

Something's gone wrong with my contract

A recent case from the House of Lords examines the options when a contract is badly worded. **Christopher Nugee QC** of **Wilberforce Chambers**, who acted for Persimmon in the litigation, explains the decision and its practical implications.

KEY POINTS

- In interpreting a contract, the court can conclude that something must have gone wrong with the wording if it makes no commercial sense
- The court will then interpret the contract in the way a reasonable person would have understood the parties to mean
- The court cannot look at the negotiations between the parties to resolve questions of interpretation
- If a contract contains a mistake, it can be rectified so long as the parties were outwardly agreed on what it should have said

In October 2009 the Supreme Court replaced the House of Lords as the final court of appeal. In one of the last judgments handed down by the House of Lords, they considered a badly drafted contract between a landowner (Chartbrook) and a housebuilder (Persimmon Homes) (see *Chartbrook Ltd v Persimmon Homes Ltd* [2009] UKHL 38, [2009] 3 WLR 267).

The facts

Chartbrook owned an old warehouse site in Wandsworth. Persimmon thought it would be suitable for a mixed development (with commercial premises below and flats above), and made a number of offers for the site. Initially it offered Chartbrook an outright

purchase, but in February 2001 it offered a 'building licence' instead. Under this contract, Chartbrook would remain the owner of the land, but Persimmon would obtain planning permission, construct the development and then sell the flats (the commercial premises being sold back to Chartbrook). It would pay nothing upfront but Chartbrook would get a percentage of the sale proceeds with minimum guaranteed amounts. Chartbrook accepted this offer in principle, and apart from a re-working of the figures in May 2001 when the site was expanded, this remained the basis of the deal between the parties.

When the contract was signed in October 2001, it therefore provided for Persimmon to pay Chartbrook a price in two parts: (i) a guaranteed minimum sum (the 'Total Land Value') calculated on the net internal area for which permission was obtained; and (ii) an additional payment (the 'Additional Residential Payment' or ARP). The Total Land Value came to about £6.4 million, the bulk of which (about £4.68 million) was attributable to the 100 flats for which permission was obtained.

The dispute was over the ARP. This was defined in the contract as:

'23.4% of the price achieved for each Residential Unit in excess of the Minimum Guaranteed Residential Unit Value less the Costs and Incentives.'

(Residential Unit simply meant a flat; Minimum Guaranteed Residential Unit Value (MGRUV) was the amount of the Total Land Value attributable to the flats divided by the number of flats; Costs & Incentives (C&I) were amounts spent by Persimmon to induce sales.)

There was no doubt what Persimmon intended, which was to pay Chartbrook 23.4% of the sale proceeds, or the minimum guaranteed sum, whichever was the greater. The contract was therefore meant to provide that one calculated 23.4% of the net proceeds (deducting the C&I off the price achieved), compared this with the minimum sums (the MGRUVs) and the ARP was the excess, if any. In mathematical terms this could be expressed as: $(23.4\% \times (\text{Price} - \text{C\&I}) - \text{MGRUVs})$. Since the price achieved was about £24.1 million and the C&I £250,000, this came out at: $(23.4\% \times (£24.1\text{m} - 0.25\text{m})) - £4.68\text{m} = \text{c } £900,000$.

There were two fairly obvious difficulties with this. First, it is not the natural meaning of the words; and second, it requires moving the C&I from where it appears at the end of the definition and sticking it in the middle.

Chartbrook's case was that this was not what the contract said. What the contract said was that you took the price achieved in excess of the MGRUV, deducted the C&I, and then took 23.4% of that figure. In mathematical terms this was: $23.4\% \times ((\text{Price} - \text{MGRUVs}) - \text{C\&I})$. On the figures it came out as: $23.4\% \times ((£24.1\text{m} - £4.68\text{m}) - £0.25\text{m}) = £4.48\text{m}$ thereby giving Chartbrook a total of some £10.88m for its land rather than the £7.3m which Persimmon intended.

Both the trial judge (Briggs J) (see [2007] EWHC 409 (Ch), [2007] 1 All ER (Comm) 1083) and a majority of the Court of Appeal (Tuckey and Rimer LJ, Lawrence Collins LJ dissenting on this point) agreed (see [2008] EWCA Civ 183, [2008] 2 All ER (Comm) 387), Rimer LJ saying that the definition was clear, certain and unambiguous and the arithmetic straightforward.

Persimmon appealed to the House of Lords. It had three arguments: (i) that its interpretation of the contract should be preferred; (ii) that the court in interpreting the contract should look at the letters in which Persimmon set out what it was offering; and (iii) that the contract contained a mistake and should be rectified.

The ruling

All five Law Lords allowed the appeal on the first argument. The leading judgment was given by Lord Hoffmann who is well known to contract lawyers for two earlier cases in which he laid down the modern principles for interpreting written contracts, *Mannai Investment Co Ltd v Eagle Star Life Assurance Co Ltd* [1997] AC 749, [1997] 3 All ER 352 and *Investors'*

Compensation Scheme Ltd v West Bromwich Building Society, Investors' Compensation Scheme Ltd v Hopkin & Sons (a firm), Alford v West Bromwich Building Society, Armitage v West Bromwich Building Society [1998] 1 All ER 98, [1998] 1 WLR 896. (*Chartbrook v Persimmon* was in fact the last case Lord Hoffmann heard as he stood down in April after over 14 years as a Law Lord.) He accepted that Chartbrook's interpretation was more in line with the wording of the contract. But he said that if the contract as literally construed 'makes no commercial sense', or is 'commercially absurd' then the court can conclude that something has gone wrong with the language. Chartbrook's interpretation was irrational because the MGRUV was clearly intended to be a minimum guaranteed amount and the ARP only payable in certain circumstances, but on Chartbrook's case the ARP would be paid in any case where the sale proceeds exceeded the MGRUVs which they were bound to do unless the market suffered a catastrophic collapse.

The decision itself is a one-off case which only concerns the parties. But the approach is of general interest. It is another, and particularly strong, example of a case where judges are prepared to reject the plain meaning of a contract in favour of what they think must have been intended. Lord Hoffmann went out of his way to say that if the court concludes that something has gone wrong with the language, there is no 'limit to the amount of red ink or verbal rearrangement or correction' the court is allowed: it interprets the contract in the way a reasonable observer would have understood the parties to mean.

Other issues

Pre-contractual negotiations

Having allowed the appeal on this basis, the other points strictly did not arise but Lord Hoffmann dealt with them anyway as they are of general importance in contract litigation. The first was whether the courts could look at Persimmon's letters. In general a court interpreting a contract can take into account any background fact reasonably available to the parties; but there is a long-standing rule that negotiations and drafts cannot be looked at. This rule has been under attack for some time now, with various commentators and even some judges suggesting it was contrary to principle and capable of producing injustice. Persimmon argued that the time had come to sweep it away.

The present case was an ideal one for testing the point because the letters made it crystal clear what Persimmon was offering, and if the court could look at them, the interpretation of the contract would have been obvious.

Lord Hoffmann however reaffirmed the rule. He accepted that sometimes looking at the negotiations would produce a better interpretation of a contract, but thought it would mean that parties would adduce evidence of the negotiations in virtually every case, and that it would make advising on, or litigating, interpretation points both more expensive and less predictable. This decision (with which all the other Law Lords agreed) has effectively put a lid on the suggestion that the rule should be reconsidered, probably for a generation or more.

Rectification

Finally, Lord Hoffmann dealt with rectification. A written contract can be rectified where the contract as executed by mistake does not do what both parties intended it to. The general understanding of practitioners has been that for this purpose one looks at what each party thought the bargain was. Persimmon had no difficulty at trial in showing what its own intention was; and set out to establish that Chartbrook must have had the same understanding of the contract. But Chartbrook's directors denied this and said they always understood Persimmon to be offering the higher amounts. Despite some difficulties in their case, the trial judge accepted their evidence, and the Court of Appeal refused to overturn his findings.

But in the House of Lords, Persimmon ran a new argument which did not require them to reconsider the facts (the House of Lords will not in general re-open factual findings where the Court of Appeal has refused to overturn a trial judge). This was that everyone (including Persimmon's own advisers) had got the law wrong and that it was not necessary to look at the parties' subjective intentions at all. All that was necessary was to look at what the parties wrote and said to each other – if that revealed a consensus, objectively ascertained, which the contract was intended to implement but failed to do so, that was enough. The House of Lords had not had a rectification case for well over 50 years, and it could declare that this was the law. Lord Hoffmann said this 'objective theory' of rectification was right, and that Persimmon would have been entitled to rectification. This is probably the biggest

surprise in the case, and may lead to these cases being run quite differently.

What lessons can be learnt?

For those negotiating and drafting contracts, the ideal is of course to avoid the problem in the first place by expressing them clearly and unambiguously. But this is sometimes easier said than done. Contracts of any complexity often require calculations to be carried out and as the case illustrates (and it is not the only example), there is a particular danger in trying to express what are really mathematical formulae in words. Words and grammar are less precise than mathematical notations, and if the ARP had been defined as '23.4% x Price – MGRUV – C&I' the potential for ambiguities would one hopes have been obvious, and the various elements put in the right order with the brackets in the right places so that it read '(23.4% x (Price – C&I)) – MGRUV'. Or a worked example or two can be included in, or annexed to, the contract: this will help focus the parties' minds on how the formula is meant to work and should tease out whether both parties understand it in the same way.

For those trying to understand, or advise on, a contract, the case is another reminder that modern courts do not simply adopt a literal interpretation, but try and work out whether the interpretation makes any real sense. It is essential therefore to understand the practical operation of a contract rather than just read its language. It no doubt requires a strong case before a judge will conclude that something has gone wrong with it, but what strikes one judge as insufficiently irrational to depart from the ordinary meaning of the contract may strike another as so commercially absurd that it must be interpreted in another way.

Finally if things have gone wrong, and litigation ensues, *Chartbrook v Persimmon* has clarified the technical rules in two important respects. Negotiations between the parties are confirmed to be inadmissible when the court is interpreting the contract; this has long been the law but makes it doubly important to check the final contract with care. Second, the requirements for rectification have been clarified; this will place less emphasis on the parties' assertions as to what they thought the contract meant, and more on what they said and (particularly) wrote to each other. For those involved in litigating, these rules can make all the difference between success and failure. **CL**