

Lost in interpretation

When negotiating contracts, make sure the provisions in the final document are what you intended – otherwise, the courts may end up interpreting them for you, warns **Alan Ma**



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Consider a situation where after months of negotiation, a contract is finally drawn up and executed by supplier and buyer. There is a pricing provision in the contract and the payment is based on the supplier's performance. A dispute arises as to its actual meaning. Literally, the supplier is entitled to a payment of £4.6 million, but the buyer claims only £900,000 is due based on the actual intention of the parties.

These were the underlying facts of the House of Lords' decision on *Chartbrook Limited v Persimmon Homes* (Court report, 27 August). The contract was a development agreement such that the landowner, Chartbrook, should be entitled to receive an excess payment if the price achieved by the developer for each flat sold exceeded a base figure. The excess payment was expressed to be "23.4 per cent of the price achieved for each residential unit in excess of the Minimum Guaranteed Residential Unit Value (MGRUV) less Costs and Incentives (C&I)".

The literal meaning of the pricing provision reflected the formula:

Payment = (23.4% x (Price – MGRUV – C&I))

However, the actual meaning of the parties is:

Payment = (23.4% x (Price – C&I)) – MGRUV.

Persimmon claimed the second equation represented the actual intention of the parties and only £900,000 was payable. It argued the parties were in agreement over the meaning of the payment term during negotiations and they should be allowed to use evidence of the negotiations to prove this.

Both the High Court and the Court of

Appeal rejected Persimmon's submission and ruled that pre-contract negotiations were inadmissible. But the House of Lords allowed the appeal by unanimous decision.

Prior to this case there is a line of cases on this issue and the courts' approach in contract interpretation can be summarised as follows:

- The test is objective. How would a reasonable person have understood the meaning of the provisions? The reasonable person should have all the available background knowledge to the parties in the situation during the time of the contract.
- Pre-contract negotiations are inadmissible for the purpose of interpreting a contract.

The rationale is that parties' positions change during negotiation and only the final document records a consensus.

- The court decides to go beyond the literal meaning of a provision and examines the true intention of the parties when it is clear that there has been a misunderstanding with the language and it should be clear what a reasonable person would have understood the parties to have meant.

Chartbrook confirms that the above approach is still good law. The reason that Persimmon's appeal was allowed is that Chartbrook's interpretation made

the structure and language of the relevant provisions appear arbitrary and irrational, when it was possible for the concepts employed by the parties to be combined in a rational way. The law lords preferred Persimmon's view of the proper construction of the contract.

Careful drafting ensures contracts reflect parties' true intentions. Reviewing, commercially and legally, a drafted contract prior to its execution should reduce the risks of problems arising in the future.

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