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Welcome

We are pleased to have two superb articles this month by our guest writers.

The first is by Richard Lyons, Counsel and James McKenzie, Associate of King & Wood Mallesons on reforms which will allow third party funding of arbitrations. In particular the article explores what the construction industry can expect from these reforms including the benefits and associated risks of such funding arrangements. The Hong Kong Law Reform Commission's final report, setting recommendations for third party funding, is available at the following link: *http://www.hkreform.gov.hk/en/publications/rtpf.htm*.

We are also very pleased to welcome back Steven Walker QC and David Johnson of Atkin Chambers who provide a very comprehensive summary of the law in relation to the interpretation of written documents in light of two recent English Supreme Court judgments.

James B Longbottom
Managing Director

Getting on the Third Party Funding Bandwagon: Opportunities and Risks for Hong Kong's Construction Industry

By **Richard Lyons** Counsel
and **James McKenzie** Associate,
King & Wood Mallesons

Introduction

The Law Reform Commission's (LRC) recent Report on Third Party Funding for Arbitration (Report) has recommended that the Arbitration Ordinance (Cap. 609) be amended to allow third party funding. The reforms have the potential to significantly affect the construction industry and disputes concerning it.

Should the reforms go ahead, they will permit third party funding in arbitration, mediation and litigation proceedings under the Arbitration Ordinance, cutting across various sectors. The reforms have the potential, however, to have an outsized effect on the construction industry which (pending the outcome of the Government's proposed security of payment legislation)[1] continues to rely heavily on arbitration as a primary mechanism of dispute resolution.

This article provides a brief outline of the current status quo of third party funding of arbitrations in Hong Kong, and

...restrictions on third party funding of arbitrations act to deny access to justice in Hong Kong and are increasingly hard to justify...

explores what construction industry participants can expect if this reform goes through including both the benefits and the associated risks of funding arrangements.

Current Status Quo of Third Party Funding of Arbitrations in Hong Kong

As a common law jurisdiction, Hong Kong inherited, and continues to adhere to, the now somewhat archaic English legal doctrines of maintenance and champerty. Broadly speaking, these doctrines prohibit funding of legal proceedings by third parties. Whilst there has been a loosening of the scope of the doctrines, the Hong Kong courts have continued to resist their outright abrogation.

As a result, and subject to some exceptions,[2] third party funding in litigation is impermissible in Hong Kong. In arbitration, a line of authority ending most recently in the Hong Kong Court of Final Appeal's decision in *Unruh v Seeberger* [2007] HKLRD 414 has expressly left open the permissibility of third party funding. Out of concern for this lack of clarity, in June 2013 the Chief Justice and the Secretary for Justice asked the LRC of Hong Kong to review the subject and decide whether reform was needed. The LRC set up the Third Party Funding for Arbitration Sub-Committee (the "Committee") to consider whether third party funding should be permitted in arbitration and, if so, whether corresponding ethical and financial standards for funding should be introduced.

The Report recommended that third party funding of proceedings under the Arbitration Ordinance be allowed. Some of its other key recommendations include:

1) **Light touch regulation:** the LRC has proposed a "light touch" approach to regulation of funders for an initial, introductory three year period. This is in keeping with the current trend in other common law jurisdictions.

   The LRC has recommended that a code containing clear ethical and financial standards for third party funders providing funding to parties should be developed ("Code"). The LRC has recommended that the Hong Kong Advisory Committee on the Promotion of Arbitration should oversee the adoption of the Code and assess its effectiveness after this initial three year period.

2) **Disclosure of Funding:** the LRC has recommended that where a funding agreement is entered into, the funded party must give written notice to the other party to an arbitration and any administering arbitral institution of the fact that a funding arrangement has been entered into and the identity of the third party funder.

   Disclosure of funding agreements will assist to minimize the possibility of conflicts of interest and foster a more open and transparent system of funding.

3) **Adverse costs orders:** LRC did not recommend that any changes be made to the power of the arbitral tribunal to make an adverse costs award against third party funders. The Report found that the current powers of a tribunal under the Arbitration Ordinance to order a party to give security for costs was adequate protection.

4) **Mediation and Court Proceedings:** the LRC has also recommended that consideration be given to whether to make consequential amendments at the same time to the Mediation Ordinance (Cap 620) to extend such non-application of the common law doctrines.

The Report makes clear that restrictions on third party funding of arbitrations act to deny access to justice in Hong Kong and are increasingly hard to justify when most other major common law jurisdictions and all the major arbitral centres either have already, or appear shortly to,[3] liberalise funding options.

Should the reforms go ahead, they will have a tangible effect on arbitrations in Hong Kong and on the construction industry in particular. Indeed, these changes may happen sooner rather than later depending upon the speed of the legislative process and perceptions that the uncertainty of whether or not third party funding is permissible in Hong Kong is damaging its status as a leading arbitral centre.

Potential Benefits of Funding Arrangements

So what can the construction industry expect if reform goes ahead? The effect of third party funding on construction arbitrations in Hong Kong will depend upon a variety of factors including the way in which reform is legislated for, the types of funders who operate in the Hong Kong market, and the particulars of funding arrangements in place. We highlight some of the potential benefits below.

Increased funding scope and risk distribution

The clearest and most obvious change that is likely to be brought about by the presence of third party funding is an increase in the scope of funding and therefore construction arbitration claims in Hong Kong. This is likely to affect not only employers, contractors and subcontractors otherwise unable to pursue claims in arbitration but also parties seeking to mitigate their risks in bringing a claim.

In the case of impecunious subcontractors and other parties in Hong Kong construction projects, third party funding will provide new avenues for claims that they have otherwise been unable to bring or have traditionally been settled. Although the scope of such increase may be offset by the introduction of security of payment legislation, funding arrangements are nevertheless likely to open up a significant slice of existing, un-arbitrated claims and potential future claims.

Third party funding provides not only financial resources with which to pursue a claim but also provides opportunities to manage the risks associated with pursuing a claim through arbitration. Those parties who can afford to arbitrate may be able to use a third party funder to mitigate financial risks associated with the pursuit of a claim through arbitration. For instance, if an employer or contractor decides to transfer some or all of its arbitration risk to a funder, it may be able to achieve a successful recovery in arbitration proceedings without having to pay legal fees and other costs. It may also be able to avoid having to obtain or allocate funds to deal with the consequences should the claim fail.

All of the above has the potential to assist with cashflow on projects in which there are disputes being run parallel to the project's work, and assist to free up otherwise encumbered cashflow from construction companies' other projects.

Speculative claims or screened claims?
One of the concerns often leveled at third party funding is the potential for the practice to encourage frivolous and vexatious claims. Although this criticism has historically been a legitimate one, practice in most of the major funding market places,[4] and amongst the main funding bodies,[5] now appears to favour a highly selective and rigorous process of funding which mitigates much of this concern. This makes sense: funders only recover their investment in a claim where it is successful and therefore have a direct economic incentive to be selective in funding cases.

In being selective, funders can provide much needed additional due diligence to arbitration claims. Typically, before agreeing to fund a claim, extensive due diligence work will be undertaken by a funder. In many cases, this will involve employing Queen's Counsel and/or external legal counsel to review the merits of the claim before agreeing to fund it. This process can assist to screen unmeritorious or speculative claims and ensure that the decision to take a claim to arbitration is rigorous; something that many may feel is lacking in some construction arbitration claims in Hong Kong.

Once a funding arrangement is in place, the funder often acts as a go between in settling legal costs and estimates with external counsel, something downstream parties unsophisticated in dealing with legal counsel will benefit from. Further, under many funder's funding arrangements, legal teams acting on the claim and the funded party are often required to provide regular reports to enable the funder to monitor the claim's progress, chances of success and compliance with the funding agreement. This active monitoring may help enhance case management of downstream disputes and, as a result, assist in costs management. Care must nevertheless be taken by the funded party and funder to ensure that lines of reporting are clear.

Promotion of settlement and deterrence of oppressive conduct
One of the potential corollary effects of funding arrangements is the effect the presence of a funder has on the administration of the claim. A notable potential area in which the presence of a funder may assist is in the discouragement of vexatious or oppressive interlocutory applications or discovery processes which are often used by defendants to stifle a claimant's claim in arbitration. Where a claimant is funded, its deeper pockets may discourage such applications being taken out. A further corollary benefit is in the settlement of claims: knowledge of a funding arrangement (if disclosed) may promote settlement by increasing the defendant's perception of the claim's strength.

Potential Risks Associated With Funding

Third party funding is not, however, without its risks. The speed with which third party funding has fallen into vogue has raised legitimate concerns in relation to the conduct of arbitration proceedings where a funding arrangement is in place and gives rise to issues such as:

a) To what extent should the funding arrangement be disclosed?
b) What is the impact of a funding arrangement on the award of security for costs?
c) To what extent should conflicts of interest be disclosed and managed?

Many of these concerns, and the extent to which regulations should seek to deal with them, are expected to be addressed by the Committee in its final report.

In many instances, conflicts of interest, such as the disclosure of any relationship between the funder and an arbitrator, will need to be carefully considered and hard and soft legal regulations enacted as appropriate.[6] Nevertheless, some risks can be addressed by parties themselves through careful management of the funding arrangement.

Conflicts of interest
Potential conflicts of interest are one major source of concern to construction parties seeking to use a third party to fund an arbitration. Although the LRC has recommended the adoption of the Code and the disclosure of funding agreements, funded parties should ensure that conflicts arising from the funding agreement are carefully managed.

One issue of particular concern arises where the funder pays the legal costs of proceedings directly. This arrangement may result in the claimant's lawyer being unduly influenced by the funder and therefore favour the funder's interests and views over those of the claimant beyond the terms set out in the agreement.

This is a real concern and should militate that those construction industry claimants accepting funding carefully consider the nature and extent of a funder's control over proceedings. Independent legal advice should be sought on the terms of the funding arrangement, which should clearly set out the relationships between the parties and any necessary disclosures.

...conflicts of interest, such as the disclosure of any relationship between the funder and an arbitrator, will need to be carefully considered and hard and soft legal regulations enacted as appropriate.

Capital requirements and the nature of the funder
Construction claimants should also be careful in choosing their funder to ensure that they are financially able to see a claim through. Although there are now established players in the Hong Kong funding market, the reform, should it pass, is likely to encourage other funders to enter the market.

Funders internal financing can vary significantly: some are publicly listed, some are backed by high net worth individuals whilst others have lines of credit available to them. The nature of a funder's financing structure can affect not only its ability to maintain necessary funds but may influence its approach to management of claims. Different funders will focus on cases of different claim sizes, types and in differing jurisdictions.

It is therefore critically important for a construction industry claimant to do its due diligence on any funder.

Disclosure and privilege
Generally speaking, in order to ensure that the funder can perform its due diligence, a claimant will provide significant access to the information held by the claimant or the claimant's lawyer that might be relevant to the claim and the funder's decision to provide funding.

However, parties accepting funding should be aware of their lawyer's duty of confidentiality to the client and the potential for this to be compromised by providing information about

the claim to the funder. Legal privilege in documents prepared by the claimant's lawyer, or for the purpose of the dispute, may be waived when otherwise privileged communications are given to the funder. Communications between the funder and the funded claimant and/or claimant's lawyer about the claim may also not be protected by privilege.

The extent to which this will be problematic should therefore be carefully considered before entering into a third party funding arrangement. Legal advice should be sought on the impact of any disclosures before they are made and particular scrutiny should be made of the terms of any funding agreement. To safeguard a party's position, at a minimum any funding agreement should state that documents provided to the funder that are not already in the public domain remain confidential and privileged.

Conclusions

Time will tell what the contours of reform, if any, will look like. The LRC Report suggests that, in keeping with Hong Kong's typically cautious approach to enacting change, regulation and the extent of reform will be incremental. Of course, the reform still also has to navigate its way through the Legislative Council.

The speed of such change, however, may be affected by Singapore's recent movement toward abolishing the doctrines of champerty and maintenance, and so the construction industry should familiarize itself with the benefits of funding arrangements sooner rather than later.

In doing so, particular care should be taken to examine both the structure of funders and funding arrangements which will ultimately prove the most determinative elements in the success of any funding arrangement.

For further information contact:
Richard.Lyons@hk.kwm.com
James.McKenzie@hk.kwm.com

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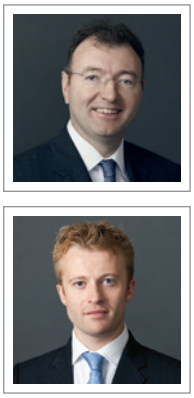
Footnotes:

1. The proposed Security of Payment Legislation for the Construction Industry is currently pending with the Hong Kong Government's most recent Report on its Public Consultation released in April of this year: *http://www.devb.gov.hk/filemanager/en/content_880/SOPL_consultation_report.pdf*. Next steps are for the Government's Development Bureau to finalise the framework of the legislation and to prepare a bill for submission to the Legislative Council.
2. In *Unruh v Seeberger* [2007] HKLRD 414, the Hong Kong Court of Final Appeal confirmed that three exceptions to the application of the doctrines of maintenance and champerty still apply: (i) where parties have a legitimate common interest in the outcome of the litigation; (ii) where there are access to justice considerations; and (iii) a miscellaneous category involving practices which have been accepted as lawful (e.g. the sale and assignment by a trustee in bankruptcy of an action commenced in the bankruptcy to a purchaser for value.).
3. Singapore's Ministry of Law has recently published draft legislation to legalise and regulate third party funding for arbitration: the *Civil Law (Amendment) Bill* 2016 and *Civil Law (Third Party Funding) Regulations* 2016.
4. Notably, this includes England and Wales, Australia and most states in the United States.
5. See, for example, Clause 23(1)(b) of the Government Design-build Conditions.
6. CIETAC's Hong Kong Arbitration Centre has been one of the first movers in Hong Kong on this establishing a working group to consider the role of the arbitral centre in regulating third party funding. The working group has unveiled draft guidelines dealing with, inter alia, conflicts of interest. The guidelines are currently in public consultation and are available at: *https://hkarbitration.files.wordpress.com/2016/05/cietac-draft-guidelines-17-may-16.pdf*

Contractual Interpretation After *Arnold v. Britton*: What Does It All Mean?



By **Steven Walker QC** *and* **David Johnson,**
Atkin Chambers

Introduction

A key theme in Leo Tolstoy's great novel, *Anna Karenina*, is that of communication and miscommunication. Tolstoy contrasts the perfect, telepathic understanding between characters such as Kitty and Levin, who are able to understand each other using only the first letters of words, with misunderstandings borne out of Anna's own written communications that travel thousands of miles, leaving her increasingly isolated.

In the present day, understanding the true meaning of written words is a problem that confronts parties, lawyers and lovers of fiction alike. Communication is riddled with nuances, layers and distinctions that the written word alone cannot itself convey. To compound the problem, words are usually deciphered by a host of different individuals long after they have been committed to text by another. For that reason therefore, interpretation and the rules that guide it are a central component of contract law.

Last year saw a number of significant judgments with potential implications for contract and construction law generally. Amid pronouncements on liquidated damages[1], notification provisions[2], construction adjudication and limitation periods[3], the Supreme Court issued two important rulings that contained detailed comments on the regimes of contractual interpretation (*Arnold v. Britton*[4]) and the implication of terms (*Marks and Spencer Plc v. BNP Paribas Securities Services Trust Company (Jersey) Ltd*[5]). This article will examine the approach taken by the courts to interpretation of written documents, what wider trends those judgments appear likely to signify, and whether, much like Tolstoy's heroine, commercial parties' attempts to clarify the meaning of their contracts will continue to be prone to misinterpretation.

The Development of the Purposive Approach

At the end of the first decade of the 21st century, the then-outgoing Lord Hoffmann was the principal architect of a number of judgments in the United Kingdom House of Lords that, to many, appeared to herald the evolution and integration of a number of distinct areas of contract law in which contractual interpretation, remoteness of loss[6], the implication of terms in fact[7] and rectification[8] as essentially part of the same process: namely, turning on the identification of the parties' intentions at the time of contracting.

English law has always placed a high degree of emphasis on 'freedom of contract': the ability of parties to reach whatever

A contract agreed between two parties can be capable of having harsh, absurd or draconian effects on one and yet would be upheld by the courts if the wording used was clear.

agreement they choose, in the knowledge that it will be upheld by the courts. A contract agreed between two parties can be capable of having harsh, absurd or draconian effects on one and yet would be upheld by the courts if the wording used was clear.

The great Lord Denning was the leader of the resistance to this 'literalist' approach. Nowhere was this more apparent than in the courts' approach to exclusion and limitation clauses, with which a party, usually in a vulnerable bargaining position, would effectively be forced to 'agree' to draconian provisions excluding or restricting liability for breach by their counterparty. Over time, the courts developed a great many ways of interpreting such provisions to restrict their effect to avoid perceived injustices from resulting from their usage[9].

Against this backdrop, the House of Lords in *Investors Compensation Scheme Ltd v. West Bromwich Building Society (ICS)*[10] took the opportunity to clarify things in a case in 1997 involving a claim based on the assignment of claims arising out of negligent financial advice. The case turned on the meaning of a clause that purported to exclude the assignment of:

> "*Any claim (whether sounding in recission for undue influence or otherwise)*";

and whether or not this excluded claims for damages as well as recission. The lower courts having reached contrary conclusions, the House of Lords held, despite the wording, that it did not, effectively by concluding that, when executing the contract of assignment, there was no such apparent intention to do so.

In so concluding, the House of Lords set out clear principles that were said to be applicable when approaching the interpretation of a written document. Declaring the previous 'intellectual baggage' of interpretation largely a dead letter, Lord Hoffmann explained that[11]:

1) The court must consider the meaning a document would convey to a reasonable person having all the background knowledge that would reasonably have been available to the parties at the time the document was made.
2) This background knowledge includes all relevant factual information that was available to the parties, and which would have affected the way in which the language used in the document would have been understood by a reasonable person.
3) Pre-contractual negotiations, however, are excluded from this background information.
4) The meaning of a document may not be the same as the meaning of the words used. The court can and should attempt to ascertain what the words were intended to convey as opposed to their literal meaning.
5) Whilst parties must be taken to have used the words they did for a reason, it may be possible to conclude that something has gone wrong with that language, and the Court must attempt to give effect to what the parties meant to say.

The exercise of interpretation (or, as it is commonly referred, 'construction') is therefore to identify what a reasonable individual would have understood the parties to have meant by the language used. Crucially, this is not the same as identifying what the parties themselves understood, or intended: subjective intent is irrelevant to the process of interpretation and evidence of such should not be relied upon as an aid to construction. The only relevant evidence is therefore that which was known or reasonably available to both parties at the time of contracting[12].

ICS has been cited extensively before common law courts around the world and has received approval in numerous jurisdictions[13]. However, as set out below, the approach it laid the foundations for has, in our view, had the effect of adding a layer of complexity and unpredictability to commercial disputes beyond that which was likely to have been the intended result at the time.

Did You Really Mean *That*?

What made the approach of the House of Lords in *ICS* especially noteworthy was Lord Hoffmann's express acknowledgment that the court should be open to the possibility that the drafted words may not reflect the objectively ascertained intention of the parties - and that the parties may therefore have used the wrong words or syntax in their drafting. Whilst parties should be understood normally not to have made linguistic mistakes, it is nevertheless possible for something to have 'gone wrong with the language'. This approach followed from earlier House of Lords decisions such as *Wickman Machine Tool Sales v L Schuler AG*[14] where Lord Reid said[15]:

> "*The fact that a particular construction leads to a very unreasonable result must be a relevant consideration. The more unreasonable the result, the more unlikely it is that the parties can have intended it, and if they do intend it the more necessary it is that they shall make that intention abundantly clear*";

and *The Antaios*[16] where Lord Diplock said:

> "*If detailed and syntactical analysis of words in a commercial contract is going to lead to the conclusion that flouts business common sense it must yield to business common sense.*"

This approach provides the court with flexibility; however, the extent to which the courts can and will ultimately end up

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rewriting the parties' contractual bargain on this basis has frequently been a cause for concern.

The approach to be adopted where a provision is open to more than one interpretation was developed further by the Supreme Court in *Rainy Sky v. Kookmin Bank*[17]. It was explained[18] that the correct approach was to start (and finish) by looking for and adopting the interpretation that most accords with commercial common sense. Crucially, the exercise of identifying the correct commercial intention was to be carried out from the outset, and is not simply a 'fallback' tool to be deployed once it has been concluded that the natural meaning of the words produces a result that appears to have been unintended[19].

As *ICS*, the *Rainy Sky* approach has been followed in multiple common law jurisdictions. The Hong Kong Court of Final Appeal confirmed its approval in the recent decision of *Sinoearn International Limited v. Hyundai-CCECC Joint Venture (A Firm)*[20], and previously in *Ying Ho Company Limited (and Others) v. The Secretary for Justice*[21]. In the former, the Respondent had obtained mud-dumping permits on the Appellant's behalf. When it transpired the dumping could not take place, the question arose as to the Appellant's obligation to dump (and, accordingly, pay for) the contaminated mud. The Court of First Instance and the Court of Appeal having reached opposing conclusions, the Court of Final Appeal adopted the *Rainy Sky* approach and sought to identify the 'commercial common purpose' shared between the parties[22]. It ruled that, although the commercial purpose of the contract was clear, there was no assumption that the Appellant would be liable if the dumping did not take place.

The Problem of Pre-contractual Negotiations

The third of Lord Hoffmann's principles from *ICS* has arguably proved the most contentious. As a matter of law, pre-contract negotiations are however inadmissible evidence as an aid to interpretation of the contract. Lord Hoffmann explained in *ICS* that this distinction was drawn on the grounds of *"practical policy"*[23], and that its boundaries were 'unclear'. In *Chartbrook v. Persimmon Homes*[24], Lord Hoffmann took the opportunity to reiterate it[25]. Whilst such evidence was inadmissible for interpretation of the contract, it was, however, admissible for other purposes, such as to establish what facts were known to the parties at the time, or, notably, in support of a claim for rectification of the contract. However, the rule has been subject to an extensive amount of criticism, most notably by Lord Nicholls writing extra-judicially[26]. Lord Hoffmann himself accepted in *Chartbrook*[27] that it was, in some cases, justifiable only on pragmatic grounds.

There are also numerous exceptions to the rule. The most commonly referred to is the so-called 'private dictionary' rule: negotiations can be admissible if they show that the parties ascribed a particular meaning to a provision or form of words based on linguistic usages between themselves[28].

Moreover, the prohibition applies to interpretation, which is in theory at least conceptually different from an action for the equitable remedy of rectification of a contract document, in which circumstances pre-contract negotiations are admissible. Of rectification itself, Baroness Hale stated[29]:

> *"...negotiations where consensus has been reached are very helpful indeed. If the language in the eventual contract does not reflect that consensus, then unless there has been a later variation of it, the formal contract should be rectified to reflect it. It makes little sense if the test for construing their prior consensus is different from the objective test for construing their eventual contract".*

Accordingly, rectification itself requires more or less the same enquiry to be carried out by the court: to work out what the objectively ascertained shared intentions of the parties were[30]. Evidence of the parties' pre-contractual communications will be admissible as long as an action for rectification is maintained. Even if that action fails, it opens the door to the parties submitting and relying on voluminous evidence of pre-contractual conduct. The likelihood of the court being able to discount this in relation to the process of interpretation where a separate action for rectification is maintained seems unlikely.

The Unified Approach

Subsequent decisions saw numerous areas of law subsumed into, or, at the very least, linked with, interpretation and the objective ascertaining of the parties' intentions. This has had the effect of yet further broadening the type and volume of such evidence relied upon by parties in commercial litigation.

In *Attorney General of Belize v. Belize Telecom*[31], Lord Hoffmann for the Privy Council held that the process of implying terms in fact was no different from the ordinary process of interpretation. The question for the court in deciding whether to imply a particular term was[32]:

> *"...whether such a provision would spell out in express words what the instrument, read against the relevant background, would reasonably be understood to mean".*

His Lordship made clear[33] that the tests of 'officious bystander', and, more importantly, 'business efficacy', are;

> *"not... to be treated as different or additional tests. There is only one question: is that what the instrument, read as a whole against the relevant background, would reasonably be understood to mean?"*

Separately, and somewhat controversially, the five Law Lords of the House of Lords adopted varying approaches to the principle of remoteness in *Transfield Shipping v. Mercator Shipping (The Achilleas)*[34]. Owing to the fact that all five Law Lords gave different speeches, the ratio of the case is not especially clear. Lord Hoffmann, however, supported by Lord Hope, explained that recoverability of damages for breach of contract required an assumption of responsibility by one party to the other in respect of those losses; it was necessary once again to look at the intentions of the parties, objectively ascertained, in order to work out whether such an assumption of responsibility had taken place. Lord Rodger and Baroness Hale favoured the orthodox, policy-based approach to remoteness that is best known from *Hadley v. Baxendale*, whilst Lord Walker expressed support for both camps. On one view at least, *The Achilleas* represents a significant development in the law of remoteness, focusing the enquiry not on the factual connection between breach and loss but instead on the nature and content of the parties' contractual bargain.

The combined effect of these decisions was that interpretation implication of terms, rectification and remoteness could all be summarised thus: **a contractual agreement will generally be held to have the legal effect that a reasonable person in all the circumstances would have understood the parties to have agreed it would have.** However, subsequent, recent decisions from the Supreme Court appear to indicate a retreat from this assimilated approach.

The Recent Decisions of the Supreme Court

Arnold v. Britton[35] was the first of the key decisions from the Supreme Court that indicated a potential retreat from the high point of the unified approach. That was, however, perhaps

due as much as anything to the very particular facts of the case. The court was required to interpret a service charge provision in relation to a 99-year leasehold agreement from 1974. Pursuant to that agreement the lessee had promised:

> "*To pay to the Lessor...as a proportionate part of the expenses and outgoings incurred by the Lessor in the repair maintenance renewal... and the provision of services... the yearly sum of Ninety Pounds... for the first Year of the term hereby granted increasing thereafter by Ten Pounds per hundred for every subsequent year or part thereof*".
>
> (emphasis added)

The lessor argued that the underlined words stipulated that the annual service charge was a fixed £90 charge for the first year, increasing by 10% per year on a compound basis. The lessee may or may not have had in mind the quote frequently attributed to Albert Einstein; namely, that:

> "*Compound interest is the eighth wonder of the world. He who understands it, earns it... He who doesn't... pays it*".

Based on the Bank of England's published inflation figures, it was calculated that by 2012 the annual service charge (on a chalet retailing for around £70,000) was £3,366. By 2072, it was estimated to be some £1,025,004. Not surprisingly, the lessee argued that this was not the intention of the lease, and that the words "*up to*" were required to be inserted prior to "*the yearly sum of Ninety Pounds*".

The Supreme Court disagreed. Considering that there was, in fact, only one literal interpretation of the wording, it held that it was this that had to be given effect to. Lord Neuberger stated[36] that:

> "*It is true that the first part of the clause refers to a lessee paying a 'proportionate part' of the cost of the services, and that, unless inflation increases significantly in the next 50 years it looks likely that the service charge payable under each of the 25 leases may exceed the cost of providing services to the whole of the Leisure Park. However, if, as I believe is clear, the purpose of the second part of the clause is to quantify the sum payable by way of service charge, then the fact that, in future, its quantum may substantially exceed the parties' expectations at the time of the grant of the lease is not a reason for giving the clause a different meaning. As already explained, the mere fact that a court may be pretty confident that the subsequent effect or consequences of a particular interpretation was not intended by the parties does not justify rejecting that interpretation*".
>
> (emphasis added)

After referring to Lord Hoffman's speech in *Chartbrook* for the general approach to the interpretation of a written contract,

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Lord Neuberger then went on to identify six general factors that were important in the *Arnold* case[37], namely:

1) Reliance placed on commercial common sense and surrounding circumstances should not undermine the importance of the language and wording of the provision to be construed.
2) The less clear the centrally relevant words to be interpreted, the more ready the court can properly be to depart from their natural meaning.
3) Commercial common sense is not to be invoked retrospectively.
4) Whilst commercial common sense is an important factor to be considered, a court should be slow to reject the natural meaning of a provision simply because the consequences seem imprudent for a party. The purpose of interpretation is to identify what the parties have agreed, not what the court considers they should have agreed.
5) When interpreting a contractual provision, one can only take into account facts or circumstances that existed at the time the contract was made and were known or reasonably available to both parties.
6) In cases where an event subsequently incurred that was plainly not intended or contemplated by the parties on the basis of the wording, but it is clear what the parties would have intended, the court will give effect to that intention[38].

The Court made clear that business common sense is therefore just one factor in the exercise of identifying how the words of the contract would be understood by a reasonable person with the background knowledge held by the parties. Moreover, the court cannot rely on what it perceives to be business common sense to find a different meaning where there is only one possible meaning.

Analysis of *Arnold v. Britton*

Arnold v. Britton is not of itself revolutionary in its approach: where a court or tribunal is faced with a dispute as to the meaning of particular wording in a provision or provisions of a contract, it must begin by considering the wording itself in its documentary, factual and commercial context, and, where that wording is, when placed in context, unambiguous, it must be applied[39].

Other than the harsh result for the lessee[40], there is one particular aspect of *Arnold v. Britton* that marks the case out as somewhat unusual. There was, in fact, no background documentation against which the lease agreements could be construed by any of the courts: the lease documents themselves were the only evidence available. In such circumstances, it is perhaps hardly surprising that the court considered it was unable to displace the wording of the agreement with business common sense: with no evidence, identifying that business common sense would have been nothing more than speculation on the part of the court.

By contrast, where such evidence is available, the court is in reality likely to take it into account, as Lord Neuberger's principles make clear. The observation by Baroness Hale in *Chartbrook*[41] that the fact the court had been made aware of the parties being in agreement on a particular interpretation in their negotiations had assisted and had influenced their decision in reaching the conclusion it did on the contract's interpretation is noteworthy.

It is worth noting that, prior to *Arnold v. Britton*, in *Sembcorp Marine Limited v. PPL Holdings Pte Ltd*[42], the Singapore Court

of Appeal considered that questions of admissibility of evidence had to be considered by reference to the existing law of evidence, which, in Singapore, is largely governed by the Evidence Act. The court noted the tendency of many parties to rely on the *ICS* line of authority and produce extensive evidence of little or no value in support of their contended-for construction. The court concluded that it was necessary for any background facts or matters, circumstances and other elements of the 'matrix of fact' to be specifically pleaded, with any evidence introduced to be limited to those pleaded matters. It is notable that the England and Wales Commercial Court rules also adopts such a rule, and other divisions of the courts may yet follow suit.

Interpretation is also highly subjective; it should be noted that, in cases such as *ICS*, *Chartbrook* and *Hyundai*, the different courts each reached different conclusions on the relevant interpretation. That, to us, appears to be a difference of opinion rather than as a result of any particular difference in approach to interpretation and is an issue that arises not from the proper legal approach but from the inevitably open-textured nature of language[43]. As Lord Hoffmann observed in *Chartbrook* (at [15]):

> "*It is, I am afraid, not unusual that an interpretation which does not strike one person as sufficiently irrational to justify a conclusion that there has been a linguistic mistake will seem commercially absurd to another".*

Moreover, as Lord Carnwath observed in his dissenting judgment in *Arnold*[44]:

> "*As Tolstoy said of unhappy families, each ill-drafted contract is ill-drafted 'in its own way'".*

This demonstrates the issue: it is one thing to set down general principles of interpretation; it is quite another to conclude that, in practical terms, the principles will provide certainty as to the outcome in a particular case.

Further Developments

However, the other key recent decision from the Supreme Court also suggests a more restrictive approach to be adopted in future in relation to the implication of terms in fact, and appears to be demonstrative of a more widespread 'sea change' in the approach to be adopted by the Supreme Court. The case, *Marks and Spencer Plc v. BNP Paribas Services Trust Company (Jersey) Ltd*[45], rests on relatively simple facts: M&S was the tenant; BNP was its landlord. M&S had paid rent for the quarter year in full before validly serving a break notice. M&S sought repayment of the rent relating to the post-break period in the absence of an express contract term dealing with the consequences of such a scenario. The Supreme Court found that an express term would be needed in all but the most exceptional circumstances if such repayment were to be made. More significantly however, drawing on previous criticisms made by the Singapore Court of Appeal in *Foo Jong Peng v. Phua Kiah Mai*[46], it made clear that any approach to the implication of terms based on intentions of the parties, following *Belize Telecom*, was too wide, and that *Belize Telecom* was not to be regarded as having changed the law in this respect.

The majority of the Supreme Court explained that construing the words used and implying additional terms are different processes governed by different rules, and that Lord Hoffman's suggestion in the *Belize Telecom* case that the implication of terms forms part of the process of construction could obscure that fact. Whilst accepting that the factors taken into account when interpreting a contract are also taken into account on an issue of implication, that did not mean that the exercise of implication should be classified as part of the exercise of construction or that it should be carried out at the same time as interpretation.

In other words, parties should not and cannot assume that the court or tribunal will save them by implying a term into a contract that is otherwise silent on a particular matter. Similarly, parties cannot expect the court to rewrite a contractual bargain that has harsh or otherwise extreme consequences for one or more parties if the wording of that contract is clear and unambiguous.

Based on the above, although *Arnold v. Britton* does not, of itself, restrict the courts' approach to how a contract should be interpreted, the combined effect of the two decisions does appear to represent both a greater textural fidelity and a recognition that the intention/agreement-centred model of contract law is not a universal panacea. There will be plenty of cases, just as with *Arnold v. Britton* itself in relation to interpretation, where there is no available evidence from which intentions can be ascertained. In such circumstances textual fidelity reduces the prospects of the court resorting to legal fictions to produce the result it considers the parties may have intended; that is a wholly separate enquiry.

On that basis, we think it not unlikely that in the near future the court will re-examine the 'assumption of responsibility' basis of remoteness from *The Achilleas*. The decision has never been overruled, but subsequent judicial and academic treatment indicates scepticism for the ability of the 'agreement-centred' approach to remoteness to provide the correct outcome in all cases. In addition to criticism in England and Wales[47], it has been the subject of considerable negative judicial treatment in Singapore[48].

Conclusions – Has Anything Changed?

Although the recent case law has demonstrated that there are limits to the extent to which the courts' own perception of commercial purpose can be used to interpret a contract[49], we think it unlikely that *Arnold v. Britton* will of itself lead to much change either in the legal or the procedural approach applied by a court or tribunal when interpreting a contract or written document. There are, however, three further conclusions we think that it is possible to draw from the case and from the judicial developments that surround it.

The first is that it appears to indicate that the 'grand unified theory' based on interpretation and the ascertaining of the parties' intentions has been stopped – for now. We would not be surprised if further judicial pronouncements were made by senior courts in respect of remoteness or rectification in the near future.

The second is that the courts may be less likely to introduce implied terms where there is no express wording in the contract. The situations in which a party will be able to rely on an implied term to avoid a loss are likely to be more restrictive, and there is less prospect of the court determining questions of interpretation by reference to commercial expectation of a bargain under the guise of commercial common sense.

Finally, we think that a consequence of this more restrictive approach is that it may reduce the amount of documents and evidence put before the court by parties in favour of their contended-for construction. This is to be welcomed; whilst the approach to interpretation has doubtless afforded great flexibility to the parties we are concerned this has at times risked coming at a cost to predictability and efficiency. Both

are, of themselves, equally 'commercial' considerations likely to play heavily on the mind of a party considering its options.

We do not, however, think this marks the end of battles over interpretation, implication and remoteness. Given the nature of language and words, there will still be arguments over the natural meaning, the context and whether those words admit more than one meaning or not, and so on. The issue, we suggest, is not one that arises as a result of any approach taken by the courts, but rather a more fundamental problem that Tolstoy at least was alive to: an author cannot assume that his or her readers will share the same understanding of what has been written on the page.

For further information contact:
sjwalker@atkinchambers.com
djohnson@atkinchambers.com

AtkinChambersBarristers

Footnotes:

1. *Cavendish Square Holding BV v. El Makdessi*; *Beavis v. ParkingEye* [2015] UKSC 67.
2. *NH International (Caribbean) v. National Insurance Property Development Company* [2015] UKPC 37 (PC).
3. *Aspect Contracts (Asbestos) Ltd v. Higgins Construction Plc* [2015] UKSC 38.
4. [2015] UKSC 36.
5. [2015] UKSC 72.
6. *Transfield Shipping Inc. v. Mercator Shipping Inc. (The Achilleas)* [2008] UKHL 48.
7. *Attorney-General of Belize v. Belize Telecom* [2009] UKPC 10. Note this was a decision of Law Lords sitting in the capacity of the Privy Council of the United Kingdom.
8. *Chartbrook Ltd v. Persimmon Homes Ltd* [2009] UKHL 38.
9. As explained by Lord Denning in typically colourful terms in *George Mitchell v. Finney Lock Seeds* [1983] QB 284 (at pp. 296-9).
10. [1998] 1 WLR 896.
11. [1998] 1 WLR 896 at 912-913.
12. As stated at [18] of *Sirius International Insurance Company v. FAI General Insurance Limited and Ors* [2004] 1 WLR 3251 (HL), per Lord Steyn: *"The aim of the inquiry is not to probe the real intentions of the parties but to ascertain the contextual meaning of the relevant contractual language. The inquiry is objective: the question is what a reasonable person, circumstanced as the actual parties were, would have understood the parties to have meant by the use of specific language. The answer to that question is to be gathered from the text under consideration and its relevant contextual scene."*
13. See, for example, *Marble Holding Limited v. Yatin Development Limited* [2008] HKCFA 29 (Hong Kong), *City Wall Properties (Scotland) Ltd v. Pearl Assurance plc* [2007] CSIH 79 (Scotland), and *Seiko Epson Corp v. Sepoms Technology Pte Ltd* [2008] FSR 14 (Singapore).
14. [1974] AC 235.
15. *Ibid.*, at 251.
16. *Antaios Compania Navera SA v. Salen Rederierna SA ('The Antaios')* [1985] AC 191.
17. [2011] UKSC 1 WLR 2900 (SC). See also Lord Bingham in *The Starsin* [2003] UKHL 12: *"...a business sense will be given to business documents."*
18. *Ibid.*, at [21].
19. *Ibid.*, at [20].
20. [2013] HKCFA 84 (at [76]), per Mr Justice Tang PJ.
21. [2004] 7 HKCFA 333.
22. Per Mr Justice Tang PJ at [79].
23. *ICS v. West Bromwich* [1998] 1 WLR 896 at 913.
24. [2009] UKHL 38.
25. *Ibid.*, at [42].
26. Lord Nicholls, *"My Kingdom for a Horse"* (2005) 121 LQR 553. Relied upon by Mummery LJ in *Pro Force Recruit Ltd v. The Rugby Group Limited* [2007] EWCA Civ 1621.
27. [2009] UKHL 38 at [32].
28. *Ibid.*, at [45], per Lord Hoffmann.
29. *Ibid.*,at [100]
30. A point also noted by the House of Lords in *Oceanbulk Shipping and Trading SA v. TMT Asia Limited* [2010] UKSC 44. Hudson notes (at 1-035) that *"There is often a very fine line to be drawn between interpreting contracts and in effect rectifying mistaken words used by the parties in their contracts."*
31. [2009] UKPC 10.
32. *Ibid.*, at [16].
33. *Ibid.*, at [21].
34. *Transfield Shipping Inc v Mercator Shipping Inc* [2008] UKHL 48 at [87].
35. [2015] UKSC 36.
36. *Ibid.*, at [34].
37. A seventh, more specific principle stated that there were no special or particular rules to be applied in relation to the interpretation of service charge clauses.
38. e.g. *Aberdeen City Council v. Stewart Milne Group Ltd* [2011] UKSC 56, where the court concluded that *"any approach"* other than that which was adopted *"...would defeat the parties' clear objectives."*
39. See *Rainy Sky SA and Ors v. Kookmin Bank* [2011] 1 WLR 2900 (SC) at [23]. Similar observations were made in *US Bank Trustees Ltd v. Titan Europe 2007-1 (NHP) Ltd* [2014] EWHC 1189 (Ch) (at [25]): *"If...the court concludes that the language used is unambiguous, then the court must apply it, even though some other result might be thought more commercially reasonable, and even if it gives a result that is commercially disadvantageous to one of the parties. The court's function is to interpret the contract, not to rewrite it".*
40. Mitigated in reality by the fact that the lessor indicated, via her counsel in open court, that she was prepared to agree to the variation of the provision to tie the charge payable to consumer price index inflation.
41. *Chartbrook Ltd v. Persimmon Homes Ltd* [2009] UKHL 38 at [99].
42. [2013] SGCA 43, 151 Con LR 170.
43. In this regard note the observations of Lord Sumption in *Sans Souci Ltd v. VRL Services Ltd* [2012] UKPC 6 (at [14]): *"...True linguistic ambiguities are comparatively rare. The real issue is whether the meaning of the language is open to question. There are many reasons why it may be open to question, which are not limited to cases of ambiguity".*
44. *Arnold v. Britton* [2015] UKSC 36, at [108].
45. [2015] UKSC 72.
46. [2012] SGCA 55.
47. *Supershield Limited v. Siemens Building Technologies Limited* [2010] EWCA Civ 7; *Grimes v. Gubbins* [2013] EWCA Civ 37. See also Robertson (2008) 28 Legal Studies 172; Peel (2009) 125 LQR 6; Wee [2010] LMCLQ 150.
48. *MFM Restaurants Pte Ltd v. Fish & Co Restaurants Pte Ltd* [2011] 1 SLR 150; *Out of the Box Pte Ltd v. Wanin Industries Pte Ltd* [2013] SGCA 15.
49. The observation of Leggatt J in *Tartsinis v. Navona Management Company* [2015] EWHC 57 (Comm) (at [54]) that *"...Judges are not always the most commercially-minded, let alone commercially experienced, of people"* is of interest here. See also the similar observations of the Court of Appeal in *BMA Special Opportunity Hub Fund Limited v. African Minerals Finance Ltd* [2013] EWCA Civ 416 (at [24]).

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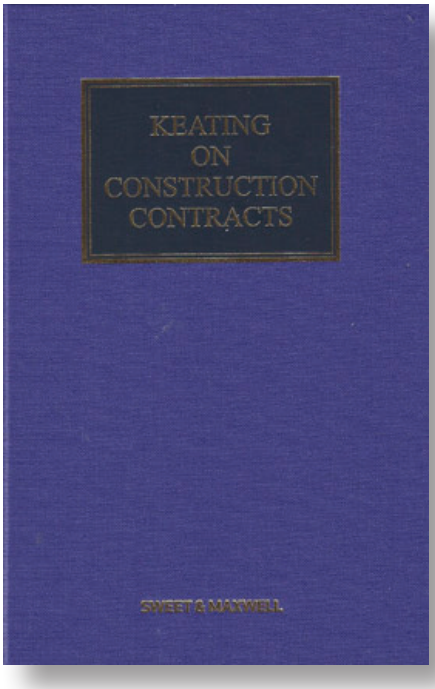

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23 Nov	*The Lighthouse Club YMG Networking Drinks – LinkedIn, 38/F Hysan Place*
2 Dec	*The Lighthouse Club YMG Christmas Party – Tipping Point Brewing Co, 1/F 79 Wyndham Street*
7 Dec	*The Society of Construction Law Christmas Cocktails – Foreign Correspondents Club*
9 Dec	*The Lighthouse Club – Hong Kong Charity Golf Tournament*

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Partners in Alternative Dispute Resolution

ADR Partnership Limited
1711 Citicorp Centre, 18 Whitfield Road, North Point, Hong Kong
t: (852) 2234 5228 f: (852) 2234 6228
e: info@adrpartnership.com www.adrpartnership.com

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