

Capita and Sureterm informed the Financial Services Authority (FSA) and agreed to pay compensation to those customers who had been affected by the mis-selling.

The SPA contained an indemnity clause at 7.11 which provided that (emphasis added):

> ... the Sellers undertake to pay to the Buyer an amount equal to the amount which would be required to indemnify the Buyer [...] against all actions, proceedings, losses, claims, damages, costs, charges, expenses and liabilities suffered or incurred, and all fines, compensation or remedial action or payments imposed on or required to be made by the Company following and *arising from claims or complaints registered with the FSA, the Financial Services Ombudsman or any other Authority against the Company, the Sellers or any Relevant Person* 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.

Claim history

Capita brought a claim against Wood under clause 7.11, claiming it had suffered a loss as a result of the mis-selling of insurance which took place before it entered into the SPA. One of Wood's defences was that Capita's claim fell outside the scope of clause 7.11 as the requirement to compensate the customers was not as a result of a claim made by Sureterm's customers, or a complaint by those customers to the FSA or another public authority (since Capita and Sureterm voluntarily made the report to the FSA).

The High Court said that clause 7.11 obliged Wood to indemnify Capita, even if there had been no claim or complaint. The Court of Appeal disagreed and said that 7.11 operated in such a way that a claim or complaint must have been brought in order to trigger the indemnity.

Capita then appealed to the Supreme Court. Capita's final appeal was brought on the basis that the Court of Appeal had been influenced by Wood's argument that the decision of the Supreme Court in *Arnold v Britton* [2015] had 'rowed back' from the guidance on contractual interpretation which the Supreme Court gave in *Rainy Sky v Kookmin Bank* [2011]. Capita said that the Court of Appeal had placed too much emphasis on the words of the SPA, and had not given enough weight to the surrounding facts when interpreting the meaning and operation of clause 7.11.

The rival interpretations

In order to illustrate the differing interpretations of the clause, Lord Hodge split the wording into components as follows:

> The Sellers undertake to pay to the Buyer an amount equal to the amount which would be required to indemnify the Buyer [...] 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 from 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. (i) and which relate to the period prior to the Completion Date
>
>   (ii) pertaining to any mis-selling or suspected mis-selling of any insurance or insurance related product or service.

Capita submitted that the clause should be read by treating (2) and (a) as a composite phrase so the sellers were bound to indemnify against both (1) and (2+a), each of which would be subject to the conditions in (b).

Wood however said that the proper construction was to treat both (1) and (2) as being subject to three conditions in (a), b(i) and b(ii), and that (a) should be read as if there was a comma after 'claims'. This would mean that a condition of triggering the indemnity under (1) or (2) was that there must be either claims by customers, or complaints made to the regulatory authorities, in each case against the company, the sellers or any relevant person.

The Supreme Court has now made clear that its decision in Arnold did not involve any 'recalibration' of the approach taken in Rainy Sky.

What did the Supreme Court say in *Arnold* and *Rainy Sky*?

In *Rainy Sky* (which concerned the interpretation of refund guarantees issued by Kookmin Bank), the Supreme Court held that if the parties to a contract have used wording that leads to more than one interpretation, it is in most cases appropriate to choose the interpretation most consistent with business common sense. While the actual words used in the relevant agreement may have justified the bank's interpretation, the bank could not offer any commercial reason why the buyer would have agreed to such wording. Given the uncommercial result that would arise for the buyer from the bank's interpretation, the Supreme Court preferred the buyer's interpretation, essentially because it made more commercial sense.

In *Arnold*, which related to a tenant's appeal against the Court of Appeal's interpretation of a service charge clause, the Supreme Court seemingly adopted a different approach to *Rainy Sky*, saying that 'the reliance placed in some cases on commercial common sense' should not undermine the importance of the actual wording of the provision in question. In this way the Supreme Court did indeed seem to be 'rowing back' from its decision in *Rainy Sky* and said that if wording and meaning are clear, commerciality or otherwise should not necessarily detract from that fact.

The decision in *Wood*

The Supreme Court has now made clear that its decision in *Arnold* did not involve any 'recalibration' of the approach taken in *Rainy Sky*. It held that the task of the court is to ascertain the objective meaning of the language the parties have used to express their agreement, and this is not an exercise focused solely on the wording used. The court must consider the contract as a whole and give more or less weight to the elements of the wider context in reaching its view.

In the Supreme Court's judgment, Lord Hodge summarised the position by stating that:

> ... where there are rival meanings, the court can give weight to the implications of rival constructions by reaching a view as to which construction is more consistent with business common sense.

However, he noted that the court must be careful to strike a balance and must take into account the possibility that one party may have agreed something that in hindsight did not serve their best interest. Lord Hodge said that 'textualism [ie, the approach exemplified by the comments in *Arnold*] and contextualism [ie, the approach of *Rainy Sky*]' were both tools available to the court to be used to interpret the meaning of contractual wording, and that the question of which tool would be the most useful would depend on the facts of each case. In this way the approaches in *Rainy Sky* and *Arnold* were the same.

It is noteworthy that Lord Hodge said in the judgment that textualism may be the more appropriate approach if the contract is drafted by skilled professionals, although he acknowledged that negotiators of complex formal contracts may often struggle to achieve a logical and coherent text given the conflicting aims of the parties, failures of communication, differing drafting practices or deadlines which require the parties to compromise to reach agreement. In such circumstances he commented that consideration of the factual matrix and the purpose of similar provisions in contracts of the same type may assist in interpretation. In this case although the contract was professionally drafted, the parties accepted that clause 7.11 was 'opaque' and could have been drafted more clearly.

What this meant for Capita

Capita had argued that the correct interpretation of clause 7.11 was that all actions, proceedings, losses, claims, damages, costs, charges, expenses and liabilities suffered and incurred would trigger clause 7.11. Wood said that only claims or complaints registered with the regulator by a customer would trigger clause 7.11.

Having carefully reviewed the language used by the parties, Lord Hodge noted the commercial context of the clause and, in particular, the general purpose of clause 7.11. Had the clause stood on its own, he considered that the requirement for a claim or complaint by a customer and the exclusion of loss caused by a regularity action might have appeared anomalous. However, when considered in the context of the other wide-ranging warranties in the agreement, which he considered probably covered the circumstances which eventuated but which were time-limited, it was more understandable. Although the fact that Capita had failed to make a warranty claim within the relevant time limit apparently now made the SPA a poor bargain for Capita, it was not the function of the court to improve that bargain.

The Supreme Court accordingly dismissed Capita's claim, saying the Court of Appeal had interpreted clause 7.11 correctly: the indemnity was confined to loss arising out of a complaint.

Ultimately, a balance must be struck between legal certainty on the one hand, and the ability of the court to look at any factors it feels will assist in resolving ambiguity in contractual wording on the other.

Commentary

In many ways, *Wood* simply restates the approach to contractual interpretation adopted by the English courts, as established over many years of case law. The approaches in *Arnold* and *Rainy Sky*, broadly said to be 'textual and contextual', are not at odds with one another. The court will seek to use each of these tools to assist with interpretation and which tool is used will depend on the individual circumstances of each case.

This is a reaffirmation that the court will use all the tools available to it to seek to understand the meaning of the wording in a contract, using the text itself, but also the wider contract and commercial intention of the parties. The court will not look at the words to the exclusion of all other factors, nor will it ignore the actual words used. In particular, the court will take into consideration the risk allocation provisions of the contract, and look to maintain an internal consistency.

It is to the benefit of contracting parties using English law that the English courts will adopt this long-established approach, and that the courts will seek to resolve any ambiguity in the wording of a contract to ascertain its proper meaning and function.

However, it could also be said that *Wood* does not provide sufficient certainty to contracting parties as to how the court will seek to resolve ambiguity and disagreement as to the meaning and effect of contractual wording. Although the court can use the tools of textualism and contextualism at its disposal, this use will vary from case to case depending on the circumstances. In this way, parties considering submitting a dispute to court will have limited certainty as to the approach the court may take. If the Supreme Court had said the approach in either *Arnold* or the approach taken in *Rainy Sky* was correct, then parties to a dispute could at least assess the strength of their position knowing what the courts would do and how they would approach interpretation of their contract.

Certainty as to the approach the court is likely to take is conducive to avoiding disputes, and in this respect the finding in *Wood* that both the *Arnold* and the *Rainy Sky* approaches are valid, and do not conflict with one another, may mean a party feels it is 'worth a try' referring a dispute to court.

Ultimately, a balance must be struck between legal certainty on the one hand, and the ability of the court to look at any factors it feels will assist in resolving ambiguity in contractual wording on the other. The judgment is also a reminder of the importance of clear drafting, and that even a 'detailed and professionally drafted contract' can suffer from unclear language. Each party in this dispute agreed that the provision in question could have 'been drafted more clearly'.

On any view, ambiguity in contractual wording will continue to be a fertile breeding ground for dispute and, on a practical note, this case is a timely reminder to parties entering into a contract to ensure the wording used is clear, and reflects the intention of the parties. ■

Arnold v Britton & ors
[2015] UKSC 36
Rainy Sky SA & ors v Kookmin Bank
[2011] UKSC 50
Wood v Capita Insurance Services Ltd
[2017] UKSC 24