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Textualism and Contextualism in the Interpretation of Avoidably Opaque Contract Terms

The author considers Wood v Capita Insurance Services Ltd [2017] AC 1173

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Introduction:

In *Wood* the Supreme Court rejected an argument that *Arnold v Britton* [2015] AC 1619 had rowed back from guidance given in *Rainy Sky SA v Kookmin Bank* [2011] 1 WLR 2900 on contractual interpretation by overemphasising the text and underemphasising the context. The heart of the construction issue in *Wood* was whether an indemnity clause in a share purchase agreement ("SPA") required the seller to indemnify the buyer if there had been no complaint or claim by a customer to the Financial Services Authority (FSA) but the target company was nevertheless liable or potentially liable to make compensation pursuant to law or in accordance with regulatory requirements.

The Context:

In April 2010 W had sold to C Ltd the entire issued share capital of a company ("the Company") which carried on business as a specialist insurance broker. The SPA contained an indemnity clause which provided that W would indemnify C Ltd 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 out of claims or complaints registered with the FSA...". Under the SPA W also warranted that the Company had conducted its business in accordance with applicable financial services laws; however, in contrast to the indemnity which was not limited by time, the warranty had a two year lifespan and Lord Hodge JSC noted that C Ltd had not notified W of a warranty claim within the two year lifespan.

The Company sold insurance through online aggregator sites such as Confused.com but completed the sales directly over the telephone with the customer in order to confirm their risk details before selling the policy. Shortly after the share sale, employees of the Company reported concerns of mis-selling which had occurred prior to the share sale and in which telephone operators had substantially increased premiums from the original online quote by inflating the Company's arrangement fee. The FSA was informed and a remediation scheme was set up by the Company to compensate customers treated unfairly. It was common ground that the requirement to pay compensation arose not from legal claims raised by clients or a complaint made by clients to the FSA or any other regulatory authority but as a result of the referral by the Company, the requirement by the FSA that compensation should be paid and the agreement with the FSA to put into effect the remediation scheme. C Ltd estimated that compensation would exceed £1.35m and claimed under the indemnity in the SPA. W refused to pay out, arguing that on a proper construction the indemnity in relation to any loss was only triggered if that loss arose from a claim or complaint. By contrast, C Ltd argued that the indemnity in relation to 'actions, proceedings etc' was separate from the indemnity in relation to 'fines, compensation etc' so that it was only the latter which had to arise out of a claim or complaint and as a result W was liable under the indemnity.

First Instance and Court of Appeal Decisions:

The question of the proper construction of the indemnity was tried as a preliminary issue before Popplewell J ([2014] EWHC 3240 (Comm)) who agreed with C Ltd. His analysis focused solely on the terms of the indemnity and the commercial context and at [15] he asked rhetorically why the indemnity should be engaged only when an FSA investigation had been triggered by a customer complaint but not by employee whistleblowing or responsible management referral, and held at [16] that W's construction would produce the anomalous result that if, following an FSA investigation, the FSA required the Company to compensate all customers where the selling met certain criteria, and the Company wrote inviting such customers to lodge a claim and agreeing to pay it, the indemnity would be engaged whereas if the Company merely sent the customers a cheque in fulfilment of its obligations without inviting a claim it would not. W appealed.

The Court of Appeal's judgment reversing that decision ([2015] EWCA Civ 839) was given by Christopher Clarke LJ on behalf of Patten and Gloster LJJ. At [54-55] he noted that the judge had not referred to the fact that C Ltd had the benefit of two-year warranties and that mis-selling prior to completion would highly likely a breach of one or both of the warranties. He speculated that W might have taken the view that claims for mis-selling from a client would be likely to materialise during the first two years and so was willing to have the indemnity with no time bar applicable only to late claims brought by third parties (anticipated to be small in number) but not to claims which arose otherwise e.g. because of some (unpredictable) FSA initiative. At [29] he observed that care should be taken 'in using "*business common sense*" as a determinant of construction since what was business common sense depended on the standpoint from which the question was asked and the court would not be aware of the negotiations between the parties. What might appear, at least from one side's point of view, as lacking in business common sense might be a compromise which was the only means of reaching agreement so it was not surprising to find covenants which were not altogether logical from the point of view of either party or did not entirely achieve the probable aims of either of them.

W's counsel had offered an interesting analysis based on the relative likelihood of different meanings of a hypothetical predicate; if X said " *I like cats and dogs which are black and fluffy*" it might mean (a) " *I like cats and dogs which, in each case, are both black and fluffy* "; or (b) " *I like cats of any kind and dogs that are black and fluffy* " but it was most unlikely to mean "*I like cats which are fluffy and dogs which are black and fluffy* " which was the effect of what C Ltd was arguing. At [38] the judge said this analogy provided a 'small pointer' to the right construction. He also noted that the exercise of dividing the clause into component parts had been a useful aid to proper parsing but that the parties had not written the contract in that way and that it was necessary to look at the structure of the clause read as a whole in its original form.

Supreme Court:

The Supreme Court's judgment dismissing the appeal was given by Lord Hodge JSC on behalf of Lords Neuberger, Mance, Clarke and Sumption JJSC. He noted that counsel for C Ltd did not have the opportunity to advance his argument (that the Court of Appeal had placed too much emphasis on the words of the SPA and given insufficient weight to the factual matrix because of a submission by W's counsel that *Arnold v Britton [2015] AC 1619* had "rowed back" from the guidance on contractual interpretation in *Rainy Sky SA v Kookmin Bank [2011] 1 WLR 2900)* since the Court did not accept that *Arnold* had altered the guidance given in *Rainy Sky*, and he was invited him to present his case without reference to the well-known authorities on contractual interpretation with which the Court was familiar. He added at [13] that textualism and contextualism were not 'conflicting paradigms in a battle for exclusive occupation of the field of contractual interpretation'. Rather, the lawyer and the judge, when interpreting any contract, could use them as tools to ascertain the objective meaning of the language which the parties have chosen to express their agreement. The extent to which each tool would assist the court in its task would vary according to the circumstances of the particular agreement or agreements. Some agreements could be successfully interpreted principally by textual analysis, for example because of their sophistication and complexity and because they have been negotiated and prepared with the assistance of skilled professionals while the correct interpretation of other contracts might be achieved by a greater emphasis on the factual matrix, for example because of their informality, brevity or the absence of skilled professional assistance. But even negotiators of complex formal contracts might not achieve a logical and coherent text. There might often be provisions in a detailed professionally drawn contract lacking clarity and the lawyer or judge in interpreting such provisions should be particularly helped by considering the factual matrix and the purpose of similar provisions in contracts of the same type. The iterative process assisted the lawyer or judge to ascertain the objective meaning of disputed provisions.

At [24] he said that the disagreement between the first instance judge and the Court of Appeal arose from avoidably opaque drafting. He effectively adopted the reasoning of Christopher Clarke LJ, finding that the commercial context of the two-year warranties meant that restricting the ambit of the time-unlimited indemnity to claims was the proper construction. At [40] he said it was not contrary to business common sense for the parties to agree wide ranging warranties, which were subject to a time limit, and in addition to agree a further indemnity, not subject to any such limit but triggered only in limited circumstances.

Conclusion:

The decision is significant for at least two reasons. Firstly, Lord Hodge's description of textualism and contextualism as interpretive tools properly refocuses the constructive exercise back onto the meaning of the words used with neither concept having primacy. Secondly, the absence of reference to 'similar cases' as authority or even the need to set out the case law on interpretation of contract terms emphasises the fact-specific nature of the

‘iterative process’ and the likelihood that in the majority of situations ‘similar cases’ will in fact be nothing of the sort. As Lord Hodge noted, it was similar provisions in contracts of the same type which might help.